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# Breakfast Club

## Latest SMSF Issues

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# 1 SELF MANAGED SUPERANNUATION FUND (SMSF) BORROWING

Limited recourse loans (often referred to as instalment warrant arrangements) have been available to SMSF trustees since September 2007. These have steadily grown in popularity and many banks and other commercial lenders now offer finance packages tailored for SMSFs. These arrangements were originally introduced in order to legitimise investments by SMSFs in traditional instalment warrants over listed securities. However, the laws allow SMSF trustees to borrow directly in order to buy any asset that is permitted to be acquired under superannuation laws. This has resulted in a boom in gearing strategies to acquire real estate, which is now overwhelmingly the most popular type of asset being acquired under these arrangements.

In 2010 the Cooper Review considered the appropriateness of these arrangements. While the Panel expressed some concern about the risk of borrowing to members' retirement savings, it concluded that gearing should continue but it should be monitored to ensure that it does not become a core focus of SMSFs.

A recent development impacting these arrangements has been the further amendments to the borrowing provisions in the *Superannuation Industry (Supervision) Act 1993 (SISA)*, which took effect from 7 July 2010. While the purpose of these amendments was to clarify several uncertainties about limited recourse loans, the amendments themselves have created some new questions. Some of these issues are currently the subject of consultation between the ATO and industry via the National Tax Liaison Group, Superannuation Technical Sub-Group (**NTLG**). It is hoped that clarification will be provided soon, whether this is in the form of interpretive guidance provided by the ATO or (if necessary) further legislative amendment.

The essential features of a limited recourse loan are still largely the same. That is, the rights of the lender against the trustee for a default must be limited to the asset being acquired, and the legal title to the asset must be held on trust by another entity with the SMSF trustee having beneficial ownership. This paper does not address the detailed requirements for implementing a borrowing but highlights some of the key issues that practitioners are currently facing when advising on SMSF gearing arrangements.

## 1.1 'Single acquirable asset'

One notable change that was introduced in July 2010 was the requirement that SMSF trustees may only borrow in order to purchase a "single acquirable asset". This was introduced in response to concerns that some existing arrangements involved borrowing for multiple assets, under which a lender could effectively pick and choose which security to enforce in the event of a default.

While the term "asset" is generally defined to mean "any form of property", the expression "*single acquirable asset*" is not specifically defined. It is deemed to include a collection of assets which are identical and have the same market value, which means that a SMSF trustee could have one

borrowing to buy a tranche of securities (eg, 10,000 BHP shares) but not a portfolio of different securities.

However, it is the meaning of this term in respect of real estate that from a practical perspective is causing some headaches for trustees and advisers. The explanatory memorandum to the amendments states that a single title to land would be considered a "single" asset. It also suggests that a single title to land which is subdivided while the loan is still in place would result in "replacement" assets (with replacement assets being expressly prohibited under the new laws). This suggests that an asset is to be defined by its legal title and that multiple legal titles therefore reflect multiple "assets". This approach also suggests that a change to the legal title (e.g., after subdivision) results in a new or different asset.

For those SMSF trustees who simply wish to purchase a property that is registered under one legal title, the July 2010 amendments do not create any difficulties. However, questions have been raised about the following types of property:

- a residential apartment that has a car park on a separate title;
- commercial or farming property that is used and sold as one property but which is registered over multiple titles (e.g., for historical reasons; see below); or
- a serviced apartment that is sold together with furnishings under one sale contract (where that contract is subject to a lease under which the owner is paid one fixed monthly rental amount for use of the land *and* the furnishings, i.e., there is no apportionment).

A typical example of a property that could have multiple titles for historical reasons is where there has been an original grant of land over a parcel comprising many crown allotments described in one deed or title to a first landowner (**L1**). Assume that a part of that land was then sold (or subdivided and then sold) and a new title was issued to a second landowner (**L2**) in respect of the part of the land that was transferred. L2 then purchased the balance of the land from L1 (and acquired the title to that balance). If a single title is considered to be a single "asset" (and not merely a description of an assets or assets), then when L1 owned the land the title would have been a single asset. However, when L2 owned the land the two titles would be two separate assets. It would be very surprising if this outcome was the intention of the legislature.

As indicated earlier, it also suggested in the explanatory memorandum that a single title to land cannot be subdivided while it is subject to a borrowing arrangement because the new titles are considered to be new, separate assets to the original parent title (even if there is no change to the physical property itself).

A number of submissions have been made to the NTLG to the effect that focusing on the legal title to an asset is not the correct approach. These have generally argued that the legal title to property is a register of ownership, but it does not define an asset itself. Accordingly, multiple titles do not necessarily indicate multiple assets and a change to the legal title does not necessarily indicate a change to the asset.

It has also been noted that land registration systems differ between the States and Territories. Even within one jurisdiction, it may possible to register a property in a variety of ways. Focusing on the legal title would produce arbitrary results in this respect.

Alternative approaches suggested by industry have included suggestions that the term “asset” for the purposes of the SISA should be given an “in substance” meaning (for example, an asset might be something of economic value). It has even been submitted that an accounting definition of “asset” be adopted in order to ensure practical and commercial outcomes for SMSFs. At the date of writing this paper, the ATO has not yet indicated what interpretive approach it will take.

### 1.1.1 One or multiple loans?

Until clarification is provided, trustees wishing to borrow to buy any of the problematic assets identified above might consider whether it is possible to implement multiple loans in order to comply with the stricter interpretation of the law. For example, a loan could be taken out to buy a residential apartment, with a separate loan taken out to buy the car park. However, this approach also raises a number of questions, such as:

- Whether the separate titles are capable of valuation;
- Whether it is possible to register separate mortgages over the multiple titles. For example, in Victoria the titles might be linked so that it is only possible to register one mortgage over both titles. This could effectively result in cross-security for the lender and possibly breach the requirement that the security of the lender for each borrowing be limited to the particular asset acquired under that borrowing. While it is possible for the parties to execute security documentation without formally registering a mortgage, commercial lenders would generally not be prepared to rely solely on unregistered security agreements and may not approve finance for such arrangements;
- Whether it is possible to deal in one title and not the other. If one loan is repaid earlier than the other (or the trustee defaults on one loan but not the other), the ability to transfer only one title without the other could be restricted under the local land registration system.

The authors’ view is that these practical difficulties demonstrate that legal title to property is not reflective of whether a property is one or multiple “assets” and that the expression “asset” has an in substance meaning for the purposes of the SISA.

Until clarification is provided, those wishing to buy property on multiple titles should consider whether it is possible to consolidate into one title before implementing the borrowing arrangement. This may be more feasible if purchasing property from a related party.

## 1.2 “Off the plan” purchases

The ATO has indicated that SMSF trustees may potentially borrow in order to buy property “off the plan”. However, it has raised some important timing issues. For example, it is suggested that the borrowing by the SMSF trustee should only be undertaken after development has been completed and the final title has been issued. This is because the completed property might constitute a “replacement” of the undeveloped land, which would not be permitted under the new borrowing laws.

If a strict interpretation of “asset” is taken, there are also questions about timing of other key documentation such as the execution of the holding trust deed. Until clear guidance is provided by the

ATO, trustees wishing to borrow to buy off the plan should seek appropriate advice in relation to these specific technical issues before any documentation is completed.

### 1.3 Improvements to property

The new laws have clarified that SMSF trustees are not permitted to use borrowed money in order to improve an asset and this has ruled out gearing to develop land. However, it is unclear whether a SMSF trustee could borrow to buy vacant land and use existing cash for a development. The concern is that developing vacant land could give rise to a “replacement asset”. Replacement assets are expressly prohibited under the new laws (there is a limited range of exceptions, but none of these apply to real estate).

This issue also has potentially serious ramifications for unexpected events. For example, if a property is completely destroyed by fire, flood or other natural disaster, many SMSF trustees would wish to use insurance proceeds to reconstruct new premises on the land. If the land is still subject to a limited recourse loan arrangement, a question arises as to whether the reconstruction gives rise to a “replacement” asset.

The rationale for prohibiting replacement assets is that SMSFs may be exposed if the value of security to the lender is increased. Where property is accidentally destroyed, it is the authors’ view that this rationale does not exist and in many cases a SMSF could become more exposed if the trustee does not use insurance proceeds to reconstruct the premises and restore the capital value and income earning capacity of the asset.

### 1.4 Guarantees

The requirement for a third party guarantee has become a standard feature of many commercial lenders’ SMSF offerings. For example, the members of the SMSF might be requested to personally guarantee the loan to the SMSF trustee. The new laws clarify that guarantees are acceptable, provided that the rights of the guarantor (or indeed any third party) against the SMSF trustee are limited to the asset being acquired.

It is important that the rights of the guarantor are clearly documented. Guarantors have a common law right of subrogation whereby they effectively step into the shoes of the lender in the event that the guarantee is called upon. This means that the guarantor has the same rights against the borrower as the lender (in this case, security over the underlying asset). However, the rights should not be extended any further. For the complete avoidance of doubt, it is prudent that guarantee documentation states that the guarantor has no additional rights against the trustee.

Members should also generally be aware that if their SMSF defaults and a member is called upon by the lender to make a payment, the member guarantor may be treated by the ATO as having made a contribution to the SMSF (refer to Taxation Ruling 2010/1). This contribution is taken to be made when the payment is made under the guarantee (if the guarantor has no right of indemnity against the trustee of the SMSF) or if the guarantor does have a right of indemnity, when that right expires (e.g., under the statute of limitations) or is waived.

## 1.5 Bank documentation

Most of the major banks and many more smaller commercial lenders now have standard SMSF finance packages. However, borrowers should not assume that the documentation of the lender is necessarily compliant with the SISA and it is prudent to have these independently reviewed. If there is any deficiency in the documentation, it is the SMSF trustee who will be in breach of the superannuation legislation.

By way of example, the authors are aware of some security documentation which purports to give the lender security over the asset, as well as the “interest” of the SMSF trustee in the holding trust. This itself is interesting because, in many cases, a holding trust deed simply evidences a “bare trust” relationship between the custodian who holds the title to the asset and the SMSF trustee who is the beneficial owner. In such cases, the SMSF trustee does not have any interest in the holding trust itself. However, this will not necessarily be the case under all holding trust deeds. The borrowing provisions require that the rights of the lender must be limited to the underlying asset only and any security that is purportedly taken over an interest in the holding trust would infringe this requirement.

SMSF trustees sometimes ask whether it is possible to use a bank guarantee in lieu of paying a cash deposit. While this is not an uncommon practice in commercial arrangements, the implications for the SMSF must be considered. In particular, the terms of the bank providing the guarantee might effectively create a charge over the assets of the SMSF because the bank ultimately has recourse to, e.g., a cash account in the name of the SMSF trustee with the bank. This would be in breach of the prohibition against giving charges over SMSF assets, which includes money (refer to regulation 13.14 of the *Superannuation Industry (Supervision) Regulations 1994 (SISR)*). As a general guide, bank guarantees should therefore be avoided unless the SMSF trustee has the terms of the guarantee independently reviewed beforehand.

## 1.6 Refinancing

The amendments discussed in this paper apply only to arrangements entered into on or after 7 July 2010. However, if an arrangement entered into before that date is refinanced on or after 7 July 2010, the new laws will apply to the arrangement. Trustees should consider whether a change to an arrangement will amount to a refinancing and, if so, whether the arrangement is capable of meeting the requirements of the new laws.

The explanatory memorandum to the amendments states that renegotiation of an arrangement with the same lender is not necessarily a refinancing. However, if the renegotiation results in the “rescission or replacement” of the original loan contract, or if there is a change to the terms and conditions that “fundamentally alters the character of the arrangement”, the new laws will apply.

Some SMSF trustees may simply wish to extend the term of their loan and careful consideration should be given to whether this could amount to refinancing. The ATO has stated in its “Questions and Answers” guide to SMSF borrowing of 29 July 2010 that relevant factors include the length of the extension relative to the original loan term, whether the loan agreement contemplates extension of the loan term and whether other terms of the loan are also changed.

As will be clear from this paper, a refinancing of an older arrangement could raise particular compliance issues for assets involving multiple titles or where development or subdivision has or will be undertaken to the land. SMSF trustees should seek advice about their arrangement before restructuring or renegotiating a borrowing.

## 2 DEATH OF A PENSIONER

One of the major attractions of holding assets in the superannuation environment is the exemption from income tax (including CGT) that applies to the extent that a SMSF is in pension mode. Although this offers many planning advantages, trustees and practitioners should be mindful of the taxation implications of death and plan in advance where possible. A taxation ruling on the life cycle of superannuation pensions is due to be released by the ATO in 2011 so now is a good time to revisit these issues.

### 1.7 Pension exemption on death

Income from assets that are set aside to meet current pension liabilities is exempt from tax. This is the case where the assets are “invested, held in reserve or otherwise being dealt with” for the sole purpose of enabling the SMSF to discharge all or part of its pension liabilities (contingent or not). Where the SMSF assets are not set aside for this purpose, to that extent a proportion of the income will not be tax exempt.

ID 2004/688 confirms the ATO view that upon the death of a pensioner, the exemption from tax generally ceases at that time. If the pension reverts to another member (e.g., the surviving spouse), the exemption will not cease.

A reversionary pension could be clearly documented so that it is a term of the pension (i.e., during the life of the first spouse) that the pension will automatically revert on the death of the pensioner. Alternatively, the ATO also accepts that where a binding death benefit nomination (**BDBN**) that was made by the pensioner during his or her life requires the trustee to pay a reversionary pension to one or more persons, the pension exemption also continues after death. (Members should ensure that the contents of any BDBN they have made is consistent with the terms of their pension documentation to avoid any ambiguity.)

However, the ATO has suggested that if the trustee exercises a *discretionary* power to pay a death benefit pension to one or more persons after the death of the original pensioner, the pension exemption ceases on the death of the member (refer to discussion item 6 of the March 2009 minutes of the NTLG). The ATO has not confirmed its view of how this would impact the operation of the pension exemption (e.g., where some time elapses between death and the decision of the trustee to pay a pension to the spouse of the deceased).

The ATO has indicated that it plans to issue a formal ruling product to address these issues. A draft taxation ruling on the “life cycle” of a pension is set to be released in June 2011, although at the date of writing this paper the ATO had indicated it was consulting with Treasury and APRA and that further research would be required.

## 1.8 Death of the surviving spouse

From a taxation viewpoint, a potentially more significant event for many SMSFs will be the eventual death of the surviving spouse. Although a couple might have adult children, it is no longer possible to pay death benefits in the form of a pension to most adult children. Where members have died on or after 1 July 2007, their death benefit may be paid to a spouse and the following children:

- a minor child;
- an adult child under 25 years who was financially dependent on the deceased member (provided the pension is commuted to a lump sum when the child reaches 25 years); or
- an adult child of any age who has a disability of the kind described in s 8 (1) of the *Disability Services Act 1986*.

(refer to regulation 6.21(2A) of the SISR).

Therefore, in many cases the death benefits of the surviving spouse will be required to be cashed as a lump sum either to adult children directly and/or to the deceased's estate. This will require either an in specie transfer of the SMSF assets or a sale and distribution of the proceeds, both giving rise to a CGT event. SMSFs are entitled to a one third discount on the gain arising from any asset held for at least 12 months, so SMSFs can expect to pay CGT of 10% (ie, 15% reduced by one third).

The ATO has now also confirmed that death benefits which are purportedly paid by issuing a promissory note to the recipient which is not cashed but simply endorsed back to the SMSF trustee as a "contribution" is not effective (see Taxpayer Alert 2009/10 and SMSF Determination 2011/1). The compulsory cashing rules require that death benefits be cashed as soon as practicable, which means that cash or assets must actually be paid or transferred to the recipient.

Trustees and practitioners should consider whether any steps can be taken to manage the CGT consequences of death. As part of long term tax planning, it might be generally desirable for the SMSF to realise large capital gains prior to the members' death. If trustees find themselves faced with large unrealised gains on the death of the second spouse, they should consider whether there are any grandchildren who were financially dependent and therefore eligible to be paid a pension from the SMSF. Alternatively, if an anti-detriment payment is able to be paid the deduction available to the SMSF could be sufficient to offset any gains.

Members should also take these issues into account when making investment decisions during their lifetimes. For example, a common strategy is to sell or contribute a commercial property or primary production farm land to a SMSF for the asset protection and lifetime taxation advantages. If the members would like this property to pass to the next generation and are willing for the SMSF to incur CGT when it is paid out *in specie*, will the SMSF have sufficient cash to fund its CGT liability? Regardless of whether the adult child's lump sum is paid in cash or in specie, the "taxable component" of the lump sum itself will also incur a death tax of 16.5% (or up to 31.5% if the SMSF has claimed deductions for life insurance policies held for the deceased). There are various strategies that can be put in place to manage these issues on death so that members can still take advantage of the lifetime benefits of holding assets in superannuation. For some SMSFs the consequences of death will be less significant (for example, those with more liquid assets or those that will realise capital gains

during the members' lifetimes) but others will require careful planning, such as those with family or business succession plans that involve SMSF assets.

## 3 PRE-1999 UNIT TRUST INVESTMENTS

There will be many SMSFs with pre-12 August 1999 investments in related unit trusts which still have some level of debt owing, or which have only discharged their debts in recent years. Whether a unit trust can convert and a SMSF trustee can rely on the "non-gearred" exemption to allow further investment in the unit trust has recently been examined by the ATO.

The laws that apply to pre-12 August 1999 investments in related trusts apply in the same way to investments in related companies. For simplicity this paper refers only to investments in trusts.

### 1.9 Status of investments after 30 June 2009

All investments that were made by SMSFs in related trusts before 12 August 1999 are exempt from being in-house assets and this exemption continues to apply forever (section 71A of the SISA). Further, any additional investments that were made in the transitional period up to 30 June 2009 are also exempt (forever) provided that those investments complied with the transitional rules (namely, sections 71D or 71E of the SISA).

From 30 June 2009, any further investments in a related trust will not be exempt from being in-house assets (subject to the satisfaction of the requirements outlined below). However, the activities of the unit trust are not restricted in any way. For example, the trust was not required to have discharged its debts by 30 June 2009 and it may even undertake further borrowings (if appropriate to do so).

### 1.10 Conversion to a 'non-gearred' trust

If a SMSF trustee wishes to make further investments after 30 June 2009 and the value of the total in-house assets of the SMSF would exceed 5% of all SMSF assets, consideration should be given to whether it is possible to rely on what is often referred to as the "non-gearred" trust exception.

A "non-gearred" trust is one that has no borrowings, no charges over its assets, no loans to other entities, no interests in other entities and numerous other requirements (refer to regulations 13.22B and 13.22C of the SISR). Generally, the investment by a SMSF in a non-gearred trust is excepted from being an in-house asset (for example, if the trust was established in 2011).

Many have queried whether a trust in which a SMSF trustee invested before 12 August 1999 could simply "convert" to a non-gearred trust by ensuring all its debts are discharged (and all other requirements are met) to allow further SMSF investment. The ATO has considered this and taken the view that this will only be possible in certain circumstances.

Specifically, conversion (for the purposes of further SMSF investment) is possible if:

- the trust has now discharged any pre-28 June 2000 borrowings (or rectified any other relevant pre-28 June 2000 activities, such as discharging any mortgage that was registered over an asset before 28 June 2000 or disposing of any interests in other entities that were held before 28 June 2000); and
- aside from the pre-28 June 2000 activities referred to above, the trust has continued to meet all of the relevant requirements since 28 June 2000. This means that the trust must not have undertaken any new borrowing after 28 June 2000, even if that borrowing has subsequently been discharged. (The same applies to other activities such as charging trust assets or owning interests in other entities, etc.)

This view of the ATO differs from that held by some others in the industry. The difference in views is due to alternative interpretations of the relevant provisions of the SISR. From a technical perspective, the ATO position is that regulation 13.22B applies to all units acquired by a SMSF prior to 28 June 2000 (and regulation 13.22C applies to all units acquired after that date), *even if* those units were exempt from being in-house assets pursuant to sections 71A, 71D and/or 71E of the SISA and the SMSF did not need to rely on regulations 13.22B or 13.22C for an exemption. If the trust subsequently fails to meet any of the requirements of sub-regulations 13.22B(2) or 13.22C(2) after 28 June 2000, regulations 13.22B (and where relevant 13.22C) would therefore “cease” to apply to the units which, pursuant to regulation 13.22D, means that neither regulation 13.22B nor 13.22C can ever be relied on by the SMSF as an exemption for investments in that trust. The alternative view held by some in the industry is that regulations 13.22B and 13.22C have never “applied” to units in a trust which have been exempt from being in-house assets pursuant to sections 71A, 71D and/or 71E of the SISA. Accordingly, any non-compliance with the requirements in sub-regulation 13.22B(2) or 13.22C(2) after 28 June 2000 would not have caused regulations 13.22B and 13.22C to “cease” to apply and the operation of regulation 13.22D would not have been triggered. (Those who are interested in the detailed technical analysis should refer to the NTLG Superannuation Sub-Group minutes of June 2010 and September 2010.)

The ATO interpretation appears to be correct from a technical viewpoint. However, from a policy perspective there are sound arguments that would support the alternative view. If a unit trust has now fully discharged its debts (and rectified all other relevant matters), when considering the risk to the SMSF investor there is no basis for distinguishing between unit trusts which had borrowings after 28 June 2000 (which are now discharged) and those that did not. The position for the SMSF investor is the same in either case.

However, SMSF trustees should be aware that the ATO has taken a strict view and this appears to be technically correct. The ATO has indicated it would be willing to test this via the courts, but trustees should consider the expense and delay that would be associated with challenging this matter in court. If the ATO view is confirmed to be correct, a SMSF who had invested on the basis of the alternative view could still ultimately be made non-compliant.

In summary, on the basis of the ATO view some trusts will have an opportunity to convert in order to allow further SMSF investment, while others will not. It will be necessary to closely examine the history of the activities of the trust in order to determine whether conversion is possible. If a unit trust is not eligible to convert, SMSF trustees should consider whether other entities such as family trusts or companies could subscribe for further units in order to finance the activities of the trust.

## 4 RELATIONSHIP BREAKDOWN

In November 2010 legislation was passed to make it easier to roll-over superannuation assets to a new SMSF following the breakdown of a marriage or de facto relationship. This brings the superannuation compliance laws in line with the CGT relief available to separating couples.

### 1.11 Related party acquisitions and in-house assets

There is now an express exception to the prohibition against acquiring assets from a related party in the context of relationship breakdown (subsections 66(2B) and (2C) of the SISA). Where a couple has separated and there is no reasonable likelihood of cohabitation being resumed, either or both parties may establish their own new SMSF and roll-over assets in specie from the old SMSF they shared as a couple (provided the roll-over of assets is directly in connection with the relationship breakdown). This means assets such as residential property, unlisted shares and units in a geared unit trust may be rolled-over (in addition to assets already covered under other exceptions, such as business real property and listed securities).

The exception applies where the roll-over represents the benefits of the member in the old SMSF or alternatively their entitlements in the superannuation benefits of the other spouse as determined by family law (e.g., under a superannuation split).

An exception has also been inserted into the in-house asset provisions to ensure that the roll-over does not result in inadvertent in-house assets arising (section 71EA of the SISA). Without this exception, any pre-12 August 1999 investments in a related unit trust held by the original SMSF of the couple (or units acquired in the transitional period up to 30 June 2009) would become in-house assets of the new SMSF after they are rolled over.

This has provided much needed certainty for SMSF members who wish to make a fresh start after a relationship breakdown. While the Commissioner had previously issued a general determination to provide an exemption to the prohibition against related party acquisitions (SPR 2006/MB1), it only applied to married couples and not de facto (including same sex) couples. Further, there was no equivalent relief for in-house assets. (Until recent developments, trustees were required to make individual applications to the Commissioner to exercise his discretion to grant relief for pre-12 August 1999 investments rolled over to a new SMSF.)

### 1.12 CGT relief

Subdivision 126-D of the *Income Tax Assessment Act 1997 (ITAA 97)* also provides CGT relief for assets rolled over between SMSFs as a result of relationship breakdown. This includes roll-overs made in accordance with property orders and agreements as well as binding financial agreements that were entered into before or during the relationship.

Broadly, any gain or loss of the transferring SMSF is disregarded, and the receiving SMSF inherits the cost base of the transferring SMSF as at the date of transfer.

Note that in relation to pre-CGT assets, subdivision 126-D expressly states that a pre-CGT asset of a transferring entity is also taken to be a pre-CGT asset of the receiving entity. However, complying superannuation funds who acquired assets before 20 September 1985 are always deemed to have acquired those assets on 30 June 1988 (refer to the general modification in section 295-90 of the ITAA 97).

## 5 CASHING OF BENEFITS

In the previously referred to SMSFD 2011/1, the ATO outlined its view about the use of cheques or promissory notes (**PN**) in cashing superannuation benefits. This an important determination for many SMSF trustees because it may be relevant to determining whether a trustee has paid the minimum annual payment required from a pension by the end of the financial year.

The key message is that benefits paid by way of cheque or PN are cashed when they are given to the member, provided that the amount is payable immediately, there is money available for payment, the trustee takes all steps necessary to ensure the money is paid promptly and the money is actually paid. One example provided is where a SMSF has insufficient funds as at 30 June but will have sufficient funds on 30 September when a term deposit expires. The trustee provides the member with a cheque by 30 June which she then cashes on 1 October. The ATO view is that the benefit was *not* cashed by 30 June because there were insufficient funds at the time. The same analysis would presumably apply to sale proceeds expected from the settlement of an asset sale. SMSF trustees should be aware of the ATO view when planning to make pension payments in these circumstances.

One part of the determination which has caused some consternation is the statement that a benefit is not cashed when a cheque is given to member if the member delays presentation of the cheque because he or she does not immediately require the funds, even if the SMSF had sufficient cash available at all times. The ATO view is that, unless there were circumstances outside of the control of the member which prevented the member from cashing the cheque, this indicates there was no objective intention to immediately transfer funds to the member. The example given is a delay of approximately three months and the ATO states that a reasonable period for presenting a cheque or PN would generally be “within a few business days”.

The ATO justifies its position that the delay of a member in presenting a cheque reflects on the intention of the trustee because a person holding office as a SMSF trustee is considered to have control over their actions as a member. This might be the case in a single member SMSF, but it is unclear whether the ATO would relax its view where there are multiple trustees. For example, if a majority of trustees determine that a pension payment should be made for all pensioner members prior to 30 June and cheques are given to each pensioner, does the failure of one member to bank his or her cheque reflect upon the intention of the trustees?

The determination illustrates the focus of the ATO on timing requirements and on ensuring that minimum pension payments are cashed each year. If a minimum payment is not made, the pension will not meet the standards of the SISR and this may mean the assets of the SMSF do not qualify for the pension exemption. For this reason, making minimum pension payments is a critical planning issue and trustees should consider their cash flow requirements each year when making investment decisions.