SMSFD 2007/D2 - Superannuation: can an investment made by a self managed superannuation fund in a related company or unit trust be excluded from being an in-house asset of the fund even though an event in subregulation 13.22D(1) of the Superannuation Industry (Supervision) Regulations 1994 has happened which means investments by the fund in a different related company or unit trust are in-house assets of the fund?

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Draft Self Managed Superannuation Funds Determination

Superannuation: can an investment made by a self managed superannuation fund in a related company or unit trust be excluded from being an in-house asset of the fund even though an event in subregulation 13.22D(1) of the Superannuation Industry (Supervision) Regulations 1994 has happened which means investments by the fund in a different related company or unit trust are in-house assets of the fund?

Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which provisions of the Superannuation Industry (Supervision) Act 1993, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Determinations (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than the final version of this ruling indicates, the fact that you acted in accordance with the final version of this ruling would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

Ruling

1. Yes, the investment in the related company or unit trust can be excluded from being an in-house asset of the fund even though an event in subregulation 13.22D(1) of the Superannuation Industry (Supervision) Regulations 1994 (SISR)[1] happens which means investments by the fund in a *different* related company or unit trust are in-house assets of the fund.

[1] All legislative references in this draft Determination are to the Superannuation Industry (Supervision) Regulations 1994 unless otherwise indicated.

2. The reason an investment can be excluded from being an in-house asset depends upon the nature of the event which causes investments in the other related company or unit trust to become in-house assets.

3. If the event in paragraph 13.22D(1)(a)[2] happens (that is, the members of the SMSF increase to five or more), regulation 13.22B[3] or 13.22C,[4] as appropriate, ceases to apply to investments in *all* related companies or unit trusts held at the time when the event happens. Further, regulation 13.22C does not apply to later investments in any of those companies or unit trusts. However, regulation 13.22C can apply to later investments in *other* companies or unit trusts if the members of the SMSF are again less than five (that is, paragraph 13.22C (2)(a) is satisfied) and the other requirements of regulation 13.22C are satisfied.

4. If an event in paragraph 13.22D(1)(b) to (n)[5] happens in relation to a related company or unit trust, regulation 13.22B or 13.22C, as appropriate, only ceases to apply to investments in that *particular* company or unit trust. Further, regulation 13.22C does not apply to later investments in that particular company or unit trust. However, regulation 13.22B or 13.22C, as appropriate, can continue to apply to investments in *other* related companies or unit trusts held at the time when the event in paragraphs 13.22D(1)(b) to (n) happened. Regulation 13.22C can also apply to later investments in a related company or unit trust that is not a company or unit trust in relation to which an event in paragraphs 13.22D(1)(b) to (n) happened.

5. An investment in a company or unit trust is excluded from being an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the *Superannuation Industry (Supervision) Act 1993* (SISA) if regulation 13.22B or 13.22C of the SISR applies to that investment. If regulation 13.22B or 13.22C of the SISR does not apply, or ceases to apply to an investment because an event in subregulation 13.22D(1) of the SISR happens, the investment is not excluded from the SMSF's in-house assets under subparagraph 71(1)(j)(ii) of the SISA. If regulation 13.22B or 13.22C of the SISR ceases to apply the investment is not excluded from the SMSF's in-house assets from the time when the event happened.

Date of effect

6. It is proposed that when the final Determination is issued, the Determination will apply to years of income commencing both before and after its date of issue. However, the Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

[2] Upon the happening of this event, the fund is no longer an SMSF under section 17A of the SISA, which requires an SMSF to have fewer than five members – see paragraph 17A(1)(a) of the SISA. Instead, it is a 'former SMSF'; that is, a fund to which subsection 10(4) of the SISA applies.
[3] Regulation 13.22B is relevant if the investment in a related company or unit trust was acquired by the SMSF before 28 June 2000.
[4] Regulation 13.22C is relevant if the investment in a related company or unit trust was acquired by the SMSF on or after 28 June 2000.
[5] See paragraph 17 of this draft Determination where the events are summarised.

Funds to which this Determination applies

7. This draft Determination applies to SMSFs[6] and former SMSFs.[7] References in the draft Determination to SMSFs include former SMSFs unless otherwise indicated.

Commissioner of Taxation
17 October 2007

[6] As defined in section 17A of the SISA.
[7] A former SMSF is a fund that has ceased being a SMSF and has not appointed a registrable superannuation entity (RSE) licensee as trustee – see subsection 10(4).

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached.

Explanation

8. Subparagraph 71(1)(j)(ii) of the SISA excludes certain assets prescribed in the SISR from the meaning of 'in-house asset' in section 71 of the SISA. Regulation 13.22B or 13.22C (in Division 13.3A) of the SISR specifies the requirements that must be met if the regulation is to apply to an investment by an SMSF in a related company or unit trust thereby excluding the investment as an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the SISA.

9. Regulation 13.22B or 13.22C of the SISR can cease to apply to an investment made by the SMSF in a company or unit trust if an event in subregulation 13.22D(1) of the SISR happens. In addition, subregulation 13.22D(3) of the SISR ensures that if regulation 13.22B or 13.22C of the SISR ceases to apply to an investment in a company or unit trust because an event in subregulation 13.22D(1) of the SISR happens, neither regulation can apply to any other existing or future investment by the SMSF in *that* company or unit trust. If neither regulation 13.22B nor 13.22C of the SISR applies to an investment, the investment is not excluded from being an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the SISA.

10. However, the happening of an event in subregulation 13.22D(1) does not necessarily mean that regulation 13.22B or 13.22C ceases to apply to all investments held by the SMSF in related companies or unit trusts, or that regulation 13.22C cannot apply to future investments in other related companies or unit trusts. The scope for regulation 13.22B or 13.22C to continue applying to investments will depend on the nature of the event that happens, as explained in the following paragraphs.

Investments to which regulation 13.22C may apply even though an event in paragraph 13.22D(1)(a) has happened

11. Where the event in paragraph 13.22D(1)(a) happens (that is, the number of members of the SMSF increases to five or more) regulations 13.22B and 13.22C cease to apply to all existing company and unit trust investments held at that time and to any future investments in those particular companies and unit trusts (see subregulation 13.22D(3)).

12. However, regulation 13.22C may apply to investments in *other* companies and unit trusts that are made at some later time once the number of members is again fewer than five (that is, paragraph 13.22C(2)(a) is satisfied) and the other requirements of regulation 13.22C are met.[8]

[8] Regulation 13.22B is not relevant as it is only applicable to company or unit trust investments acquired prior to the commencement of Division 13.3A and a company or unit trust investment that was held at the time when the Division commenced would be an investment to which the event in paragraph 13.22D(1)(a) happened.

Example 1 – the number of members of the SMSF increases to five (that is, event 13.22D(1)(a) happens)

13. *On 1 June 2000 an SMSF invests in related unit trusts (Trust A and Trust B). At this time the number of members in the SMSF is four. The SMSF's investments in Trust A and Trust B satisfy all the requirements of regulation 13.22B of the SISR and therefore the investments are not in-house assets of the SMSF as they are excluded under subparagraph 71(1)(j)(ii) of the SISA.*

14. *On 1 February 2007 the number of members of the SMSF increases to five for a short period of time until 31 July 2007 when the number reduces to four members. It has subsequently remained at four members.*

15. *The effect of the event in paragraph 13.22D(1)(a) of the SISR happening is that regulation 13.22B of the SISR ceases to apply to the investments in Trust A and Trust B. Subregulation 13.22D(3) of the SISR ensures that neither regulation 13.22B nor 13.22C of the SISR can apply to the existing investment, or any future investments, by the SMSF in Trust A or Trust B. Therefore, the existing investments, and any future investments, in Trust A and Trust B are not excluded from being in-house assets of the SMSF under subparagraph 71(1)(j)(ii) of the SISA. Assuming that no other exception in section 71 of the SISA applies, investments in Trust A and Trust B are in-house assets of the SMSF under subsection 71(1) of the SISA.*

16. *On 15 August 2007 the SMSF invests in another related unit trust (Trust C). The investment in Trust C would be an in-house asset of the SMSF but for subparagraph 71(1)(j)(ii) of the SISA and the operation of Division 13.3A of the SISR. As the number of members of the SMSF is less than five at the time of the investment (and thus paragraph 13.22C(2)(a) of the SISR is satisfied), regulation 13.22C of the SISR can apply to the SMSF's investment in Trust C provided all the other requirements of subregulation 13.22C(2) of the SISR are met. If regulation 13.22C of the SISR applies, the SMSF's investment in Trust C is excluded from being an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the SISA.*

Investments to which regulation 13.22B or 13.22C may apply even though an event in paragraphs 13.22D(1)(b) to (n) has happened

17. Paragraphs 13.22D(1)(b) to (n) describe various events that can happen in relation to a company or unit trust that an SMSF has invested in. Broadly, the events described involve the company or the trustee of the unit trust:

- acquiring an interest in another entity (for example, acquiring shares or units in another company or unit trust respectively) – subparagraph 13.22D(1)(b)(i);
- making a loan to another entity, unless the loan is a deposit with an authorised deposit-taking institution[9] – subparagraph 13.22D(1)(b)(ii);
- borrowing money – subparagraph 13.22D(1)(c)(i);
- giving a charge, or allowing a charge to be given, over, or in relation to, a company or unit trust asset – subparagraph 13.22D(1)(c)(ii);
- conducting a business – paragraph 13.22D(1)(d);

[9] Within the meaning of the *Banking Act 1959*.

- becoming a party, either directly or indirectly, to a lease arrangement involving a related party of the SMSF that does not involve business real property – paragraphs 13.22D(1)(e) to (k);
- conducting a transaction other than on an arm's length basis – paragraph 13.22D(1)(l);
- acquiring an asset (other than business real property acquired at market value) from a related party of the SMSF – paragraph 13.22D(1)(m); or
- acquiring an asset (other than business real property acquired at market value) from any party if the asset had been an asset of a related party of the SMSF since the later of:
  - the end of 11 August 1999; or
  - the day 3 years before the day on which the asset was acquired by the SMSF – paragraph 13.22D(1)(n).

18. An event listed in paragraphs 13.22D(1)(b) to (n) happens in respect of a *particular* company or unit trust. On such an event happening, regulation 13.22B or 13.22C ceases to apply to the existing investments, and any future investments, in *that particular* company or unit trust under subregulation 13.22D(3).

19. However, regulation 13.22B or 13.22C continues to apply to investments held by the SMSF in *other* related companies or unit trusts in respect of which the event did not happen if the requirements of the regulation continue to be met. Further regulation 13.22C may apply to later investments in a related company or unit trust that is not a company or unit trust to which an event in paragraphs 13.22D(1)(b) to (n) happened.

Example 2 – a unit trust in which the SMSF has an investment borrows money (that is, event 13.22D(1)(c)(i) happens)

20. *On 1 June 2000 an SMSF invests in a related unit trust (Trust D). On 1 January 2007 the SMSF invests in another related unit trust (Trust E). Both investments would be in-house assets of the SMSF but for subparagraph 71(1)(j)(ii) of the SISA and the operation of Division 13.3A of the SISR.*

21. *The SMSF's investment in Trust D satisfies all the requirements of regulation 13.22B and therefore the investment is not an in-house asset of the SMSF as it is excluded under subparagraph 71(1)(j)(ii) of the SISA.*

22. *The SMSF's investment in Trust E satisfies all the requirements of regulation 13.22C and therefore this investment is also not an in-house asset of the SMSF as it is excluded under subparagraph 71(1)(j)(ii) of the SISA.*

23. *On 15 May 2007 the trustees of Trust D borrow money, which is an event listed at subparagraph 13.22D(1)(c)(i). The effect of the event happening is that regulation 13.22B of the SISR ceases to apply to that investment.*

24. *Subregulation 13.22D(3) ensures that neither regulation 13.22B nor 13.22C can apply to the existing investment, or any future investments by the SMSF, in Trust D. Therefore, the existing investment, and any future investments, in Trust D are not excluded from being in-house assets of the SMSF under subparagraph 71(1)(j)(ii) of the SISA. Assuming that no other exception in section 71 of the SISA applies, investments in Trust D are in-house assets of the SMSF under subsection 71(1) of the SISA.*

25. *However, the SMSF's investment in Trust E, is not affected by the borrowing undertaken by the trustees of Trust D. Therefore, regulation 13.22C continues to apply and the investment in Trust E is excluded from being an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the SISA.*

26. *Any later investments in a related company or unit trust other that Trust D can also be excluded from being an in-house asset of the SMSF under subparagraph 71(1)(j)(ii) of the SISA provided that the conditions in regulation 13.22C are met in relation to that investment.*

Appendix 2 – Your comments

27. We invite you to comment on this draft Determination. Please forward your comments to the contact officer by the due date. (Note: the Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel or relevant Tax officers. The Tax Office may use a version (names and identifying information removed) of the compendium in providing responses to persons providing comments. Please advise if you do not want your comments included in the latter version of the compendium.)

Due date: **16 November 2007**
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References

Previous draft:

Not previously issued as a draft

Subject references:

- in-house assets
- self managed superannuation funds
- superannuation

Legislative references:

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- SISA 1993 10(4)
- SISA 1993 17A
- SISA 1993 17A(1)(a)
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