

Technically Speaking...

Can a pre-99 unit trust be converted to a non-g geared unit trust?

Recently SPAA sought clarification from the ATO about whether a SMSF can purchase units in a pre-99 unit trust without those units being classified as an in-house asset. Specifically, the question raised by SPAA was as follows:

A SMSF held units in a related geared unit trust as at 11 August 1999 which have been excluded from the fund's in-house assets under section 71A of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act). On or after 28 June 2000 the unit trust satisfies the requirements of Division 13.3A of the SIS Regulations and on or after satisfying these requirements the SMSF acquires additional units in the unit trust which are not covered by the provisions of section 71D or 71E of the SIS Act. Will the purchase of the additional units constitute an in-house asset in the fund?

Background

Under section 71A of the SIS Act units in a unit trust held by a superannuation fund as at 11 August 1999 are not included in the measurement of the fund's in-house assets. Reinvestments of distributions from the unit trust in additional units up until 30 June 2009 may also be excluded from the fund's in-house assets by virtue of section 71D. Where the appropriate election is made, under section 71E of the SIS Act certain additional units in the unit trust could be purchased up until 30 June 2009 by the superannuation fund to the value of loans outstanding in the unit trust as at 11 August 1999. The provisions of section 71D apply unless the election is made that section 71E applies.

Division 13.3A of the SIS Regulations provides for certain investments in companies and unit trusts to be excluded from the in-house assets of superannuation funds with less than 5 members under paragraph 71(1)(j) of the SIS Act. This Division of the SIS Regulations came into effect from 28 June 2000. The Division is composed of 4 regulations as follows:

- Regulation 13.22A which contains definitions
- Regulation 13.22B which applies to investments in companies and unit trusts acquired prior to 28 June 2000
- Regulation 13.22C which applies to investments in companies and unit trusts acquired from 28 June 2000; and
- Regulation 13.22D which lists events which will cause regulations 13.22B and 13.22C to cease to apply to all investments in the affected company or unit trust.

A question which commonly arises is whether the operation of Division 13.3A applies in situations where a unit trust prior to 28 June 2000 did not meet the requirements of the Division and subsequently a superannuation fund acquires units or additional units in the unit trust after the unit trust meets the requirements of the Division.

A scenario may involve an SMSF which owns units in a geared trust as at 11 August 1999. The units held as at 11 August 1999 plus any subsequent purchase of additional units in the unit trust up until 30 June 2009 are not included in the value of the fund's in-house assets by virtue of the transitional rules in sections 71A-71E of the SIS Act. In many cases these pre-99 unit trusts may have eliminated their debt and may now satisfy all the requirements of SIS Regulation 13.22C.

ATO response

Assuming the acquisition of the additional units would not otherwise be excluded as an in-house asset under the transitional rules in section 71A-71E of the SIS Act, the ATO considers that additional units purchased by a superannuation fund in a pre-99 unit trust on or after 28 June 2000 will not be classified as an in-house asset as long as the following conditions are satisfied:

1. At the time the additional units were acquired by the superannuation fund, the unit trust satisfied the requirements of SIS Regulation 13.22C(2)
2. The unit trust has not experienced an event listed in 13.22D(1) since 28 June 2000.

The ATO considers that subregulation 13.22D(1) is only concerned with events which happen after the commencement of the regulations on 28 June 2000. Therefore, a borrowing made prior to 28 June 2000 will not trigger the operation of regulation 13.22D, notwithstanding that it is not discharged prior to 28 June 2000. By virtue of subregulation 13.22B(1), regulation 13.22B will still apply to the units acquired by the superannuation fund prior to 28 June 2000.

If one of the events in subregulation 13.22D(1) occurs after 28 June 2000, regulation 13.22B will then cease to apply to those units. However, this does not affect the in-house assets of the superannuation fund as these units are separately excluded from the in-house assets of the fund by section 71A of the SIS Act. The operation of subregulation 13.22D(1) will however have a flow on effect by virtue of subregulation 13.22D(3) which will effect the application of regulation 13.22C to any units purchased after the event has occurred. In other words, if an event in 13.22D(1) occurs after 28 June 2000, the original units acquired by the fund will remain excluded from the fund's in-house assets but the acquisition of any additional units after 28 June 2000 will be included in the fund's in-house assets (assuming the additional units are not excluded from the fund's in-house assets by virtue of the transitional rules in section 71A-71E of the SIS Act).

It is also important to note that a borrowing made by the trustee of the unit trust after 28 June 2000 will mean regulations 13.22B and regulations 13.22C will cease to apply to any units held by the superannuation fund at the time of the borrowing and any new units acquired at a later time, regardless of whether the borrowings have been discharged.

The ATO also advised that they will consider whether it is necessary to develop a more formal ATO view on this issue and this may involve the release of a SMSF Determination to properly convey the ATO's interpretation.

Example 1

On 11 August 1999 the XYZ super fund held 100 units in a related geared unit trust, the XYZ unit trust. These units are excluded from the fund's in-house assets by virtue of subsection 71A of the SIS Act. On 1 August 2009, the XYZ super fund acquires another 100 units in the XYZ unit trust. At this time the original borrowing has been discharged and all of the other requirements in subregulation 13.22C(2) have been met. In addition, none of the events listed in subsection 13.22D(1) have occurred since 28 June 2000.

The 100 units acquired on 1 August 2009 are excluded from the in-house assets of the fund by virtue of subregulation 13.22C(2). The original 100 units acquired before 28 June 2000 are still not excluded from the in-house assets of the fund under subregulation 13.22B(2) due to borrowings which existed on 28 June 2000, however they remain excluded from the in-house assets of the fund under section 71A of the SIS Act. As a consequence, all of the 200 units held in the XYZ unit trust are excluded from the in-house assets of the XYZ super fund.

Example 2

On 11 August 1999 the ABC super fund held 100 units in a related geared unit trust, the ABC unit trust. These units are excluded from the fund's in-house assets by virtue of subsection 71A of the SIS Act. On 1 July 2004, the trustee of the ABC unit trust borrows a further \$5,000. This triggers subregulation 13.22D(3) ensuring that regulation 13.22C cannot apply to any other units acquired after the new borrowing was made.

On 1 December 2010, the ABC super fund acquires another 100 units in the ABC unit trust. At this time all the borrowings have been discharged and all of the other requirements in subregulation 13.22C have been met. However, due to the operation of subregulation 13.22D(3), regulation 13.22C cannot apply to the new units and therefore these units will not be excluded from the in-house assets of the ABC super fund. However, the exclusion of the original 100 units from the in-house assets of the ABC super fund under section 71A of the SIS Act remains unaffected. Consequently, only the 100 units acquired on 1 December 2010 are included in the in-house assets of the ABC super fund.

Implications for SMSF trustees and practitioners

SMSFs who hold units in a pre-99 unit trust are permitted to acquire additional units in those trusts, without those units being classified as an in-house asset, as long as the unit trust now satisfies the requirements of SIS Regulation 13.22C(2) and the unit trust has not experienced an event listed in 13.22D(1) since 28 June 2000.

Assuming these requirements are satisfied, the unit trust can be re-capitalised using funds from the SMSF and used to undertake transactions and strategies normally associated with a SIS Regulation 13.22C unit trust. However, extreme care needs to be taken to ensure the unit trust does not experience an event listed in SIS Regulation 13.22(D)(1) anytime after the additional units are acquired by the SMSF.