TECHNICAL COMMITTEE MEETING

MINUTES OF MEETING HELD ON 26 May 2011 AT 3.30 p.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
Larisa Moran (**LM**) KPMG
Teresa Parletta (TP) Superfund Accounting Services
Darren Kingdon (**DK**) Plan Wealth

Apologies:

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

1. **Welcome:**
Rob Jeremiah opened the meeting at 3.30 p.m. AEST.

2. **Conversion to a regulation 13.22C compliant trust**
It was noted that **PB**, **CR** and **RJ** were in the process of preparing a submission regarding units trusts that had undertaken borrowings after 28 June 2000 and the ability of those trusts to convert to regulation 13.22C compliant trusts.

PB noted that the submission would outline two arguments; firstly, that the Australian Tax Office's (**ATO**) technical view of the regulations is incorrect and secondly, that there are sound policy reasons for allowing such trusts to convert.

An email prepared by **PB** outlining the technical analysis was tabled. The main technical issue is whether regulation 13.22B has ever "applied" to pre-August 1999 unit trust investments and therefore whether it can "cease" to "apply" (triggering regulation 13.22D). PB believes there is an argument that the ATO's interpretation is incorrect because when the Division commenced a geared unit trust would not have met all the conditions in 13.22B(2). Even though the conditions in 13.22B(1) are met, the SMSF has never relied on 13.22B. **CR** commented that it is not clear on the face of the regulations whether the provisions were ever intended to apply to pre-August 1999 unit trust investments. She has a clerk looking at the explanatory statements to the regulations and will report back on this.

On the second argument that these unit trusts should be allowed to convert for policy reasons, it was agreed by the Committee members that there would be no mischief in permitting such trusts to repay their borrowings in order to allow further SMSF investment. It was agreed that as far as a SMSF is concerned, there is no difference in that scenario to investing in a new non-geared unit trust that is established today.

3. **Report on progress of ATO draft ruling on limited recourse borrowing arrangements**

RJ reported that he has spoken to Andrew Lee (ATO) about progress of the draft ruling on limited recourse borrowing. It is understood the draft will be presented to the rulings panel in June 2011 and is expected to be released publicly in draft form in August 2011. Other stakeholders such as APRA have been closely consulted in preparing the draft ruling.

RJ reported that the draft ruling will address:

- Improvements to assets.
- The meaning of "single acquirable asset".
- The nature of the custodian trust relationship (and specifically whether a "bare trust" can exist).

It was noted that the discussion about "improvements" might distinguish in some way between voluntary improvements and re-building after flooding or other natural disasters.

Regarding the third topic, it was noted that others such as the Law Council have previously submitted to the ATO that the presence of a mortgage over the property held in the custodian trust does not preclude the existence of a bare trust relationship. **RJ** understands that the upcoming draft ruling is likely to not accept that argument but that the ATO may provide some form of "workaround" in order to allow a property to remain in a custodian trust after the SMSF's loan has been repaid without triggering an in-house asset problem. This would be a positive outcome for SMSFs with properties in States where a stamp duty liability would be triggered by a transfer of property from the custodian trust to the SMSF trustee.

RJ noted that he does not have any details about what the work around is likely to be, but commented that one solution could be to recognise that when a loan is repaid a custodian trust does not cease to be "in connection with" a limited recourse borrowing arrangement. According to that interpretation, the in-house asset exemption in section 71(8) would continue to apply after the loan is repaid.

4. **Discussion about exposure draft regulations on collectables and personal use assets**

It was noted that the exposure draft regulations on collectables and personal use assets had received significant press and that Michael Lorimer had made comments on behalf of SISFA.

The Committee expressed concern that the draft regulations reflect a heavy-handed approach to regulating investment in collectables. **RJ** suggested that the industry needs to consider, as a starting point, whether these regulations are needed at all, and if so, whether improper use of collectables should be made an offence (as per the draft regulations). It was suggested that if certain activity is difficult to police, making it an offence is not necessarily the most appropriate regulatory response.

It was noted that the list of collectibles and personal use items set out in the regulations is a very narrow list of particular items and there is no "catchall" provision to capture other kinds of collectables. For example, a collection of exotic items other than stamps or coins would not be captured. It was also noted that racehorses have not been included.

The Committee also discussed a number of other difficulties with the technical application of the regulations. The meaning of "lease arrangement" was discussed in detail. It was noted that this is defined in section 10 of the SISA and that the ATO has previously interpreted this expression in SMSFR 2009/4. However, it was agreed that the meaning of "lease arrangement" is unclear in the context of these draft regulations. For example, it is unclear whether hanging a painting on a wall is a lease arrangement.

A "lease arrangement" must be "in the nature of a lease" and this generally connotes exclusion possession; it is unclear how this concept is to be applied to collectables. It was also noted that the difference between "storage", "use" and "lease arrangement" is practically difficult to discern for some collectables. It was agreed that SISFA should ask that this be clarified (for example, by providing a definition of "lease arrangement" for these particular regulations). The Committee also discussed some technical issues regarding the requirement to insure assets.

DK volunteered to circulate his thoughts on this topic and get input from the Committee members with a view to preparing something for the SISFA Policy Committee. It was also suggested that separate submissions could be made by both the Technical and Policy Committees.

It was also queried whether the necessary enabling provisions in the SISA had been introduced. *[Addendum: the new provisions in the SISA allowing regulations to be made regarding collectables and personal use assets are to be inserted by the Tax Laws Amendment (2011 Measures No. 2) Bill 2011. As of 6 June 2011 the Bill has been tabled in the Senate but not yet passed.]*

5. **Federal budget announcements affecting SMSFs for report and discussion**
The Committee discussed the following announcements made in the 2011/12 Federal Budget:

- SMSF reforms as part of the Stronger Super initiative. $40.2 million would be provided to the ATO over 5 years to implement a range of reforms, including the introduction of administrative penalties, knowledge and competency requirements for auditors, tighter restrictions on collectibles and personal use assets, requirements to value assets at net market value, illegal early release penalties and other initiatives.

- Freezing indexation of the superannuation co-contribution until 2012/13.

- Allowing a parent or guardian of a SMSF member who is a minor child to be a director of a corporate trustee. It was agreed this was sensible because the current law allowing guardians or parents to be individual trustees only is arguably an anomaly.

- Requirement for payslips to contain superannuation information from 1 July 2012. It was suggested that this has been introduced to promote compliance by employers with their superannuation obligations. Others suggested that if it is aimed at reminding members about their contributions caps it would not provide much assistance in preventing excess contributions.

- Reduction in the minimum annual pension payment required by 25% (of the ordinary annual payment required) in 2011/12. It was agreed this is a positive measure and it recognises that some members are still experiencing the effects of the global financial crisis.

- Removal of trading stock CGT exception for complying superannuation funds to ensure gains and losses are subject to the CGT rules. This will ensure that SMSFs engaging in share trading will not be able to claim revenue losses.

- A higher concessional contributions cap for certain persons over 50 years of age.

- Refund of excess concessional contributions of up to $10,000. The Committee agreed this measure will not be sufficient in addressing the cases that typically arise in practice. It was agreed this is disappointing in light of pre-Budget discussions that had taken place regarding possible solutions. One member suggested that

increasing the contributions caps slightly could have been a better solution to spending considerable resources enforcing these new measures.

RJ also commented that it is disappointing that the new measures will not apply where excess contributions are made merely due to a member's employers complying with their superannuation guarantee contributions (eg, if a person has multiple employers and the employers' compulsory 9%contributions result in the member exceeding their cap).

The Committee discussed several alternative solutions that could be introduced. It was suggested that the Commissioner could be given a discretion to allow contributions to be returned in cases of honest mistake, similar to that for Division 7A purposes in section 109RB of the *Income Tax Assessment Act 1936*. This discretion would need to be much broader than the "special circumstances" avenue that currently exists.

Alternatively, there could be some kind of automatic return of excess contributions required with a prescribed interest component for the period that the excess amount is held in the fund. It was suggested that this obligation to return an amount could exist for a certain period of time (eg, two financial years) before reverting to the current rules (ie, imposition of penalty taxes) in order to deter members from deliberately making excess contributions in the hope of simply having them returned if they are caught.

It was suggested that, to implement this, the existing trustee obligation to return amounts in regulation 7.04(3) could be expanded upon. This would include an amendment to clarify that it is not limited only to single non-concessional contributions which on their own exceed the member's cap (ie, not when aggregated with other contributions).

It was noted that there are several technical issues that would need to be considered. For example, if a member has more than one superannuation fund it would be difficult for trustees to return amounts because they might not become aware of the excess contributions. Further, some members might actually wish to make excess contributions and pay excess contributions.

It was agreed that these possible solutions should be referred to the SISFA Policy Committee.

6. Other business

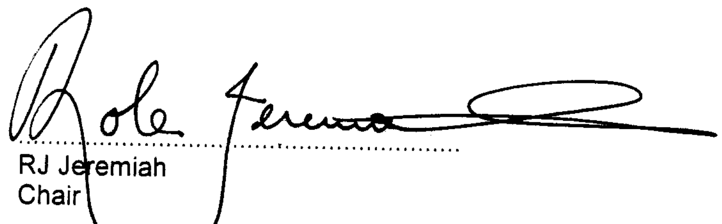
There was no other business.

7. Next meeting

It was suggested that the next meeting take place in early July 2011.

8. Closure of meeting

RJ closed the meeting at approximately 4.35pm AEST.



RJ Jeremiah
Chair