TECHNICAL COMMITTEE MEETING

MINUTES OF MEETING HELD ON 21 July 2011 AT 11.30 a.m. EST

BY TELEPHONE CONFERENCE

Present:

Rob Jeremiah, (**RJ**) Harwood Andrews Lawyers (Chair)
Claire Malone (**CM**) Harwood Andrews Lawyers (taking minutes)
Philip Broderick, (**PB**) DLA Phillips Fox
Carmel Riordan, (**CR**) Carmel Riordan Lawyers
Teresa Parletta (TP) Superfund Accounting Services
Darren Kingdon (**DK**) Plan Wealth

Apologies:

Kevin Sudlow (Multiport)
Barbie Chiro (WWSA)
Chris Hocking
Steven Skoglund (Davidsons)
Larisa Moran (KPMG)

1. **Welcome**
RJ opened the meeting at 11.30am AEST.

2. **Submission to Treasury about conversion to a regulation 13.22C compliant trust**
It was noted that RJ was in the process of finalising a draft submission to Treasury regarding conversion of unit trusts to meet the requirements of regulation 13.22C of the *Superannuation Industry (Supervision) Regulations 1994* (SISR), specifically where a superannuation fund invested in the unit trust before 12 August 1999 and the unit trust has undertaken a borrowing after 28 June 2000. It was noted that this draft would need to be approved by both the Technical and Policy Committees of SISFA.

RJ noted that the submission would describe the various arguments that have already been raised in previous Technical Committee meetings. However, he wished to raise one case he had recently become aware of which demonstrates the lengths that some SMSFs might need to go to if the Australian Tax Office's (ATO) technical view is applied. In that case:

- The unit trust had undertaken a borrowing after 28 June 2000 (and, according to the ATO view, could not therefore convert to a 13.22C compliant trust even though it had now discharged that borrowing).

- The members of the SMSF that invested in the unit trust prior to 12 August 1999 established a new SMSF with the same members.

- The new SMSF purchased the units in the trust from the original SMSF on arm's length terms.

- Although this provided a solution to the members, there were significant transaction costs in the implementation and this ultimately lead to a breakdown in the relationship with the members' accountants.

It was agreed by the Committee members that this provides evidence that the SIS regulations were probably not supposed to produce the results that arise when the strict ATO view is applied and that this highlights the absurdity of those results. It was agreed that this example should be mentioned in the submission.

RJ noted that he would be going on leave shortly and requested that CR submit this to the Policy Committee in his absence.

3. Pensions: TR 2011/D3

The Committee discussed the recently released TR 2011/D3 regarding when a superannuation income stream commences and ceases.

It was agreed that the draft ruling does not appear to contain much legal analysis in certain respects and that it is disappointing that the ATO has not addressed the technical arguments outlined in the joint submission made by SISFA and other bodies several years ago. It was noted that the lack of legal analysis gives parts of the draft ruling the appearance of a policy statement.

The following particular aspects of the draft ruling were discussed:

- It was agreed that the ATO's views on when an income stream commences are broadly correct and there is nothing in this respect that is cause for concern.
- However, the ATO's views on when an income stream ceases are more questionable. The most notable aspect in this respect is the ATO's view that an income stream ceases when the pensioner dies provided there is no automatic reversion of the income stream to another person (paragraphs 24, 115 and 116 of the draft ruling). The Committee noted that it is this aspect in particular that does not appear to be supported by any thorough legal analysis.
- It was suggested that the ATO's views on commutation of an income stream are also unusual. Paragraph 20 states that the income stream ceases upon receipt of a valid request from a pensioner to fully commute the income stream. It was noted that this is inconsistent with the approach taken to *commencement* of an income stream, which is not necessarily when a request or application is made but which is determined by reference to factors such as the terms and conditions of the pension agreement and the trust deed.

It was noted that comments on the draft ruling are due by 26 August 2011 and it was agreed that SISFA should provide a response. The Committee members recognised that although it is unlikely the ATO would adopt a different view when finalising the ruling, it is important that SISFA provides feedback to the ATO that some parts of the draft ruling do not appear to be based on thorough legal analysis.

PB and DK agreed to prepare a draft submission. It was suggested that KS and BC should be consulted as they might have feedback they wish to provide.

RJ also circulated the slides from a presentation recently given by Mark Ellem CPA SSA on pensions. It was agreed that the Committee members should review these so that some of the issues raised by Mark Ellem can be discussed at a future Technical Committee meeting. RJ noted in particular the points raised regarding bankruptcy and pensions, that is, whether a pension entitlement (not just pension payments) can vest in the trustee in bankruptcy and whether the superannuation fund's trust deed can prevent this if it provides that a pension entitlement is automatically forfeited upon bankruptcy. It was agreed that this can be discussed at a future Committee meeting.

4. Excess contributions – contributions reserves

RJ noted that he had recently been asked to consider whether the ATO's analysis in item 6.6 of the minutes of the National Tax Liaison Group, Superannuation Technical Sub-Group meeting in June 2009 applied to non-concessional contributions (NCCs) in the same way as concessional contributions (CCs). At that meeting the ATO expressed the view that if a CC is tendered to a fund at a particular time (eg, in June of a financial year) but it is not allocated to the member until the next financial year in accordance with regulation 7.08(3) (which allows the contribution to be allocated within 28 days of the end of the month), the contribution is counted towards the member's cap when it is actually allocated to them and not when it is received into the fund.

The Committee members agreed that this analysis applies equally to CCs and NCCs and that, if this scenario in fact occurs, it could potentially prevent the member from having excess contributions that would otherwise arise in the first financial year. (DK noted however that he is aware of one instance of APRA not being aware of the ATO's view.)

However, some questioned whether this contributions reserving strategy would have much application in practice. Firstly, it only applies to contributions made in June. Secondly, PB noted that some members could be tempted to rely on this after the event (ie, after they have become aware of an excess contributions problem). The question would be whether the trustee did in fact hold the contribution in reserve in June and then allocate it in July. If there is no evidence this actually occurred at the time it may be difficult to sustain this type of argument.

It was noted that the ATO has stated that a "reserve" is not necessarily required and that a suspense account would be sufficient. It was agreed that the provisions in the fund's deed regarding receipt and allocation of contributions would also be relevant.

It was also noted that, even if this strategy is successful, the allocated amount counts towards the member's contribution cap in the second of the two financial years and reduces the further contributions they could make in that year. In the long run, this strategy does not therefore allow a member to make any more contributions than they otherwise could. It would also be important for the member to closely monitor their contributions in the second year and to not forget about the allocation that occurred early in the year.

5. Superannuation fund borrowing update

RJ briefly noted that the draft ruling on superannuation fund borrowings under section 67A of the *Superannuation Industry (Supervision) Act 1993* was now due to be released on 14 September 2011 rather than August as previously advised by the ATO.

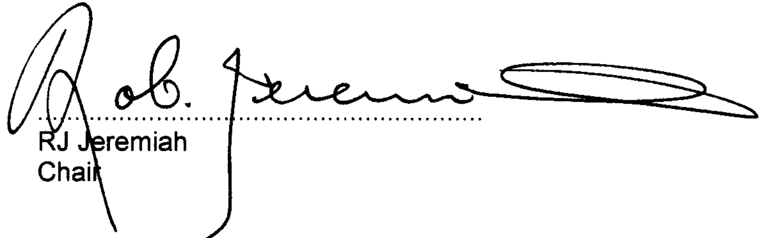
RJ also noted a recent article in the *Taxation in Australia* journal that described the current difficulties with improving an asset which is subject to a section 67A loan and the ATO's views on this. The author suggests that borrowing from a related party to buy units in a unit trust which develops a property, rather than borrowing to buy the land directly, is one strategy to overcome this concern. It was agreed by Committee members that there is no reason why a superannuation fund trustee cannot borrow from a related party to buy units in a unit trust provided the terms of the loan are on arm's length terms.

It was agreed that the unit trust arrangement might require some additional features to be documented, such as a covenant by the trustee of the unit trust that it will not allow a charge over the land (which would cause the fund's investment to fail to meet regulation 13.22C of the SISR and therefore give rise to in-house assets for the fund).

6. Other business

There was no other business.

7. Closure of meeting
RJ closed the meeting at approximately 12.25pm AEST.



RJ Jeremiah
Chair