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Member Verification Service to be provided by the ATO

The ATO will be implementing a SMSF member verification service later this year.

The service will be offered to APRA regulated funds and will permit APRA regulated funds to verify that a person requesting a rollover of benefits to a particular SMSF is, in fact, a member of the nominated SMSF.

When the member verification service commences, the ATO will also be updating the guidance issued to APRA regulated funds on processing rollovers to SMSFs.

The upshot for SMSFs is that the need to keep the ATO advised of membership movements will be even more critical. Any membership movement in an SMSF must be advised to the ATO within 28 days. The ATO can be advised by completing and submitting a paper notification (using ATO form NAT 3036). It will generally take the ATO 28 days to process the notification. A quicker and more convenient method of notifying the ATO of membership movements is by notifying the ATO electronically if the SMSF has a digital certificate with the ATO.

Once the new service is implemented, it is easy to see that a rollover request to an APRA regulated fund may be frustrated simply because the SMSF has either not advised the ATO of the admission of the member or that the information has been provided but is still being processed by the ATO. This will be particularly relevant

where the rollover is required in order to settle a property investment using a limited recourse borrowing strategy. The time taken for the ATO to process the member admission information will have to be factored in any limited recourse borrowing strategy where the rolled over amount is needed to finance the acquisition.

Capital Gains Contributions

Normally non-concessional contributions are subject to a \$150,000 limit. This is an annual limit. However, if the contribution is sourced from capital gains to which either the 15 year exemption or the retirement exemption applies, they can be counted against the CGT contribution limit.

For the 2010/11 financial year the CGT contribution limit is \$1,155,000 and is a lifetime limit. The limit is indexed each year in \$5,000 increments. The provisions which provide the capital gains concessions specify that the maximum amount of retirement concession is \$500,000 per taxpayer and this is a lifetime limit. There is no limit to the 15 year concession. Consequently, the maximum amount of CGT contribution which a super fund can report as a CGT contribution to which the retirement concession applies is \$500,000.

If a taxpayer makes a \$600,000 contribution to a super fund to which a capital gains tax cap election applies, provides the appropriate tax form (NAT 71161) and specifies that the entire amount is a retirement exemption, the election will be partially invalid. The super fund can accept that \$500,000 is a CGT retirement contribution but the balance will not be treated as a CGT contribution. The balance will be treated as an ordinary non-concessional contribution.

The election to treat a contribution as a CGT contribution must be made at or before the contribution is received. If the completed form is received by the super fund after the contribution has been made – the election is invalid.

In the example above, the election is valid to the extent of the first \$500,000 but is invalid for the balance. Consequently the balance will be treated as an ordinary non-concessional contribution.

Re-reporting of excess contributions

One of the key aspects of the ATO compliance program for 2010-11 will be in relation to the accuracy and completeness of contribution reporting by super funds.

The ATO has noticed a significant increase in the re-reporting of contributions where the member has received a notice from the ATO that excess contributions may have been made for them.

The ATO accepts that if there was an error in the initial contribution report (possibly non-concessional contributions misreported as concessional contributions) the error must be corrected. However the ATO does not accept that an excess contributions issue can be rectified by a subsequent and revised contribution report.

The view of the ATO is that trustees should take sufficient care to ensure that contributions are correctly reported in the first case. Where a member later claims that contributions have been misreported, the trustee must carefully consider the claim.

Re-reporting contributions where there is no reasonable basis for the revised report may constitute the provision of a false and misleading statement to the ATO.

Also, the ATO is not automatically bound to accept the revised contribution report as being correct. The ATO is not bound to revise the excess contributions assessment simply because of a revised contribution report.

The only sure way of avoiding an excess contribution assessment is to check that the contribution is not excessive before the contribution is made.

Non-lodging SMSFs - ATO is starting to issue default tax assessments

The ATO has commenced a pilot exercise in respect of 250 non-lodging SMSFs. These are SMSFs which have not lodged a tax return/fund annual return despite being contacted by the ATO.

The ATO is currently issuing default tax assessments against the SMSFs. The default assessment calculates the tax owing by the fund at 45% of the fund's value less the value of non-concessional contributions.

Additionally, the ATO may prosecute the trustees /directors of the trustee.

ATO Interpretative Decisions

The ATO has recently issued five Interpretative Decisions dealing with limited recourse borrowing.

Re-financing of existing loans

ATO ID 2010/169 deals with the question whether a borrowing entered before 7 July 2010 (the date from which the new limited recourse borrowing provisions apply) can be refinanced.

The answer is "Yes" provided certain conditions are satisfied.

The refinancing is permitted provided:

- the money borrowed under the refinancing loan is applied solely for the purpose of paying out the amount due under the original loan;
- the refinancing loan satisfies the requirements of the limited recourse borrowing provisions; and
- legal title to the asset which was acquired remains with the trustee of the holding trustee (aka bare trustee, custodian etc).

The same answer would apply if the loan to be refinanced was made on or after 7 July 2010 (ie the arrangement is one to which s67A of the SIS Act applies as against s67(4A)).

Third party guarantees

ATO ID 2010/170 deals with the situation whether a member (or other related party) can provide a guarantee to the lender in respect of a limited borrowing arrangement to which s67(4A) applies.

The answer is "Yes".

Section 67(4A) required that the rights of the lender be limited to the asset which was acquired with the loan. The section did not deal with the rights of other parties in relation to the acquired asset. The current provision, section 67A, does now require the rights of the lender and any other person to be limited to the acquired asset.

Under s67(4A) if the guarantee was invoked then the guarantor's rights against the SMSF trustee were not limited. Now, such rights must be limited.

If a lender requires a guarantee from a member or other related party, the lender will usually require their standard third party guarantee form to be signed. Now, because of the wording of s67A, the lender must also provide an additional guarantor waiver form.

Joint Investments

ATO ID 2010/172 deals with the issue of whether an arrangement by which two SMSFs jointly borrowed to acquire an asset which was held in a single holding trust satisfies the limited recourse borrowing exception?

The answer is “No”.

The structure of the arrangement involved one borrowing. Title to the acquired asset was held by the trustee of the Holding Trust and each SMSF acquired an interest in the property as a tenant in common.

The key reason why this structure did not satisfy s67(4A) is that the title held by the trustee of the Holding Trust does not match the title which the SMSF will acquire when the borrowing is repaid.

Had the structure been two loans and two Holding Trusts, then the outcome would be different. In a two loan/two Holding Trusts structure, the title the Holding Trustee holds is a partial interest in the property as tenant in common. The title which the SMSF will acquire on paying out the loan is partial interest as a tenant in common.

Additionally, the lender should take out two mortgages; one in respect of each loan and the mortgage should be restricted to the interest of the SMSF has in the acquired property.

Great care must be taken to correctly structure a joint investment structure and relevant professional advice should first be obtained.

Capitalisation of interest

ATO ID 2010/184 deals with the issue of whether interest on a limited recourse borrowing can be capitalised without breaching section 67(1).

The answer is a surprising “Yes”.

This answer while welcome is somewhat surprising given comments in SMSFR 2009/2 that a drawdown on a loan facility would be treated as a new loan. If the drawdown is a new loan, how has the acquisition element been satisfied in respect of the new loan?

The ID states that “the Commissioner accepts that the drawdown representing the capitalisation of interest is for the purpose of acquiring the asset under the limited recourse borrowing arrangement. That is, the requirement in former paragraph 67(4A)(a) of the SIS Act is met in respect of the drawdown if the amount capitalised is a cost related solely to the original borrowing under an arrangement which otherwise meets the requirements of the former paragraphs 67(4A)(a) to (e) of the SIS Act.”

While the ID is concerned with the previous wording of the limited borrowing exception, the reasoning of the ID would apply to the current wording found in s67A.

Charges for third parties

ATO ID 2010/185 deals with the issue whether the trustee of the Holding Trustee can, consistently with the requirements of 67A, grant a charge over the asset held in the Holding Trust for an entity other than the lender.

The answer is “No”.

If the trustee of the Holding Trust were to grant a charge over the asset held in the holding of for say, the parent company of the lender, then that charge would cause the arrangement to fall outside s67A.

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