

# ***SMSFR 2010/1EC - Compendium***

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## **Ruling Compendium – SMSFR 2010/1**

This is a compendium of responses to the issues raised by external parties to draft SMSFR 2008/D2 – Self Managed Superannuation Funds: the application of subsection 66(1) of the *Superannuation Industry (Supervision) Act 1993* to contributions of assets to a self managed superannuation fund by a related party of that fund.

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

### **Summary of issues raised and responses**

| <b>Issue No.</b> | <b>Issue raised</b><br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/D2)  | <b>ATO Response/Action taken</b><br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2010/1)   |
|------------------|--|---|
| 1.               | <p><i>Acquisition of an asset at market value</i></p> <p>Consideration should be given in the Ruling to providing guidance on:</p> <ul style="list-style-type: none"> <li>when an SMSF trustee acquires an asset for the purposes of subsection 66(1) of the SISA</li> <li>appropriate indications of market value of an asset, for example, what quoted price reflects the market value of a listed security, and</li> <li>the point in time when the market value of the asset is determined.</li> </ul> <p><i>Timing of the contribution – Income Tax Assessment Act 1997 (ITAA 1997)</i></p> <ul style="list-style-type: none"> <li>Consideration should be given to providing clarification of the timing of a contribution for the purposes of the ITAA 1997.</li> </ul> | <p><i>When an asset is acquired – paragraphs 41 and 154</i></p> <p>The Ruling explains that it is the asset's market value at the time of when it is acquired that is relevant to the 'acquired at market value' requirement. The asset is acquired when the (trustee(s) of the) SMSF becomes the owner of the asset.</p> <p><i>Valuing an asset – added footnote 4</i></p> <p>It is a question of fact, rather than an interpretative matter, as to the value of an asset or what quoted price reflects the market value of a listed security. Such matters are therefore not within the scope of this Ruling. Paragraph 11 of SMSFD 2008/2 explains that an SMSF can choose to obtain a valuation from a qualified valuer or compute their own valuation based on reasonably objective and supportable data. Further, <i>Market valuation for tax purposes</i> (NAT 72508) has been issued to provide guidance in determining the market value of an asset and is available on the ATO website <a href="http://www.ato.gov.au">www.ato.gov.au</a>.</p> <p><i>Timing of a contribution for income tax purposes</i></p> <p>This is outside the scope of this Ruling. For guidance on the timing of a contribution for income tax purposes see Taxation Ruling TR 2010/1 Income tax: superannuation contributions.</p> |

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|------------------|---|---|
| 2.               | <p><i>Acquisition of services</i></p> <p>If a fund enters into an agreement with a related party for example, a contract for services, does the trustee acquire an asset from a related party. Comment suggests that:</p> <ul style="list-style-type: none"> <li>although the fund's rights under the contract are property they probably don't amount to an asset where they cannot be assigned to another party, and</li> <li>if there is an asset, it comes into existence by the making of the contract and probably cannot be said to be acquired from the other party to the contract.</li> </ul> | <p><i>Characterising what is acquired – new paragraphs 17 to 22 and 110 to 120</i></p> <p>A new section has been added to the Ruling to explain that the Commissioner takes a holistic approach in determining if an asset is acquired and the nature of the asset acquired (for example, rights or a tangible asset). That is, the Commissioner looks at the substance of the arrangement.</p> <p>The Ruling explains that if services are acquired under a contract, it is, in the Commissioner's view, an acquisition of services and not an acquisition of an asset, being the rights to have those services performed.</p> <p>The Ruling also explains that if goods that are insignificant in value and function are provided to the SMSF as part of that service the acquisition remains the acquisition of a service. See also Examples 5 and 6 (paragraphs 57 to 60) in Appendix 1 of the Ruling.</p> <p><i>Asset is acquired upon its creation – paragraphs 14 and 103</i></p> <p>The ruling also makes clear that in the Commissioner's view 'acquire' encompasses the acquisition of an existing asset or the acquisition of an asset that is created and at the same time comes into the possession of, or is obtained by, a trustee or investment manager. For example, rights acquired under a contract.</p> |
| 3.               | <p><i>Acquisition of units in a related party unit trust</i></p> <p>Can the ruling make reference to the ability (or not) of the SMSF to acquire units in a related party unit trust from another related party unit holder?</p>  | <p><i>Example 13 – paragraphs 74 to 76</i></p> <p>An example has been added to illustrate the application of the in-house asset exception.</p>  |
| 4.               | <p><i>Acquisition of residential investment property</i></p> <p>The transfer of a residential investment property into a SMSF by a related party should be allowed if the contributing related party (for examples, member) is not paid for the property, it is to provide for the member's retirement; the property cannot be converted into cash or withdrawn; and if in the circumstances the value of the property has to be realised at the time of transfer two independent valuers are employed.</p>   | <p><i>No change</i></p> <p>Whether or not a residential investment property should be allowed to be acquired by an SMSF from a related party is a matter of policy and is outside the scope of the Ruling. For a list of assets that an SMSF is able to acquire from a related party see paragraph 85 of the Ruling; (see also paragraphs 23 to 27 and 121 to 129 concerning the acceptance of money not being a contravention).</p>  |

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|------------------|---|---|
| 5.               | <i>Managed investment schemes as listed securities</i><br>Can managed investment schemes satisfy the definition of listed securities?   | <i>No change</i><br>The Ruling explains that an interest in a managed investment scheme can satisfy the definition of 'listed security' if it is listed, for example, on the Australian Securities Exchange or other relevant market. See paragraphs 42, 157 and 160.   |
| 6.               | <i>Promissory notes</i><br>Promissory notes, payable on demand have been contributed to SMSFs. No actual cash transactions are made and the notes could, for example, be contributed by a company that is not subject to the control of the trustee, although may have some other relationship with the company.<br>Specific SISA concerns are: <ul style="list-style-type: none"><li>• Sole Purpose / Investment Strategy – no return on promissory note or any set date for payment.</li><li>• Providing financial assistance to members.</li><li>• Enables members to make contributions prior to actually having the cash resources to do so.</li><li>• Would provide the potential to increase in-house assets for example, this fund would have a \$100,000 in-house limit.</li></ul> | <i>Change in explanation but no change in outcome – paragraphs 23 to 27 and 121 to 129 and new Example 2 (paragraph 52)</i><br>Draft Ruling SMSFR 2008/D2 explained that a promissory note issued by a related party to the SMSF was money for the purposes of subsection 66(5) as the value of such a promissory note to the SMSF was in the payment of a sum of money and not as an asset other than money. Therefore its acquisition did not contravene subsection 66(1).<br>In the final Ruling the outcome remains the same if a promissory note (issued by a related party) is used as a means of transferring funds from a related party to the SMSF (see paragraph 127) – that is, there is no contravention of subsection 66(1). However, the explanation no longer refers to such notes as money as this may be misleading given that the important point is that such notes are a payment of a sum of money. Therefore, taking account of this comment and consistent with the approach to characterising an acquisition (see Issue 2 above) the focus in the final Ruling is on whether the substance of the transaction is to transfer funds from a related party to the SMSF and not on the means by which such funds might be transferred and labelling those means as money. The Ruling also explains the likely outcome if a demand is never made, or if made, is never honoured (see paragraph 128) and also mentions the relevance of section 65 to the use of promissory notes (see paragraph 129).<br>It is a separate issue as to when a contribution of funds is made using such a promissory note. See Taxation Ruling TR 2010/1.<br>The view concerning promissory notes that are issued at a discount from face value to raise finance by an unrelated entity has not changed. That is, such notes are assets, the acquisition of which contravenes subsection 66(1). This is clarified by way of footnote – see footnotes 19 and 84. |

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|------------------|---|--|
| 7.               | <p><i>Acquisition of an interest in real property that is an in-house asset</i></p> <p>The exemption in subparagraph 66(2A)(a)(i) cannot apply as outlined in paragraph 108 as an interest in real property cannot be subject to a lease between a fund's trustee and a related party until the fund first acquires the asset which will result in a contravention of section 66.</p> <p>The property must be leased by the trustee to a related party in order for the investment to constitute an in-house asset. This could not happen until the fund acquires the property.</p> | <p><i>Change in view – paragraphs 44 and 46 and 164 to 169 and 172 to 174</i></p> <p>The acquisition of an interest in real property from a related party by a trustee or investment manager that results in the trustee and a related party holding the property as tenants in common does not contravene subsection 66(1) if the business real property exception in paragraph 66(2)(b) applies.</p> <p>Consistent with the comment, the view in the final Ruling is that subparagraph 66(2A)(a)(i) cannot apply to the acquisition of leased real property, whether the SMSF effectively takes over as lessor of the real property, or immediately leases the real property to a related party, upon acquisition. This also applies to other types of assets – see Issue 9 below.</p> <p><b><i>Implementation of this view - assurance to trustees and investment managers</i></b></p> <p>If, prior to the issue of SMSFR 2010/1, a trustee or investment manager has relied upon the view in the draft Ruling in acquiring such an interest in real property, the fact that the trustee or investment manager has relied upon that view would be a relevant factor in their favour in the Commissioner's exercise of any discretion as to what action is taken in response to a breach of section 66 for that reason. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.</p> |
| 8.               | <p><i>Employee share schemes</i></p> <p>As part of an employee share scheme, if shares in a private company were transferred from that company directly to an SMSF, would this contravene subsection 66(1)?</p>   | <p><i>No change</i></p> <p>Whether the arrangement contravenes subsection 66(1) will depend on the particular facts. The principles in the Ruling will apply in determining the outcome. That is, whether or not legal title or beneficial interest in the shares was acquired by the SMSF from a related party; or whether any other asset was acquired from a related party in relation to the acquisition of the shares. (The Ruling explains at paragraphs 32 and 33; and 141 and 142 the ways in which an asset can be acquired by a trustee or investment manager from a related party.) If there is a scheme subsection 66(3) may also be a relevant consideration.</p>   |

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|--|---|---|
| <b><i>Other changes made to the ruling that are not reflected in the above responses to issues</i></b> |   |   |
| 9.   | <i>The limited application of the exception in subparagraph 66(2A)(a)(i) and (ii)</i>                       | <p><i>Paragraphs 43 and 44; and 163 to 169</i></p> <p>The Ruling explains that the exception in subparagraph 66(2A)(a)(i) is limited to assets that are investments in a related party or investments in a related trust. The exception in subparagraph 66(2A)(a)(i) does not apply if an asset that is leased to a related party prior to its acquisition is acquired and upon its acquisition the trustee(s) of the SMSF effectively takes over as lessor. It also does not apply to the acquisition of an asset that is immediately leased to a related party by the SMSF upon its acquisition. (A similar approach is also applicable to the exception covered by subparagraph 66(2A)(a)(ii).)</p> <p>The alternative view and why the Commissioner does not consider that the section could have been intended to operate in that way is explained at paragraphs 166 to 169.</p> <p><b><i>Implementation of this view - assurance to trustees and investment managers</i></b></p> <p>If, prior to the issue of SMSFR 2010/1, a trustee or investment manager has relied upon an ATO publication that indicates that an acquisition, other than an investment in a related party or a related trust, would be covered by the exception in either subparagraph 66(2A)(a)(i) or (ii), the fact that the trustee or investment manager has relied upon that publication would be a relevant factor in their favour in the Commissioner's exercise of any discretion as to what action is taken in response to a breach of section 66. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.</p> |
| 10.  | <i>Scope of the Ruling</i>  | <p>Unlike draft Ruling SMSFR 2008/D2, which focussed solely on acquisitions made by way of contributions, the final Ruling encompasses acquisitions that can be made in other ways, for example, by way of purchase.</p> <p><i>See paragraphs 13 to 16 and 100 to 109 of the Ruling.</i></p>  |
| 11.  | <i>Whether an asset is 'intentionally' acquired</i>   | <p>This section of the Ruling has been simplified for greater clarity and to improve its readability.</p> <p><i>See paragraphs 34, 35, 143 to 145 of the Ruling.</i></p>  |

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|------------------|---|--|
| 12.              | <i>The meaning of an asset</i>  | The Ruling notes that while assignability is generally a characteristic of a proprietary right it is not in all cases an essential characteristic. Examples of real property and personal property are also provided.<br><i>See paragraphs 10 to 12, and 96 to 98 of the Ruling.</i>   |
| 13.              | <i>Appendix 1 and new examples</i>  | Further examples have been added to illustrate: <ul style="list-style-type: none"> <li>• whether the acquisition of cheques and promissory notes contravene subsection 66(1)</li> <li>• that the acquisition of collectable banknotes and coins; and trade dollars contravene subsection 66(1)</li> <li>• the acquisition of services and whether goods (being assets) that form part of the service are also acquired</li> <li>• whether assets are acquired if improvements under a lease agreement are made to SMSF property</li> <li>• that the acquisition of listed securities do not contravene subsection 66(1)</li> <li>• whether the acquisition of business real property with fixtures or non-fixtures contravenes subsection 66(1)</li> <li>• that the acquisition of shares or units in a related party or a related trust does not contravene subsection 66(1) if the in-house asset exception applies.</li> </ul> <i>See Appendix 1 – paragraphs 49 – 76</i> |