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# In-house assets – are you up to date? The 2011 SISFA Forum 5 & 7 September 2011

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- What are the consequences of having an IHA?
- What is an IHA?
- Exemptions
- Particular issues
- Anti-avoidance
- Other provisions to consider



# Consequences of IHA

- 5% by market value (section 82)
- Tested at acquisition and 30 June
- Cannot buy more (section 83)
  - if over 5%
  - if take you over 5%



# Consequences of IHA

- Plan to get rid of
- Civil Penalty (section 84)
- Ability to make fund non-complying
- Does not affect the validity of trans (s 84(3))
- But trust deed – are you in breach?
  - Other recourse
  - Does it invalidate the transaction?



# What is an IHA?

- Loan to related party
- Investment in related party
- Asset subject to a lease or lease arrangement with related party
- Investment in related trust



# What is an IHA?

- Examples
  - Loan to member's company
  - Residential property leased to member's child
  - Investment in wholly owned unit trust or company
  - Beach house used by member (or relative) at all



# What is an IHA?

- Lease arrangement
  - Agreement, arrangement or understanding
  - In the nature of a lease
  - Other person is to use or control the use of
  - Whether or not enforceable or intended to be enforceable



# What is an IHA?

- Lease arrangement
  - Wide definition
  - Mere occupation or possession is enough
  - Fact there is no document does not matter
  - Regardless of rent paid



# Related party

- Member
- Standard employer-sponsor
  - Versus just an employer sponsor
- Part 8 associate of either
  - Difficult definition



# Part 8 associates

- Relatives
- Other members
- In a sole member fund, the each trustee or director of trustee company
- Partners, spouses and children and the partnership
  - Tax law partnership



# Part 8 associates

- Example
  - Tony and Malcolm are partners in a law firm
  - Part 8 associates
    - Each other
    - Each other's spouse
    - The partnership
    - Companies and trusts the part 8 associates control aggregating their interest



# Part 8 associates

- Example
  - Tony's and Malcolm's family trusts are partners in a law firm
  - Different
    - Not a partner of a controller
    - Not a controller of a partner



# Part 8 associates

- Examples
  - Julia is the sole member of her SMSF and an individual trustee
  - Wayne is a co-trustee and not a member
  - Part 8 associates
    - Each other
    - Companies and trusts they control aggregating their interest



# Part 8 associates

- Controlled entities (controlled by group)
  - Trusts and companies
  - Act in accordance with directions
  - More than 50%
    - Dividends/trust distributions
    - Capital
    - Voting rights
  - Change trustee



# Part 8 associates

- Example
  - Malcolm's SMSF and Tony's SMSF each have 50% of the shares in a company
    - Individually, neither controls
    - Together they control
  - Tony's SMSF and Julia's SMSF have 50% (unconnected)
    - Not connected as neither control and cannot connect



# Part 8 associates

- Example
  - Julia's SMSF and Tony's SMSF have 50% of the units in a unit trust
  - Julia is the only director of the trustee company of the unit trust
  - Julia has control – is a related party
  - Tony does not – is not a related party



# Exemptions

- Lease of business real property
- Widely held unit trusts
- Property owned as tenants in common
- Pre 1999 unit trusts
- Ungearred entities



# Exemptions

- Business real property (section 66 def'n)
  - Interest in real estate wholly and exclusively used by someone in carrying on a business
  - Primary production
    - 2 hectare private use carve out
  - Lack of use by someone
  - Private use necessary for business
  - For whole time is leased to related party



# Exemptions

- Business real property example
  - Tony's SMSF owns factory
  - Leases it to Tony's company to carry on its manufacturing business
  - Wholly used in business
  - Exempt from IHA rules
  - Tony's daughter lives in small flat at the back
    - No longer business real property
    - Becomes IHA



# Exemptions

- Widely held unit trust (section 71(1A))
  - Unit trust with fixed entitlements to all income and capital (effect of *Colonial First State*)
  - Not fewer than 20 entities entitled to 75% or more of income and capital



# Exemptions

- Unrelated entities
  - Related party test effectively requires *more than 50%*
  - If 2 unconnected parties have only 50% each, no control so not a related party
  - Watch
    - Directorships of trustee company
    - Chair/casting votes
    - Practical/effective control



# Exemptions

- Pre 1999 unit trusts
  - Units issued before 11 August 1999
  - Transitional rules until 30 June 2009
    - Partly paid
    - Reinvest profits
    - Debt election
  - New units otherwise are IHAs
    - Due diligence to make sure is OK
  - Could now be ungeared?



# Pre 1999 unit trusts – Capital Gain

- Retain capital gain in pre-1999 unit trust
  - Unit trust deed important - Definition of Income
    - not section 95 income
    - must allow trustee to determine income = trust income
    - *Bamford*
  - Unit Trust must
    - make a capital gain
    - have other trust income
  - Distribute other trust income to SMSF
    - Proportionate approach
    - SMSF can be assessable on capital gain even without cash



# Pre 1999 unit trusts – Capital Gain

- Example
  - Trust has:
    - capital gain \$100 (asset held > 12 months) and
    - ordinary income \$100
  - Trust deed – income = accounting income
  - Distribute only ordinary income of \$100 to SMSF



# Pre 1999 unit trusts – Capital Gain

- Example (cont)
  - For tax purposes, SMSF income = \$150
    - \$100 ordinary income
    - 50% of \$100 (net capital gain)
  - SMSF grosses up net capital gain
    - \$50 up to \$100
    - re-discounts by 1/3
  - Capital gain cash remains in the trust



# Exemptions

- Ungearred entities (Regs 13.22B & 13.22C)
  - no debt or charges
  - no loans, or investments in other entities
  - not acquired assets from related party (except business real property)
  - not lease assets to related party (except business real property)
  - not carry on a business
  - arm's length terms for all transaction
  - if breach, investments become in-house assets



# Exemptions

- Ungeared entities example
  - Establish unit trust with SMSF and family trust as unitholders (related entities 100%)
  - Trustee buys residential property
    - From arm's length seller
    - Leases to arm's length tenant
    - From funds provided by unitholder
  - Not IHA
  - SMSF can buy units from family trust at market value over time



# Particular issues

- New collectables rules
  - Artwork, antiques and artefacts
  - Jewellery
  - Coins or medallions
  - Postage stamps or first day covers
  - Rare folios, manuscripts or books,
  - Memorabilia and wine
  - Cars and recreational boats
  - Memberships of sporting or social clubs



# Particular issues

- New collectables rules
  - New assets from 1 July 2011
  - Existing assets from 1 July 2016
  - Related party must not use
  - Must not store in private residence of related party
  - Written record of decision about storage
  - Must insure
  - Must realise at market value



# Anti-avoidance

- Can trust do things super fund can't?
  - Section 71(2) – agreement to get around
  - Section 71(4) – ATO can deem anything to be an IHA
  - Section 85 – scheme for an artificial reduction of IHA percentage



# Anti-avoidance

- Can trust do things super fund can't?
  - SIS only applies to fund
  - But
    - sole purpose test
    - financial assistance
    - anti-avoidance rules
  - *Holloway*
  - *ZDDD v FCT 2011 AAT*



# Other sections

- Loans to members
- Financial assistance
- Sole purpose
- Arm's length dealings
- Early release?
  - *Smith* 2011 AAT





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# Thank you

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