

CAVENDISH SUPERANNUATION PTY LTD

SPECIALISTS IN SELF MANAGED SUPERANNUATION

ABN 30 007 778 341

TECHNICAL UPDATE

ISSUE 13
JULY 2008

IN THIS ISSUE

RELATED
PARTIES

PART 8
ASSOCIATES

INDIVIDUAL
CHART

RELATED PARTY
ACQUISITIONS

RELATED PARTY
ACQUISITIONS -
IN HOUSE ASSET
EXCEPTION

FAILURE TO
COMPLY

BUSINESS REAL
PROPERTY

IN-HOUSE
ASSETS

EXAMPLES OF
RELATED PARTY
ACQUISITIONS -
ALLOWED AND
DISALLOWED

CONCLUSION

Related Party Acquisitions

Self Managed Superannuation Fund (SMSF) Trustees acquire assets from related parties on a daily basis but are they aware of the restrictions placed on related party acquisitions and the consequences of breaching the rules of such a transaction. We examine what constitutes an acceptable related party acquisition and some handy steps to take to ensure you don't wear the wrath of the Fund Auditor or the Australian Taxation Office.

RELATED PARTIES

Section 66 of the Superannuation Industry (Supervision) Act 1993 (SISA) is titled "Acquisitions of certain assets from members of regulated superannuation funds prohibited" however the title is slightly misleading as it is carried over from prior to 1999 when there was no definition of "Related Party" in the legislation. Section 66(1) states that subject to certain exceptions a trustee of a regulated superannuation fund must not intentionally acquire an asset from a related party of the Fund. We will examine the exceptions further on.

A related party of a superannuation fund is defined in section 10(1) of the SISA as:

- a) A member of the fund
- b) A standard employer sponsor of the fund
- c) A Part 8 Associate of an entity referred to in a) or b)

We note that standard employer sponsors of a fund are unlikely to be relevant to SMSFs.



CAVENDISH
www.cavendishsuper.com.au

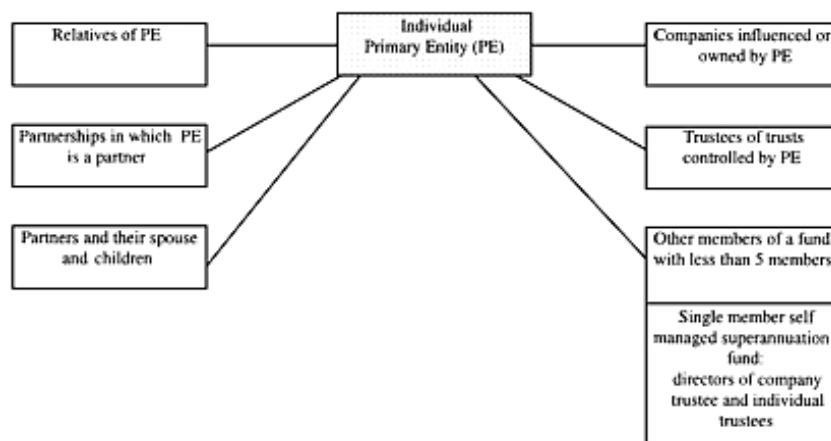
PART 8 ASSOCIATES

Part 8 Associates of an individual, otherwise known as the 'primary entity' can be summarised as follows:

- A company that is sufficiently influenced by the primary entity or the primary entity holds a majority voting interest in. This also includes companies influenced by other Part 8 Associates of the primary entity
- A partner in partnership including the spouse and or children of the partner
- A trust where the primary entity (or Part 8 Associates of) hold a fixed entitlement to more than 50% of the capital or income, has a sufficient influence or has the ability to remove or appoint the trustee or a majority of the trustees

A relative of the primary entity defined as a parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of that individual or of his or her spouse, the spouse of that individual or of any other individual specified above.

PART 8 ASSOCIATE OF AN INDIVIDUAL CHART



RELATED PARTY ACQUISITIONS

For the purposes defining “acquisition” the Regulator has clarified that to acquire includes both purchasing an asset directly from a related party or the fund receiving a contribution from the member in the form of an asset. Draft Self Managed Superannuation Funds Ruling SMSFR 2008/D2 provides a very detailed description of assets which can be contributed under section 66 of the SISA.

The related party assets which can be acquired by a SMSF are:

- Assets listed on an approved stock exchange, licensed market or exempted market
- Business real property (where the property is used wholly and exclusively in one or more businesses).

All assets purchased or contributed by a related party or member of the Fund must be transacted at market value.

In addition to these exceptions SISA goes further to make an exception for certain in-house assets.

RELATED PARTY ACQUISITIONS – IN-HOUSE ASSET EXCEPTION

Section 66(1) does not prohibit the acquisition of an asset by a trustee of a superannuation fund from a related party of the fund if:

- (a) The acquisition of the asset constitutes an investment that:
- i. is an in-house asset of the fund within the meaning of subsection 71(1); or
 - ii. would be an in-house asset of the fund within the meaning of subsection 71(1) apart from the operation of Subdivision D of Part 8; or
 - iii. is a life insurance policy issued by a life insurance company (other than a policy acquired from a member of the fund or from a relative of a member); or
 - iv. is referred to in paragraph 71(1)(b), (ba), (c), (d), (e), (f), (h) or (j); and
- (b) the asset is acquired at market value; and
- (c) the acquisition of the asset would not result in the level of in-house assets of the superannuation fund exceeding the Part 8 limit of 5 % of fund value.

An in-house asset is defined as a loan to or an investment in a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund. A fund is not permitted to acquire a new in-house asset if the level of in-house assets is already 5% or if the acquisition would make the fund exceed 5%.



Most notable under this exception is the inclusion of the ability to acquire assets under 71(1)(h) – widely held trusts. This inclusion allows a fund to purchase managed funds and unlisted property trusts amongst other trust arrangements that have at least 20 unit holders.

FAILURE TO COMPLY

We often come across investments acquired from a related party that do not satisfy all the necessary conditions spelt out in section 66 of the SISA. Some of the more common issues are highlighted here as a reference point for future transactions.

BUSINESS REAL PROPERTY

Business real property not transferred/purchased at true market value. Often the trustees will rely on their conveyancer to handle the transfer of property to their SMSF and the main consideration is given to minimising the imposition of Stamp Duty. To do this they utilise the lowest value they can obtain, often from a Council rates notice or from the Valuer General's valuation. As the SISA requires the transfer be at market rate, described as an amount a willing buyer is prepared to pay and that a willer seller is prepared to receive if the transaction was conducted at arm's length, these transfers often fail to satisfy the commercial transaction test.

Therefore care must be taken and third party valuations obtained to truly satisfy the requirements.

IN-HOUSE ASSETS

Unlisted public company and private company shares and non-standard assets subject to a lease, such as artwork, can be related party assets that do not satisfy the definition of an in-house. Each proposed related party acquisition should be assessed on its merits as it may not mimic a similar asset transaction of another SMSF.

The key to entering into these transactions is to look at the end result first and assess, once a fund owns the asset, will it satisfy the definition of an in-house asset. If it does then determine whether the investment will put the level of in-house assets over 5% of the total fund assets. If the value is below 5% then the fund can acquire the asset from the related party and satisfy the legislative requirements.



EXAMPLES OF RELATED PARTY ACQUISITIONS – Allowed and Disallowed**Example One**

Artwork valued at less than 5% of fund value acquired from a member and leased to a related party (eg members business) would be allowable. If however the fund leased the artwork to an art gallery on a permanent basis or to a non-related company then it would fail the definition of an in-house asset and the fund would not be able to acquire it from the related party.

Example Two

An executive of an unlisted public company is issued shares in the company. The value of the shares equal less than 5% of the fund value. As these shares are not listed and the company is not a related party of the fund the acquisition of the assets is not allowed. If the company lists the member could transfer the shares into the fund at that time.

CONCLUSION

As can be seen, there are subtle differences that separate what can and can't be done by a Fund when acquiring assets from related parties. It is always important to review the transaction and the relationship that exists between the parties before committing to a purchase or contribution. The ATO has released a number of draft rulings and determinations on these issues i.e. SMSFR 2008/D2 deals with contribution of assets to a SMSF from a related party and SMSFR 2008/D3 is the ATO's latest attempt at defining Business Real Property.

There are a number of other relevant in-house asset issues associated with these related party transactions such as the transitional rules that apply to pre 1999 unit trusts, loans and leases to related parties established prior to 11 August 1999 as well investments in related trusts that are of a non-g geared nature. These topics cover assets that are excluded from the in-house asset definition but without proper management could see a fund in a vulnerable position and will be discussed in our next bulletin.

For further information please contact Cavendish Superannuation Pty Ltd

PHONE

1800 808 354

FACSIMILE

(08) 8212 6747

WEBwww.cavendishsuper.com.au**MAIL**GPO Box 9981
Adelaide SA 5001

This article is written by Tim Miller, Technical Services Manager, Cavendish Superannuation Pty Ltd.

Copyright © 2008 Cavendish Superannuation Pty Ltd.

Disclaimer: The material contained in this publication is in the nature of general comment and information only and neither purports nor is intended to be advice on any particular matter. Readers should not act or rely upon any matter or information contained in or implied by this publication without taking appropriate professional advice.

**CAVENDISH**
www.cavendishsuper.com.au