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3.8 degrees of separation – do you know who you're dealing with?



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Introduction

We've all heard of the "six degrees of separation", well apparently due to global connectedness, it is now down to 3.8 degrees. However, when it comes to SMSFs, there are specific rules for dealing with related parties and in-house assets (IHA), but who are they and what assets will be included?

In this open workshop, for general and specialist members, we will consider the various conference scenarios and how they are affected by the related party and IHA rules. As a workshop, you will work in groups of 10 to navigate your way through various scenarios to identify the compliance issues and what can be done to resolve them. To assist with the workshop additional facts will be introduced.

This workshop is designed for you to apply your knowledge of the rules for SMSFs dealing with related parties and the IHA rules. Consequently, there is an assumption of a level of knowledge of these rules with this paper focusing on the model solution to each case scenario. This workshop is aimed at those with emerging and experienced level of superannuation law knowledge.

Workshop Facts

In the conference "SMSF Family Profile" document, the only existing SMSF has as its members Charlie (63) and Cammie (56). It has a total of \$1.5m in assets, split \$1.2m to Charlie and \$300k to Cammie. Both Charlie and Cammie are the individual trustees. For this workshop the SMSF is named the "C & C SMSF".

Charlie's balance is mostly tax free component as it was funded by way of a CGT retirement contribution from the sale of his interest in his accounting business. Cammie's entire SMSF account balance represents the proceeds from the sale of her interest in a service company used by Charlie's accounting firm. She did not make any other contributions to the SMSF due to her membership of a State government superannuation scheme.

All Charlie's superannuation insurance policies are owned in the SMSF. Cammie's insurance is shared between both of her superannuation arrangements.

Workshop Exercise 1 – Identify the related parties of the SMSF

Looking at Charlie and Cammie’s SMSF, identify the ‘related parties, based on the facts provided in the conference “SMSF Family Profiles” document.

Model Answer

The definition of “related party” for the purposes of the SIS rules, as defined in section 10 of the SIS Act, includes a wide range of individuals and entities that may potentially be connected with the SMSF, including:

- members of the SMSF;
- ‘Part 8 associates’ of SMSF members;
- standard employer-sponsors of the SMSF; and
- ‘Part 8 associates’ of the standard employer-sponsor.

The related party definition is extremely broad and captures most non-arm’s length business and family relationships.

Section 70B of the SIS Act outlines the group of individuals that are Part 8 associates of an individual SMSF member to include:

- relatives;
- other members of the SMSF;
- for single member SMSFs, any other trustee, or director of a corporate trustee;
- business partners (as well as any spouse or child of that business partner if an individual);
- the trustee of any trust controlled by the individual; and
- any company or trust that is sufficiently influenced by, or in which a majority voting interest is held by, the individual or any other Part 8 associates of the individual.

So, our categories of related parties for Charlie and Cammie’s SMSF are:

- Members of the SMSF;
- Any ‘relatives’, as defined, of Charlie and Cammie;
- Any standard employer sponsors of the SMSF, including a Part 8 Associate;
- Any companies or trusts that are Part 8 associates of Charlie or Cammie; &
- Any ‘partner’ of Charlie or Cammie, including the spouse or child of that ‘partner’.

Charlie and Cammie are both related parties of the SMSF as they are both members of the SMSF and are included in the relative definition as spouse of each other.

Included in the definition of ‘relative’ (section 10 (1)) for the purpose of being identified as a related party of Charlie and Cammie’s SMSF would be:

- Phil and Lizzie – parents of Charlie;

- Harry, Billy and Simon – children of Charlie;
- Katie – spouse of Billy, Charlie's child;
- Charlotte and George – grandchildren (lineal descendant) of Charlie; &
- Lisa – sister of Cammie.

The only entity included in the facts provided is Billy's housing construction company, which is owned 50/50 by Billy and his spouse, Katie. As this company is controlled by a Part 8 Associate of a member of the SMSF, it is also a related party of the SMSF.

Additional Facts for Workshop Exercise 2

- Charlie was a Business Services Partner in the accounting firm “ABC Accounting & Tax Services”;
- Other Partners were Arthur and Bruce;
- Charlie sold his interest in the firm to Catherine (Senior Manager, now a Partner);
- Charlie is no longer a Partner, but a paid consultant and receives a salary and an end of year PAYG Payment Statement;
- Charlie was never much involved with SMSFs, only set up his SMSF recently prior to the sale of his share of the practice. He treats his SMSF as a tax vehicle for retirement savings, based on Catherine’s advice.

Workshop Exercise 2 – “Free” SMSF Accounting

As part of the exit deal, the firm will attend to preparation of the financial statements and SMSF Annual Return for Charlie’s SMSF and not raise a fee invoice. The annual audit will be done by an external auditor of Charlie’s choice. A commercial fee will be charged for the annual audit.

What are the issues with Charlie’s former firm providing free accounting to his SMSF?

Model Answer

The first question is whether this is a transaction involving a related party of the SMSF. We have no details in the conference profile provided, except that Charlie had sold his interest in the accounting firm. Taking into account the “Additional Facts 1”, we could assume that Charlie currently has no equity interest in his old firm and consequently there is no connection that would make the firm a related party of the SMSF. However, it is not uncommon for the old partnership to stay in place for the purpose of collecting old debtors and WIP. If this was the case, then the partners in that old partnership would be a related party of the SMSF (s.70B(c)).

If this was the case, we would need to determine if the SMSF has acquired an asset from the related party. Section 66 of the SIS Act prohibits an SMSF from acquiring an asset from a related party, subject to limited exceptions.

Is the provision of accounting services by a related party to an SMSF an acquisition of an asset?

Section 10 of the SIS Act defines an asset to mean “*any form of property and, to avoid doubt, includes money (whether Australian currency or currency of another country)*”. However, for the purpose of section 66 of the SIS Act, the term “acquire an asset” does not include the acceptance of money (s.66(5)).

The accounting firm will perform a service for the SMSF, that being the preparation of annual financial statements and the SMSF Annual Return. Whether the acquisition of

the performance of a service from a related party is a contravention of section 66 was addressed in SMSFR 2010/1. Paragraph 18 states:

“18. If a trustee or investment manager enters into a contract with a related party entitling the SMSF to the performance of a service by the related party, the performance of that service is the substance of the transaction and not any rights that the SMSF might also acquire to have that service performed. Therefore, the acquisition of the performance of a service does not contravene subsection 66(1).”

Is there an issue with the accounting services being provided for free?

The question is whether the provision of free accounting services would be regarded as a contribution. With the fund not required to make a payment for a service, the net assets of the SMSF have not been reduced – so is this a contribution?

This is addressed in TR 2010/1 where three relevant examples are provided, as follows:

“Example 1 - contribution made by paying a fund's expense

73. Jane has a self-managed superannuation fund of which she is the sole member. During the 2010-11 income year Jane arranged accounting and audit services to ensure the fund met its income tax and regulatory obligations for the year ended 30 June 2010. Jane paid the accounting and audit fees for the fund from her own money. Jane did not reimburse her outlay from fund monies.

74. By satisfying a liability of the fund Jane has indirectly increased the capital of the fund. Jane's purpose in paying the liability of the fund without reimbursement was to increase the benefits she would ultimately receive from the fund. Therefore, Jane made a contribution to the fund when she paid the accounting and audit fees.

Example 2 - no contribution made by a free service

75. Jasmine has a self-managed superannuation fund of which she is the sole member. She is a chartered accountant and has significant experience in general accounting, taxation and superannuation matters. Jasmine prepares the accounts and income tax and regulatory return for her self-managed superannuation fund each year without remuneration.

76. By ensuring the fund does not incur a liability in having the fund accounts prepared, Jasmine does not increase the capital of the fund and there is no contribution.

Example 3 - contribution made by forgiving liability

77. Gus and Pina are the only members of a self-managed superannuation fund. They are the shareholders of a company through which they operate a successful advisory business which provides accounting, taxation and superannuation services. An employee of their company prepares the fund's accounts. The company invoices Gus and Pina as trustees of the fund for the services provided by the company, but Gus and Pina as shareholders of the company forgive the invoiced liability.

78. *By forgiving the liability, Gus and Pina have increased the capital of the fund. Therefore, they have made a contribution equal to the forgiven amount."*

Whether the provision of free accounting services would be regarded as a contribution to the fund would depend on the circumstances. Where the old firm simply attended to the work and no invoice is raised, as stated in the "Additional Facts 1" and similar to Example 2 in the ruling, there would be no contribution. However, where an invoice is raised and either paid for by, for example, Charlie, as in Example 1 or the debt forgiven, as in example 3, there is an argument that a contribution has been made to the fund. In the case of a forgiven debt, a concessional contribution by the firm as Charlie's employer would be a viable argument.

Does the SMSF have a commerciality issue?

Section 109 of the SIS Act requires investments of a fund to be made and maintained on an arm's length basis. Where the dealing is not on an arm's length basis, the terms and conditions of the transaction cannot be more favourable to the related party than those which it is reasonable to expect to apply if the terms and conditions were arm's length. That is, the fund cannot be worse off by dealing with the related party than dealing with a non-related party.

In this case, the SMSF by receiving free accounting services is better off financially, as there was no expense to pay for the service provided. Consequently, there is no section 109 issue.

There is also no Non Arm's Length Income (NALI) issue for the fund. Whilst the fund has not been charged for a service, the NALI rules generally applies to the income derived by a fund either directly, from a trust, company or from a scheme or arrangement and not to an isolated expense. NALI is concerned with non-arm's length transactions and excess income.

Additional Facts for Workshop Exercise 3

Charlie's SMSF is currently cashed up, except for a number of framed French Lithographs that Charlie acquired on behalf of the fund, using SMSF money.

Total purchase price of the lithographs was \$15,000, which equates to the last valuation.

They hung in Charlie's office until he sold his interest in the accounting practice to Catherine, who now occupies his old office. Charlie now sits at a work station amongst other staff when he's in 2 days a week. Sometimes, he uses the interview rooms, if they're not booked for client meetings for that day.

Workshop Exercise 3 – The French Lithographs

The lithographs are currently in a box at Charlie's home waiting for his home office to be renovated and then will be hung on the office walls. The lithographs are covered by the home and contents insurance policy.

What are the compliance issues for Charlie's SMSF?

Model Answer

Fund assets that fall into the category of 'Collectables and Personal Use Assets' are subject to specific rules, which apply to all such assets from 1 July 2016. Regulation 13.18AA(1) of the SIS Regulations provides an extensive list of assets that fall within the definition of such assets, including:

- a) artwork;
- b) jewellery;
- c) antiques;
- d) artefacts;
- e) coins, medallions or bank notes;
- f) postage stamps or first day covers;
- g) rare folios, manuscripts or books;
- h) memorabilia;
- i) wine or spirits;
- j) motor vehicles;
- k) recreational boats; and
- l) memberships of sporting or social clubs.

Consequently, the French Lithographs held by the SMSF would be subject to the rules that apply to Collectables and Personal Use Assets. The rules for such assets are as follows:

No storing in private residence of a related party – these types of assets cannot be stored at the private residence of a related party, for example a member of the fund.

No leasing to a related party – these types of assets cannot be displayed at the business premises of a related party. However, they can be stored in premises owned by a related party, such as a purpose built storage facility, provided the premises are not part of the private residence of the related party and the assets are not on display. Note below the requirement to document reasons for where the assets are stored.

Document storage decision – you must document the reason for where the fund decided to store the Collectables.

Insured item in fund's name – these types of assets purchase by an SMSF must be insured within seven (7) days of the purchase. The SMSF's collectables may be insured under separate policies or all under the one, however, the policy must be in the name of the SMSF. Policies such as house and contents or under a gallery's insurance will not comply.

If disposed of to a related party, must be at market value supported by 'qualified independent valuer'. Any disposal of such assets made from 1 July 2016 must comply with this requirement.

For Charlie and Cammie's SMSF, the French Lithographs provide the following compliance issues:

- They are currently stored at the private residence of the members of the SMSF. This is prohibited by SIS Regulation 13.18AA(3);
- Once they are hung in Charlie's new renovated home office, there would still be an issue with compliance with SIS Regulation 13.18AA(2) as it would be regarded as a lease arrangement between the SMSF and a related party, which is prohibited for this type of fund asset. Alternatively, 13.18AA(6) would apply, which prohibits such assets being used by a related party;
- The lithographs, whilst insured, are part of the house and contents insurance policy. This does not comply with the requirement of SIS Regulation 13.18AA(5) which requires the insurance to be in the name of the SMSF.

Where the lithographs are stored in permissible storage, SIS Regulation 13.18AA(4) requires the decision on storage of the asset to be recorded, including the reason for the decision.

An option for the SMSF would be to dispose of the lithographs. Where the disposal is to a related party, for example, Charlie, the market value for disposal purposes must be determined by a 'qualified independent valuer' to comply with SIS regulation 13.18AA(7). From the ATO's publication "Valuation Guidelines for self-managed superannuation funds", a 'qualified independent valuer' is as follows:

"A valuer will be qualified either through holding formal valuation qualifications or by being considered to have specific knowledge, experience and judgment by their particular professional community. This may be demonstrated by being a current member of a relevant professional body or trade association.

The valuer must also be independent. This means that the valuer should not be a member of the fund or a related party of the fund (for example, they should not be a relative). They should be impartial and unbiased and not be influenced or appear to be influenced by others."

Additional Facts for Workshop Exercise 4

Billy's housing construction company needs a tipper and small excavator.

He approaches his dad to provide the finance to his company to acquire the equipment

Workshop Exercise 4 – Leasing Equipment

Charlie wants to assist his son, but his immediate cash available is in his SMSF.

Charlie arranges for his SMSF to buy a used tipper for \$40k and a used bobcat excavator for \$30k and lease to Billy's construction company with a proper legal lease agreement on commercial terms.

What are the compliance issues for Charlie and Cammie's SMSF?

Model Answer

Leaving Sole Purpose; Investment Strategy and Trust Deed provisions aside, will the lease of the equipment by the SMSF to Billy's construction company be caught by the IHA rules?

We have previously identified Billy's housing construction company as a related party of Charlie and Cammie's SMSF. Section 71 of the SIS Act, amongst other things, includes as an IHA "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". An exception is where the lease is a lease of 'business real property'. A lease of a tipper and one for a bobcat excavator is not a lease of 'business real property', as whilst the equipment would be used "wholly and exclusively in one or more businesses", the property is not "real property" as it has no land content.

Section 82 of the SIS Act prohibits a fund from exceeding the 5% limit on IHA at the end of each income year. Section 83 prohibits a fund from acquiring a new IHA where the acquisition will cause the fund to exceed the 5% IHA limit.

Assuming the value of Charlie and Cammie's SMSF is \$1.5m at the time of leasing the equipment to Billy's construction company, a total value of \$70k for the equipment would mean an IHA ratio of 4.67%, within the allowable amount.

However, whilst not immediately recognizable, section 62A of the SIS Act applies, specifically in relation to the lease of the tipper. As discussed in Exercise 3, an SMSF cannot lease assets classified as 'Collectables and Personal Use Items' to a related party. Included in the definition of these assets is 'motor vehicles'. Whilst this is not defined in the superannuation law, it is taken to mean, from its ordinary meaning, to include any mechanical road transport, including, but not limited to, cars, trucks and motor cycles. However, it would not include vehicles designed to be used off road, for example, a bulldozer or excavator.

Therefore, whilst the total value of the leases of the tipper and the excavator by the SMSF to Billy's housing construction company may fall within the 5% IHA allowance, the lease of the tipper, being a truck designed for road transportation, would be included under the Collectables and Personal Use Assets rules. This would prohibit the SMSF leasing it to Billy's housing construction company. However, as the excavator is not a vehicle designed for use on a road, it would not be subject to the

Collectables and Personal Use asset rules and consequently would be allowed, provided it was within the 5% IHA allowance.

Alternative arrangement

So how could Charlie structure the funding of the tipper so as not to contravene both the IHA rules and the Collectables and Personal Use Asset rules (and assuming satisfaction of sole purpose, Investment Strategy and Trust Deed issues)?

Instead of a lease of the tipper to Billy's housing construction company, Charlie's SMSF could provide a loan of \$40k to allow the company to directly purchase the tipper. Whilst the loan would still be an IHA of the SMSF, it would not come under the Collectables and Personal Use Asset rules. The total value of the SMSF's IHAs would still be under the 5% IHA allowance and consequently there would be no contravention of the IHA rules.



Beware

If Billy's housing construction business was conducted under his own name, that is, as a sole trader or by a partnership with Billy as one of the partners, for example Billy and Katie in partnership, then in addition to the IHA rules, section 65 of the SIS Act would also apply. Section 65 prohibits the fund from lending money or providing financial assistance to a member or relative of the fund. There is no 5% allowance under section 65, so whilst the fund may comply with the IHA rule, it would contravene section 65.

Additional Facts for Workshop Exercise 5

Charlie is contacted by Arthur, he and Bruce have identified a property which currently has a house on it, but also has a DA with approval for 6 townhouses.

To purchase and construct they will need \$3.5m.

Arthur and Bruce will each contribute \$1m, they are looking for \$1m from Charlie and will borrow the remaining \$500k.

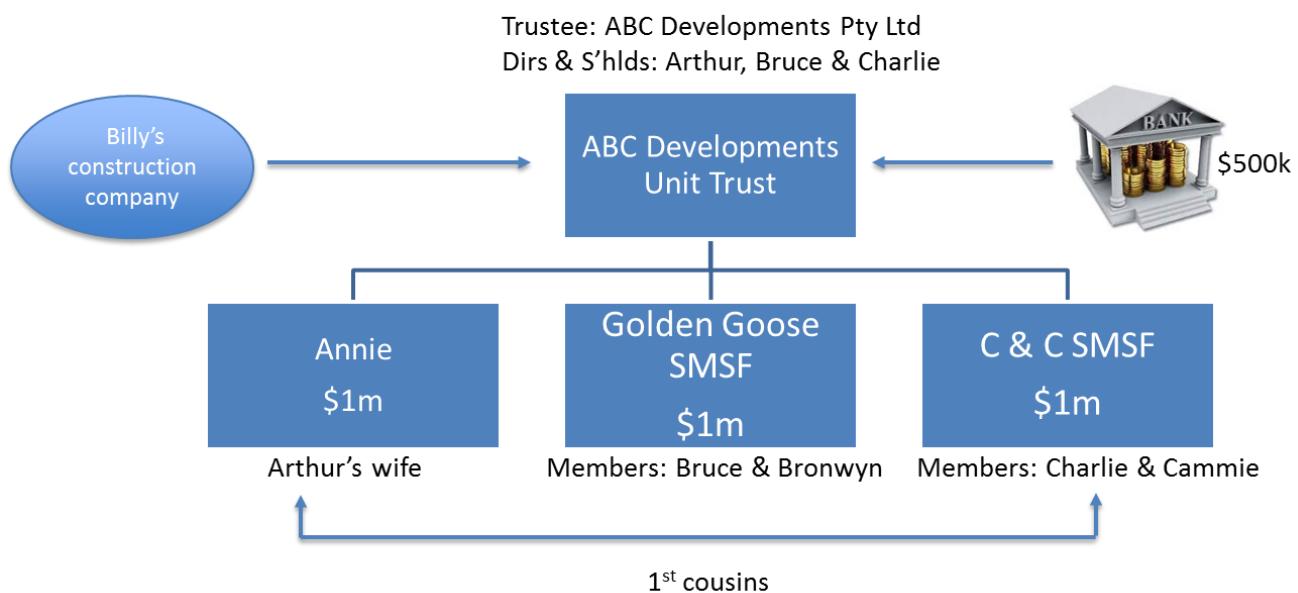
They will be using a unit trust to acquire and develop the property.

They want to know if Charlie's son, Billy would be interested in doing the build.

Charlie is keen on the project as he knows the property and even with the DA believes they have bought the property under market value.

Workshop Exercise 5 – Investing in Unit Trusts

Structure of proposed investment:



Each unit holder holds 1/3rd of the units issued by the unit trust, that is, each unit holder is entitled to 1/3rd of the income and capital of the unit trust.

Arthur, Bruce and Charlie are directors and equal shareholders of the corporate trustee.

Model Answer

Is there an IHA issue for the C & C SMSF?

This will require a determination of whether the ABC Developments Unit Trust is a related trust of the C & C SMSF.

Section 71 of the SIS Act includes an investment in a related trust as an IHA.

A related trust of a superannuation fund is defined in section 10 as meaning “a trust that a member or a standard employer-sponsor of the fund controls (within the meaning of section 70E), other than an excluded instalment trust of the fund”.

Section 70E outlines that an entity controls a trust if:

- (a) a group in relation to the entity has a fixed entitlement to more than 50% of the capital or income of the trust (*First test*); or
- (b) the trustee of the trust, or a majority of the trustees of the trust, is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of a group in relation to the entity (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts) (*Second test*); or
- (c) a group in relation to the entity is able to remove or appoint the trustee, or a majority of the trustees, of the trust (*third test*).

A “group” is defined in subsection 3 of section 70E to mean:

- (a) the entity acting alone; or
- (b) a Part 8 associate of the entity acting alone; or
- (c) the entity and one or more Part 8 associates of the entity acting together; or
- (d) 2 or more Part 8 associates of the entity acting together.

The C & C SMSF is entitled to 1/3rd of the income and capital of the ABC Developments Unit Trust. Consequently, the entitlement being not more than 50%, means the C & C SMSF does not have control of the ABC Developments Unit Trust under the first test.

With Charlie being one of three directors of the trustee company of the ABC Developments Unit Trust, provided there is equal contribution to the decision making process, there would also not be control, by C & C SMSF, under the second test.

Provided there is no provision in the unit trust deed given power to Charlie or Cammie to appoint or remove the trustee, there is no control of the unit trust under this third test.

As part of the three tests we also need to ascertain if any of the other unit holders or directors of the trustee company are related parties of or Part 8 Associates of Charlie and Cammie.

In the additional facts we are told that one of the three unit holders is Annie, Arthur's wife. Arthur is a first cousin of Charlie. Does this relationship make Annie a relative of Charlie and consequently a related party under the SIS Act? If so, it would mean that the C & C SMSF, together with Annie as a Part 8 Associate, would be entitled to more than 50% of the income or capital of the unit trust and consequently the unit trust would be a related trust of the C & C SMSF and therefore an IHA.

The extensive list of who is a 'relative' in the definition in section 10 of the SIS Act does not include cousins. Further, cousins are not lineal descendants. Consequently, a cousin is not a relative for the purpose of a Part 8 Associate/related party. Annie is therefore not a related party of Charlie as whilst Arthur is a first cousin of Charlie, he is not a 'relative' for the purpose of related party rules. This means that Annie's entitlement in the unit trust is not grouped with that of the C & C SMSF.



Tip

A first or second cousin is included in the definition of 'relative' for the purpose of section 17A of the SIS Act. No member of the fund can be an employee of another member of the fund, unless the members concerned are relatives. Consequently, first cousins can be members of the same SMSF, even where one member employs the other.

Now let's say that the old accounting firm partnership was still in place for the purpose of collection of debtors and WIP. This would mean that Bruce and Arthur were partners of Charlie and consequently would be a related party/Part 8 Associate, per section 70B(c) of the SIS Act. As Annie is Arthur's spouse, she would be a related party/Part 8 Associate of Charlie per section 70B(d) of the SIS Act. Consequently, the C & C SMSF and its Part 8 Associates would be entitled to more than 50% of the income or capital of the ABC Developments Unit Trust and the investment by the C & C SMSF in the unit trust would be an IHA.



Tip

When considering the second test for control of a trust, if there were only two directors of the trustee company, for example Arthur and Charlie and the Company Constitution provided the Chair with a casting vote in the case of a deadlock, if Charlie was the Chair of the meetings, he would have effective control. It is therefore prudent to consider a review and amendment, where necessary, of the Constitution of the company that will act as trustee of the unit trust, to remove such a clause that provides a casting vote to the Chair of the meeting.

Is there an IHA issue for Golden Goose SMSF?

The members of this fund are Bruce and his spouse, Bronwyn, so they are related parties of the SMSF. Annie is the spouse of Arthur, who is a partner with Bruce in the accounting partnership. Consequently, Annie is a related party/Part 8 Associate of the

Golden Goose SMSF and this would mean that the Golden Goose SMSF, together with its Part 8 Associates, are entitled to more than 50% of the income or capital of the ABC Developments Unit Trust, which makes the investment in the unit trust by the SMSF an IHA.

So we can see that the test for an IHA is done from each SMSF's perspective. The ABC Developments Unit Trust is not an IHA of the C & C SMSF (provided there is no old accounting partnership still in place), but it is an IHA of the Golden Goose SMSF.

Can Billy's construction company provide services to the ABC Developments Unit Trust?

Billy's housing construction company has been requested to be the builder for the project. Whilst Billy's housing construction company is a related party of the C & C SMSF, it is not the C & C SMSF that will be acquiring any assets or services from Billy's housing construction company, but the ABC Developments Unit Trust. Consequently, there is no issue with section 66 of the SIS Act. However, the terms and conditions of the building contract should be on arm's length terms. There could be a concern with the application of the NALI rules where the price charged by Billy's housing construction company is less than commercial. For an above arm's length price for construction, there may be a compliance issue with section 109 and 62 of the SIS Act.



Beware

If the C & C SMSF had its own property development project and had engaged Billy's housing construction company to do the build, care would need to be taken to ensure that the SMSF did not acquire any assets, being the building materials, from Billy's housing construction company as this would be a contravention of section 66 of the SIS Act. A solution to this issue is an agency of bare trust arrangement between the SMSF and the related party builder. Reference should be made to SMSF 2010/1, particularly paragraph 19 and examples 5 and 6, as well as SMSF Association Technically Speaking (TS Issue 7 – April 2011) "Acquiring goods and materials used in the construction of a property".

How will distributions from the unit trust be taxed in the hands of the C & C SMSF?

Prior to 1 July 2016, where a unit trust carried on a trading business, for example property development, and also met the definition of 'public unit trust' in Division 6C of the ITAA 1936, then the profits of the unit trust would be taxed as if it was a corporate entity. This presented a number of challenges, including the distribution of franking credits to the unit holders to claim back and the timing of distributions and entity tax payments.

One of the two tests for a unit trust to be a 'public unit trust' was where at least 20% of the units in the unit trust were held by an 'exempt entity' or 'exempt entities'. As this provision pre-dated when superannuation funds started paying income tax (1 July 1988 for those wondering), a superannuation fund was an 'exempt entity' for the purpose of this definition. Consequently, if the unit trust had issued at least 20% of its units to superannuation funds and carried on a trading business, the profits of the unit

trust would be taxed at the corporate rate, rather than being distributed to unit holders and taxed at the unit holders tax rate.

Prior to 1 July 2016, this would have been the treatment for the ABC Developments Unit Trust.

From 1 July 2016, complying superannuation funds were removed from the definition of an 'exempt entity' for the purpose of the Division 6C public trading trust rules. Consequently, for our ABC Developments Unit Trust, any profits from the property development activity will be distributed to the unit holders and taxed in the unit holder's income tax return.

The Miss Marple last minute fact

Bronwyn & Cammie are friends from high school. Bronwyn introduced Cammie to Charlie after the passing of his first wife, Di.

Bronwyn & Cammie come to you and advise that they have recently bought together a beach shack in a small coastal town where they would holiday together growing up.

They each contributed half the purchase price from inheritances, no borrowing.

They will rent it out for most of the year, but reserve certain periods for themselves.

They have not yet told their respective husbands as they wanted it to be a surprise

Workshop Exercise 6

Given this new information, does this change your advice about whether the investment by the C&C SMSF in the ABC Developments Unit Trust is an IHA?

Model Answer

As discussed, section 70B(c) of the SIS Act includes as a Part 8 Associate of an individual a partner of the individual or a partnership in which the individual is a partner. Owning property as tenants in common is not a general law partnership, however, could be what is commonly referred to as a “tax law partnership”.

Section 995-1(1) ITAA 1997 defines a partnership as meaning:

- (a) an association of persons (other than a company or a limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly; or
- (b) a limited partnership.

The definition in ITAA 1997 not only incorporates the general law definition of a partnership, but extends it to include the joint receipt of income from assets, for example a rental property held as tenants in common or as joint tenants.

Consequently, the purchase of the beach shack by Cammie and Bronwyn with an intention of jointly deriving rental income may result in them both being a ‘partner’ for the purpose of the Part 8 Associate definition. If this is the case, the C & C SMSF will be grouped with the Golden Goose SMSF to determine if the ABC Developments Unit Trust is a related trust of the C & C SMSF (Golden Goose SMSF is already grouped with Annie, which takes them above the 50% entitlement to income or capital threshold, so its investment in the unit trust is an IHA anyway – its goose is cooked!).

To break this connection between Cammie and Bronwyn they would have to either:

- Dispose of the property;
- One to buy the other out;
- Transfer the property to an entity in which they held 50/50 ownership.

Of course this would incur additional transaction costs.

About the Workshop Presenter



Mark holds the position of Executive Manager, SMSF Technical Services with SuperConcepts, providing technical and compliance support on SMSFs to financial advisors and accountants as well ensuring that SuperConcepts' leading SMSF administration and compliance platform, SuperMate, is compliant with the latest superannuation and taxation rules.

As well as being an FCPA and Registered Tax Agent, Mark is an accredited SMSF Specialist Advisor with the Self Managed Super Fund Association, a Fellow of the Institute of Public Accountants (IPA) and a Chartered Tax Adviser with the Taxation Institute of Australia (TIA).

Prior to his current role with SuperConcepts, Mark spent considerable time in accounting practices and SMSF administration companies, including running his own accountancy practice and SMSF administration and compliance advice company for ten years.