

# SMSF borrowing arrangements Victorian duty issues



**SMSF INSTALMENT BORROWING ARRANGEMENTS REQUIRE CLARIFICATION FROM THE VSRO OF THE STAMP DUTY IMPLICATIONS OF THE ARRANGEMENTS.**

Self Managed Superannuation Fund (SMSF) instalment borrowing arrangements are being extensively used, but there is industry concern that land instalment borrowing arrangements may be subject to triple Victorian stamp duty. The Taxation Institute has lodged a detailed submission with the Victorian State Revenue Office (VSRO) through the State Taxes Consultative Council to clarify the stamp duty implication of the arrangements.<sup>1</sup> The VSRO has requested that the Taxation Institute bring these issues to the attention of its Members.

## INTRODUCTION

From 24 September 2007 the *Superannuation Industry (Supervision) Act 1993 (SISA 1993)* was amended<sup>2</sup> to permit borrowing by superannuation funds (including SMSFs) under an instalment borrowing arrangement used to acquire permitted classes of assets. SMSF

instalment borrowing arrangements are being extensively used with most retail banks providing products.

The typical instalment borrowing arrangement can be represented by the diagram below:

Under the typical instalment borrowing arrangement:

1. the SMSF pays the deposit and the balance of the purchase price for the Asset from a combination of SMSF assets and borrows money from the Lender;
2. the Custodian enters into the land sale contract with the Seller;
3. the Custodian signs a written declaration that the Custodian holds the Asset on either bare trust or settled fixed trust<sup>3</sup> for the SMSF;
4. the Custodian grants the Lender a limited recourse mortgage on the terms required by the Lender; and

5. the Custodian retains legal title to the Asset until the borrowing is fully discharged and then the unencumbered title is transferred absolutely to the SMSF.

Alternatively, under step 2 the SMSF enters into the land sale contract and as purchaser nominates and directs the Seller to transfer the Assets directly to the Custodian which is registered as legal freehold owner on title. Care is required in this circumstance that the sub-sale rules in the *Duties Act 2000 (Vic) (DA 2000)* do not apply.<sup>4</sup>

There is concern that the instalment borrowing arrangements in respect of land may be subject to double or triple Victorian stamp duty, first on the acquisition of land by the Custodian, then upon the written declaration of trust to establish the custodian relationship and then upon the ultimate transfer of the land by the Custodian to the SMSF upon discharge of the borrowing facility.

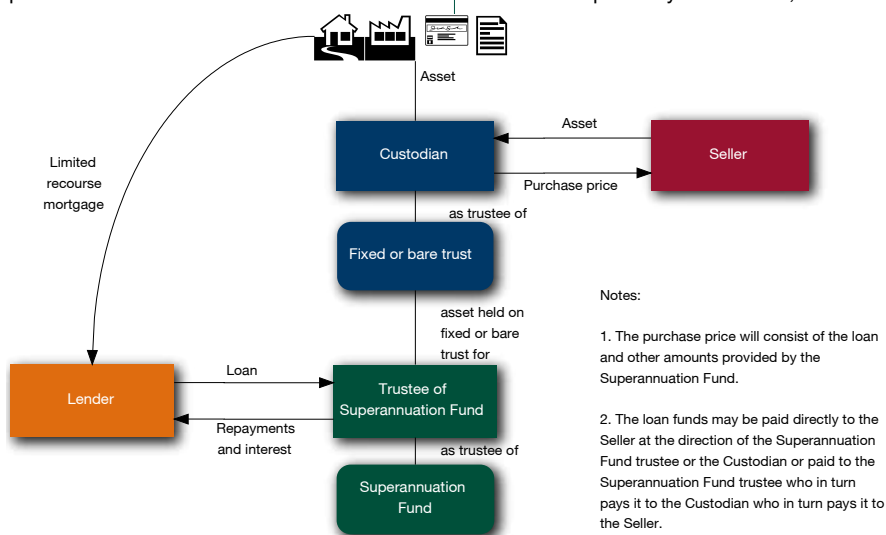
This article discusses the Victorian stamp duty issues concerning land instalment borrowing arrangements.

## FEDERAL POSITION

### Superannuation compliance

Section 67(4A) SISA 1993 exempts qualifying instalment borrowing arrangements from the general prohibition against a trustee of a regulated superannuation fund from borrowing money or maintain an existing borrowing of money.

The Australian Taxation Office (ATO) published questions and answers and *Taxpayer Alert TA 2008/5* concerning the SISA 1993 consequences of instalment



borrowing arrangements. These publications identify outstanding issues from a SISA 1993 perspective including that:

1. it may be necessary for the Asset to be the only property of a custodian arrangement;
2. assets acquired from a member or a related party may contravene the exemption;<sup>5</sup>
3. arrangements supported by third party guarantees, particularly by a member or a related party, may contravene the exemption;
4. arrangements that permit re-financing may contravene the exemption;
5. arrangements that permit capitalisation of interest may contravene the exemption;<sup>6</sup>
6. arrangements that permit multiple draw downs from a single loan facility may contravene the exemption;
7. what constitutes an acceptable replacement of an original asset is unclear;
8. loans by a member or a related party at less than commercial interest rates may constitute a contribution subject to contributions tax under Div 292 *Income Tax Assessment Act 1997 (ITAA 1997)*; and
9. loans by a member or a related party at more than commercial interest rates may constitute a breach of the sole purpose test<sup>7</sup> or prohibition on giving financial assistance to a member or a relative of a member.<sup>8</sup>

Importantly, it is common for banks to require a member or a related party to give guarantees or collateral mortgages and to permit capitalisation of interest. Whether the banks' current loan arrangements comply is unclear and requires a case by case analysis.

Accordingly, there are a number of issues that must be addressed to ensure that the relevant instalment borrowing arrangement complies with SISA 1993.

### Income tax compliance

The income tax issues are provided as background explanation on the choice of using a bare trust or a settled fixed trust. Goods and services tax<sup>9</sup> issues must also be considered, but are outside the scope of this article.

The Asset (or a replacement asset) must be held on trust so that the SMSF receives a beneficial interest in the asset which is satisfied by either a bare trust or a settled fixed trust custodian arrangement.

A bare trust custodian arrangement is often preferred for income tax reasons because:

1. the Custodian's legal title on bare trust is ignored for Capital Gains Tax (CGT) purposes and any CGT consequences are deemed to happen to the SMSF;<sup>10</sup>
2. where the bare trust is ignored for CGT purposes, the Custodian is exempted from income tax registrations and return obligations and the SMSF directly effects these reducing compliance costs;<sup>11</sup> and
3. on creation of the bare trust, CGT event E1: creation of a trust over a CGT asset does not happen where the transferor remains the sole beneficiary absolutely entitled to the asset as against the Custodian.<sup>12</sup>

However, it is unclear whether the Custodian relationship under an instalment borrowing arrangement is a bare trust,<sup>13</sup> particularly because of the obligations imposed on the Custodian under SISA 1993 or by particular loan documents. *Jacobs' Law of Trust in Australia 7th Ed (2006)* relevantly states:

[315] The term "bare trust" is often used to describe a trust in which the trustee has no "active duties" to perform. However, in *Corumo Holdings Pty Ltd v C Itoh Ltd* it was pointed out that as a matter of strict logic almost no situation could be postulated where a trustee in some circumstances does not have active duties to perform by, for example, being immediately bound to transfer the trust property to the beneficiary who was absolutely entitled. Furthermore, a trustee may be entitled by statutory provision or the terms of a trust instrument or court order to charge fees and may have a lien or charge upon the trust assets for those fees. The trustee may also have a lien upon the assets for costs properly incurred in the performance of an obligation to safeguard the trust property. Yet it may still be appropriate to describe this as a "bare trust". Thus a more precise use of the term "bare trustee" is to identify a trustee who has no interest in the trust assets other than that exist by reason of the office of trustee and the holding of the legal title, and who never has active duties to perform or who has ceased to have those active duties which the result that in either case the property awaits transfer to the beneficiaries or at their direction.

Accordingly, to avoid the uncertainty some advisers prefer the settled fixed trust structure and accept that the Custodian could have income tax registration and return obligations.

Whether the bare trust or settled fixed trust structure is adopted affects the Victorian stamp duty consequences of a land instalment borrowing arrangement.

### VICTORIAN DUTY POSITION

#### Declaration of trust duty

*Ad valorem* stamp duty is payable by the purchaser on the acquisition of land (s 7(1)(a) DA 2000). However, a declaration of trust over land may also be subject to *ad valorem* stamp duty depending on how it occurs.

A declaration of trust over dutiable property such as land is subject to *ad valorem* stamp duty. Relevantly, a declaration of trust includes any declaration that any identified property vested or to be vested in the person making the declaration is or is to be held on trust (ss 7(b)(i) and 7(4) DA 2000). Accordingly, where the Custodian's declaration specifically identifies the land then a second amount of *ad valorem* stamp duty may be payable.

A declaration of bare trust is widely considered not to be a declaration of trust as ordinarily understood or for the purposes of ss 7(b)(i) and 7(4) DA 2000, because the Custodian is merely acknowledging the trust terms under which the Custodian acquired the property on resulting trust;<sup>14</sup> there is no new trust relationship being created.

*CSR (Vic) v Lam & Kym PIL*<sup>15</sup> concerned a trustee declaring that the trustee held the trust property on trust for some of the class of beneficiaries. The court discussed the conventional meaning of declaration of trust and relevantly stated:

[27] In the course of his judgment, Mason J referred to a passage from the earlier joint judgment of the High Court in *Tooheys Ltd v Commissioner of Stamp Duties (NSW)* in which it was said that:

... Because of the inclusion of the words "vested or to be vested" and the words "is or shall be held in trust", the description extends to cases where no property is as yet vested in the proposed trustee, and it extends to cases in which no trust presently operative is declared. ....

... Ordinarily a declaration of trust signifies a declaration which operates to create a trust – it is made by a person who holds or will hold a beneficial interest at least commensurate with the beneficial interest sought to be brought into existence by the trust. *There is a possibility here that the declaration is made by the appellant as a person who will acquire no more than a legal estate and who will quite apart from the declaration be a bare trustee for [the first company].*

... The appellant does not, as I understand his case, argue that a declaration by a holder of the bare legal estate takes the declaration outside para (2), no doubt for the sound reason that such a declaration literally answers the description contained in the paragraph. *[emphasis added]*

Accordingly, it is unclear whether the declaration of bare trust by the Custodian over Victorian land would be a dutiable declaration of trust for the purposes of ss 7(b)(i) and 7(4) DA 2000. The better view probably is that the declaration is subject to *ad valorem* stamp duty unless the s 34 DA 2000 apparent purchaser exemption or s 35 DA 2000 custodian exemption applies (discussed further below).

To reduce the risk of double stamp duty, the declaration of bare trust should not refer to specific property so that it is arguable that the extended definition of declaration does not apply as no declaration is made in respect of “identified property”.

To avoid the uncertainty some advisers prefer the settled fixed trust structure and accept that the Custodian has to pay \$200 settlement duty. A declaration of trust over non-dutiable property such as a \$20 settlement sum is subject to \$200 stamp duty. A declaration of trust that declares that property, although not identified in the instrument, when vested in the person executing the instrument is to be held on trust is subject to \$200 stamp duty (s 37 DA 2000).

While it is accepted that the declaration of settled fixed trust is subject to \$200 settlement duty, advisers may not be aware that the declaration of bare trust over unidentified property is also subject to \$200 settlement duty.

## EXEMPTIONS INTRODUCTION

A declaration of bare trust by the Custodian if dutiable may be exempt from duty pursuant to ss 34 (apparent

purchaser) or 35 (transfer to/retransfer from a trustee or nominee) DA 2000. The application of each exemption has some technical uncertainties.

The subsequent transfer of the Victorian land by the Custodian to the SMSF upon discharge of the borrowing would be subject to stamp duty on the then market value of the property unless exempt from duty pursuant to ss 34 (apparent purchaser), 35 (transfer/retransfer from a trustee or nominee) or 36 (in specie

vendor with the apparent purchaser’s money. Section 34 DA 2000 is concerned only with the circumstances where the landowner acquires the property directly from the vendor with the apparent purchaser’s money.

As the exemption is based on a presumption of resulting trust, it is arguable that the declaration of bare trust by the Custodian must be drafted on and expressly acknowledge that it is a resulting trust basis in order to satisfy s 34 DA 2000.

“ There are Federal compliance and income tax uncertainties...and Victorian stamp duty uncertainties which may impose double or triple duty on land instalment borrowings ”

distribution by a fixed trust) DA 2000. Sections 34 or 35 DA 2000 may apply to a bare trust arrangement and s 36 DA 2000 may apply to a fixed trust arrangement.

To avoid the potential duty liability on the transfer of the asset by the Custodian to the SMSF when the borrowing is discharged, some declarations of trust grant the Custodian a power of sale. The inclusion of a power of sale may preclude certain exemptions from applying if a distribution in kind occurs rather than a sale.

The application of each exemption has some technical uncertainties which depend on the nature and the administration of the trust.

### Apparent purchaser exemption

Section 34 DA 2000 apparent purchaser exemption exempts a declaration of trust in favour of the real purchaser from duty and exempts a transfer of the land by the apparent purchaser to the real purchaser from duty in the circumstances of a resulting trust.

The resulting trust relationship arises differently depending on whether the apparent purchaser acquires the property from the vendor and then transfers it to the landholder or the landowner acquires the property directly from the

*Apostolou v CSR (Vic)*<sup>16</sup> stated in obiter that “...The s 34 exemption however is based upon [VA Corporation of Australia P/L] being no more than a bare trustee.” Accordingly, the exemption will not apply to a settled fixed trust.

A bare trust arises where the Custodian has no relevant active duties (see above). Arguably, a bare trust will not exist if the declaration of bare trust imposes rights, obligations or duties in addition to or which are inconsistent in any way with the *Trustee Act (Vic) 1958* and common law.

*Ruling DA .024*<sup>17</sup> in respect of s 35 DA 2000 (Custodian Trustees) states that for the exemption to apply the relationship must be a bare trust and there can be no power of sale. Since the exemption in s 34 DA 2000 is similarly reliant on a bare trust relationship, the granting of power of sale (and possibly other rights, obligations and duties) may exclude the operation of the exemption.<sup>18</sup> Accordingly, the declaration of bare trust ought to be simply and concisely drafted.

Arguably, no additional power of sale is required because the typical SMSF instrument provides these powers which the SMSF can use or can delegate to the Custodian to use.

Section 34 DA 2000 requires the deposit and all the purchase price to be paid by the SMSF. Where part of the purchase price is raised and paid by bank loan secured by a mortgage over the property, the contribution is made by the persons liable for repayment of the loan.<sup>19</sup> Third party contributions to payment of the loan may prevent the exemption from applying.<sup>20</sup>

It is unclear whether the provision of security will be a third party contribution. *Shergold v CSR (Vic)*<sup>21</sup> considered it was unclear while *Amira v CSR (Vic)*<sup>22</sup> considered that the giving of a guarantee by a third party was not consideration. The uncertainty requires clarification.

### Custodian trustee exemption

Section 35 DA 2000 custodian trustee exemption exempts a transfer of dutiable property to a trustee or nominee solely for the transferor and the retransfer of the dutiable property.

*Ruling* DA .024 states that for the exemption to apply the relationship must be a bare trust and there can be no power of sale. Accordingly, the declaration of bare trust ought to be simply and concisely drafted without granting a power of sale or other rights, obligations or duties.

The reference to “transfer to the custodian” and “retransfer to the transferor” arguably limit the exemption to a resulting trust or bare trust where the SMSF acquires the property from the Seller and then transfers it to the Custodian. SISA 1993 requires the land to be held on trust at all times which prevents the SMSF from initially acquiring the land under the instalment borrowing arrangements so the exemption cannot apply on a literal interpretation.

However, *Trust Company of Australia Ltd v CSR*<sup>23</sup> interpreted the exemption to apply to a direction to transfer the property to the Custodian under a tripartite land sale agreement between the vendor, the manager of an investment scheme as purchaser and the taxpayer as custodian. If a wide interpretation is employed, then the declaration of bare trust and the transfer from the Custodian to the SMSF may be exempt for the purposes of s 35 DA 2000 if the original land sale contract was between the Seller, the SMSF as purchaser and the Custodian as transferee.

It is unclear whether the broad interpretation could apply where the Custodian is the original purchaser under the land sale contract or is nominated under a land sale contract between the Seller and the SMSF so becomes a party to the contract by that nomination.

The exemption is unlikely to apply where the land sale contract is entered into by the directors or trustee of the SMSF rather than in the name of the SMSF.

### In kind distribution by a fixed trust

Section 36 DA 2000 in kind (*in specie*) distribution by a fixed trust exemption exempts a transfer of dutiable property by a trustee of a fixed trust to certain beneficiaries that were beneficiaries at the time the original land was acquired by the trust. Section 36 DA 2000 is relevant on the subsequent transfer by the Custodian to the SMSF upon full discharge of the loan and the mortgage if s 34 DA 2000 does not apply.

Section 36 DA 2000 does not provide any exemption on the declaration of trust by the Custodian.

Section 36 DA 2000 arguably requires a written declaration of trust to be executed for the provision to apply.<sup>24</sup> Accordingly, the exemption is unlikely to apply to a resulting trust circumstance where the declaration of bare trust merely acknowledges the trust relationship and does not create it.

To comply with the SISA 1993 requirements, the relationship between the Custodian and the SMSF in respect of the land will be a fixed trust within the definition of s 36(5) DA 2000.

Section 36(1)(c)(ii)(A) DA 2000 exempts the transfer of the land by the Custodian to the SMSF (being trustee of another trust) where all the beneficiaries of the SMSF are natural persons who were beneficiaries of the SMSF at the time of the Custodian acquiring the land under a look-through approach.

It was unclear whether a member of a superannuation fund constitutes a beneficiary generally or before a qualification event such as retirement occurred. The ATO in TD 2006/68 states:

2. The members of a complying superannuation fund do not beneficially own, or have the right to acquire beneficial ownership of, interests carrying

the right to distributions of income or capital. Further, a complying superannuation fund does not distribute income or capital as such, but rather pays benefits in the form of pensions or lump sums on the occurrence of certain events, such as retirement, death while in employment or the attainment of a stated age.

A specific exemption was enacted for transfers to a superannuation fund with unit holder members.<sup>25</sup> Arguably, the amendment was required because the legislature was of a similar view.

If the SMSF does not have beneficiaries generally or until a qualification event occurs, the look-through approach under s 36(1)(c)(ii)(A) DA 2000 cannot be satisfied. If the member does not become a beneficiary until the qualification event (such as retirement) or the dependants of a member do not become beneficiaries until a qualifying event (such as the member's death), those persons would not have been beneficiaries at the relevant time the property was acquired by the Custodian under the fixed trust.

However, *Kafataris v FCT*<sup>26</sup> held that the word “beneficiary” extends beyond a person who has a beneficial interest in the trust property to persons to whom the trustee owes fiduciary obligations so the members of a superannuation fund constitute beneficiaries within the ordinary meaning of the word generally and regardless of whether a qualifying event has occurred.<sup>27</sup>

Accordingly, the better view is likely to be that members and spouses and dependants of members of a SMSF are beneficiaries for the purposes of the exemption.<sup>28</sup>

*Ralara P/L v CSR (Vic)*<sup>29</sup> held that the former exemption in the *Stamps Act 1958* required the distribution of the property to arise as a power of appointment rather than on sale. If the ATO is correct that an *in specie* transfer occurs as a payment of a benefit and not as a distribution under a power of appointment, then the exemption will not apply.

However, if (as is usual) the SMSF has a power to distribute assets *in specie* to a member that member is a relevant beneficiary of the SMSF for the purposes of s 36 DA 2000.

The usual class of beneficiaries of a SMSF includes the members and

upon a member's death, the member's spouse and dependents and legal personal representative some of who may not have existed (been born or married) at the time the land was acquired. Although unclear, *Ralara P/L v CSR (Vic)* indicates that a transfer to a beneficiary who was not in existence at the time the land was purchased but was within the class of beneficiaries of the trust is eligible for the exemption. *Kafataris v FCT*<sup>30</sup> would also support this.

*Extra Nominees Pty Ltd v CSR (Vic)*<sup>31</sup> arguably held that the value of the dutiable property transferred must not exceed the value of the beneficiaries' interest in the trust. It is unclear whether that value is determined as an excess over the acquisition costs of the land or whether it is a value determined as an excess over the beneficiaries proportionate interest in the trust. If the former view is correct, then any accretion in value of the land will not be exempt from duty reducing the effectiveness of the exemption where the SMSF has 100 per cent of the entitlement and value of the trust. If the latter view is correct, then any accretion is irrelevant; the provision does not exempt a beneficiary from receiving more than its proportionate interest. For example, if the beneficiary has a 50 per cent proportionate interest but receives a distribution of 60 per cent of the property, the exemption does not apply to the additional 10 per cent received.

While the latter view appears to be the better interpretation, clarification is required.

## CONCLUSION

There are Federal compliance and income tax uncertainties regarding instalment borrowing arrangements and Victorian stamp duty uncertainties which may impose double or triple duty on land instalment borrowings. The benefits of instalment borrowings will be greatly outweighed if double or triple duty is imposed. Accordingly, advisers should advise client on the uncertainties and potential duty consequences of a land instalment borrowing arrangements.

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### Reference notes:

- 1 URL: <http://www.taxinstitute.com.au/go/submissions/submission-on-instalment-borrowings>.
- 2 Tax Laws Amendment (2007 Measures No. 4) Act 2007 (TLAM No. 4 2007).
- 3 A settled fixed trust arises where a settlor establishes the fixed trust with a monetary settlement sum (such as \$20) and the land is acquired by the fixed trust.
- 4 Part 4A DA 2000.
- 5 Section 66(1) SISA 1993.
- 6 Section 67(4A)(a) SISA 1993.
- 7 Section 62 SISA 1993.
- 8 Section 65(1)(b) SISA 1993.
- 9 For example see GSTR 2008/3 a bare trust.
- 10 Section 106-50 ITAA 1997 because the SMSF is absolutely entitled to the Asset as against the Custodian.
- 11 PS 2000/2: An exemption for the trustees of some trust estate from the requirement to furnish a tax return on behalf of a trust estate.
- 12 Section 104-55 ITAA 1997.
- 13 Draft TR 2004/D25 discusses bare trust in respect of its relationship with the concept of absolute entitlement but does not extensively analyse the nature of a bare trust.
- 14 A resulting trust arises by operation of law where a person purchases property in the name of another who provided none of the purchase money without an intention to provide a gift of the property: *Calverley v Green* (1984) CLR 242 at 246-247.
- 15 *CSR (Vic) v Lam & Kym P/L* (2004) 58 ATR 60 was considering s 64A Stamps Act 1958 which was held to go beyond the ordinary meaning of declaration of trust.
- 16 *Apostolou v CSR* [2008] VCAT 310 at [11].
- 17 Citing *Yellowco Five Pty Ltd v CSR (Vic)* [1993] 2 VR 529 and *CSR (Vic) v Victoria Gardens Pty Ltd* (2000) 46 ATR 61.
- 18 *Herdegen v FCT* (1988) 20 ATR 24 at 32 indicates that a bare trust can still exist where the beneficiary can direct the custodian to sell to the third parties.
- 19 *Calverley v Green* (1984) CLR 242; *Horesh v CSR (Vic)* 91 ATC 2016; *Alter v CSR (Vic)* 91 ATC 2019; *Williams v CSR (Vic)* [2004] VCAT 1367.
- 20 *Berkers v CSR (Vic)* [2004] VCAT 2022; *Triantafyllis v CSR (NSW)* 98 ATC 4484; *CSR (Vic) v Pattison* (2001) 47 ATR 71 but cf *Dyer v Dyer* (1788) 2 Cox 92 at 93-94; 30 ER 42 at 43.
- 21 *Shergold v CSR (Vic)* [2006] VCAT 694.
- 22 *Amira v CSR (Vic)* [2005] VCAT 228.
- 23 *Trust Company of Australia Ltd v CSR* (2003) 77 ALJR 1019.
- 24 *Amira v CSR (Vic)* [2005] VCAT 228 at [62].
- 25 Section 36B(2)(e) SISA 1993.
- 26 *Kafataris v FCT* [2008] FCA 1454.
- 27 *Kafataris v FCT* [2008] FCA 1454 at [43] to [45] and [50] to [53].
- 28 This analysis does not appear in the submission as the submission was lodged before *Kafataris v FCT* [2008] FCA 1454 was published.
- 29 *Ralara P/L v CSR (Vic)* (1992) 24 ATR 1133.
- 30 *Kafataris v FCT* [2008] FCA 1454 at [50] to [54].
- 31 *Extra Nominees Pty Ltd v CSR (Vic)* (1990) 21 ATR 3664.