

BENEATH THE SURFACE

The Do's & Don'ts of Self-Managed Super Funds (SMSFs)

SMSFs are regulated by the tax office and are required to comply with income tax and superannuation obligations. Last year, the tax office identified 4,700 funds that were breaching investment restrictions.

A self-managed super fund (SMSF) that is found to breach the super guidelines may lose 47% of its assets in tax.

The most common area for problems to arise is by trustees who have the attitude: *"It is my money, why can't I do what I want with it?"*

Yes, it is your money and provided that you pay tax at the top marginal rate of 47%, then you can do exactly what you want with it. However, if you want the concessional rate of tax on your superannuation contributions, then you have to comply with the guidelines.

The most common area for problems to arise is by trustees who have the attitude: *"It is my money, why can't I do what I want with it?"*

2004 rates of tax

15% minimum for adjusted taxable income* up to \$94,961, and

29.5% maximum for adjusted taxable income* above \$114,981

* adjusted taxable income includes but is not limited to: taxable income, reportable fringe benefits, and superannuation contributions for the year. A member's surcharge liability will be unaffected by any spouse contributions split.

Sole Purpose Test

The basic test that the fund's investments have to meet is the sole purpose test, ie that they are made with the *sole purpose of generating retirement benefits for members.*

Loans or Financial Assistance to Members or a Member's Relative

Trustees are prohibited from lending money or providing financial assistance to a member or a member's relative.

The use of a superannuation fund asset by a member or a member's relative for no cost or as a

guarantee to secure a personal loan would be in breach of this investment restriction.

Acquisition of Assets from 'Related Parties'

Trustees are prohibited from acquiring assets from a 'related party' of the superannuation fund. The limited exceptions to this rule include assets acquired at market value, if:

◇ The acquisition is an 'in-house asset' which, after being acquired by the trustees would not result in the level of 'in-house assets' of the superannuation fund exceeding more than 5% of the superannuation fund's assets;

◇ The asset is a listed security (for example, shares, units or bonds listed on an approved Stock Exchange);

◇ The asset is 'business real property'. 'Business real property' of an entity generally relates to land and buildings used wholly and exclusively in a business. Trustees of SMSFs are permitted to acquire up to 100% of the funds total assets as 'business real property'.

In-House Assets

In-house assets are loans to, investments in, and assets subject to a lease or lease arrangement with a related party of the superannuation fund, eg allowing a member, or other related party to use a holiday home owned by the fund, whether a formal lease exists or not.

In general, SMSFs are restricted from lending, leasing or investing more than 5% of the superannuation fund's total assets to a related party.

However, SMSFs may invest in a unit trust or a company, without that investment being considered an 'in-house asset', if certain conditions are met. The main conditions are that the trust or company:

- ◇ does not borrow
- ◇ has no assets with a charge over them
- ◇ does not loan money to individuals or other entities (except banks, etc)
- ◇ does not acquire an asset from a related party of

the superannuation fund other than business real property acquired at market value

- ◇ does not directly or indirectly lease assets to related parties, other than business real property
- ◇ does not conduct a business, and
- ◇ conducts all transactions on an arm's length basis.

SMSFs Purchasing Antiques, Artwork, etc

The tax office is concerned that an increasing number of taxpayers are using their superannuation entitlements to purchase such things as antiques, artwork, wine and luxury cars. In most cases, these more exotic types of investments are then made available for the private use of members (or their associates) of the SMSF.

Investment in more exotic items such as antiques, artwork, wine and luxury cars will not, of itself, breach the investments guidelines contained in the Supervision Industry (Supervision) Act 1993 (SIS Act). Provided the investment satisfies the investment strategy of the SMSF, there is commercial justification behind the investment, and the asset is not acquired from a member (or their associate) of the fund, it will be acceptable for superannuation purposes.

However, an investment in antiques, artwork, etc by an SMSF will be an in-house asset for superannuation purposes where the investment is "used or controlled by" a member or their associate. This will be so even where there is no formal lease arrangement between the fund and the member.

Consequently, the in-house asset rules will be breached where more than 5% of the fund's assets are in-house assets. In addition, the use of SMSF assets by members or their associates may result in the investment breaching the sole purpose test which states that an SMSF must be operated for the sole purpose of providing retirement benefits to the member (or their dependants).

If you insist on this type of investment:

(a) Acquisition

The SMSF may not purchase the antiques/artwork/wine/luxury car from a related party.

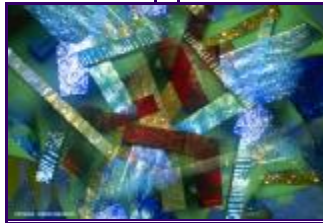
(b) Personal Use

There must be no personal use of the asset by a related party (eg a painting must not hang at the member's home or business premises, the luxury car must not be used for a relative's wedding) unless:

- ◇ the value of the asset represents less than 5% of the total market value of the assets of the fund,
- ◇ a formal lease agreement is in place between the fund and the related party, and
- ◇ a third party written opinion is obtained of the market rent to be charged for the lease of such an asset, the lease agreement is based on this amount and the appropriate rent is actually paid to the fund.

(c) Storage/Location

To avoid questions as to personal use, we would generally suggest artwork is held at a gallery or kept in a bank storage facility.



The tax office is concerned that superannuation entitlements are being used to purchase artwork.

In the case of wine collections, we are concerned about the possible application of the sole purpose test where wine is stored at the member's/trustee's home. To alleviate these concerns, trustees need to justify why their own bar area is a better place for wine to be stored than a specialised wine storage facility. The trustees would need to be satisfied that their own bar area is the best facility possible for investment reasons, not personal reasons. Trustees should also be prepared to explain their reasonings to the tax office.

(d) Insurance

The asset should be appropriately insured, with such insurance held in the superannuation fund's name.

(e) Valuation

For accounting purposes, the trustees must be prepared to have the asset valued regularly.

(f) Investment Strategy

The fund's investment strategy should specifically allow for such an investment. The reasons why such an investment has been chosen should also be included.

For members close to retirement or in pension phase, any questions of liquidity should also be addressed.

Discount Card Shares

Certain shareholder discount plans require the purchase of a nominal number of publicly listed Discount Card shares which entitles a shareholder to participate in the Shareholder Discount Plan provided they agree to a regular reduction of their dividend payments.

The shareholder may then obtain discounts on purchases from particular stores.

In such arrangements, the discount shareholder card cannot be viewed as an incidental benefit to a member because the dividend payments resulting from the shareholding are reduced in order to pay for participation in the discount shareholder plan.

This is a direct use of the fund's income to pay for a current benefit enjoyed by a member and is a breach of the sole purpose test.



A self-managed super fund (SMSF) that is found to breach the super guidelines may lose 47% of its assets in tax.

Summary - Recent Interpretative Decisions (IDs) by the Tax Office

Superannuation: Investment in Art

(ID2004/248) A self-managed superannuation fund (SMSF) is able to invest in works of art. However, a (prudent) trustee should seek expert advice.

Expert advice would include the potential income or capital growth that could be generated from the investment and the ease with which the asset could be disposed.

(ID2004/249) However, an SMSF will breach the sole purpose test when the work of art is displayed in a residence belonging to a member at no cost.

Generally where a fund acquires an asset which is utilised by the member at no cost, a breach of the sole purpose will be considered to have occurred.

(ID2004/250) The display of a work of art, owned by an SMSF, in the member's residence gives rise to an in-house asset.

Rana Jewell
 Public Accountant & Lifestyle Consultant
 13 Park Rd
 Ferny Hills Q 4055
 M 0408 51 0001
 P 07 3351 4689 F 07 3851 0132
 ranajewell@beneaththesurface.com.au