



YOUR GUARDIAN

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It's your money – but not yet!

In-House Assets

Regulations exist to prevent the use of self managed super funds (SMSFs) to provide benefits to members or related parties of the SMSF. Without these rules, it is possible people may use their superannuation savings to support their businesses, investments and general immediate financial wellbeing, regardless of whether this is a prudent investment decision for the super fund, with its own independent objectives. These issues are addressed by the 'in-house asset' rules (amongst others – eg acquisition rules, sole purpose test) and if breached – can have serious repercussions.

It is important that Trustees of SMSFs are aware of these rules, as it is an easy area to be caught out if not properly understood. An in-house asset is generally defined as a loan to or an investment in a 'related party' of the super fund, or an investment in a related trust. The in-house definition also extends to include any asset which is subject to a lease between the trustee and a related party of the fund.

Like many rules governing SMSFs, these definitions are subject to certain exclusions and transitional arrangements, and trustees should be aware of these. For example, any investment

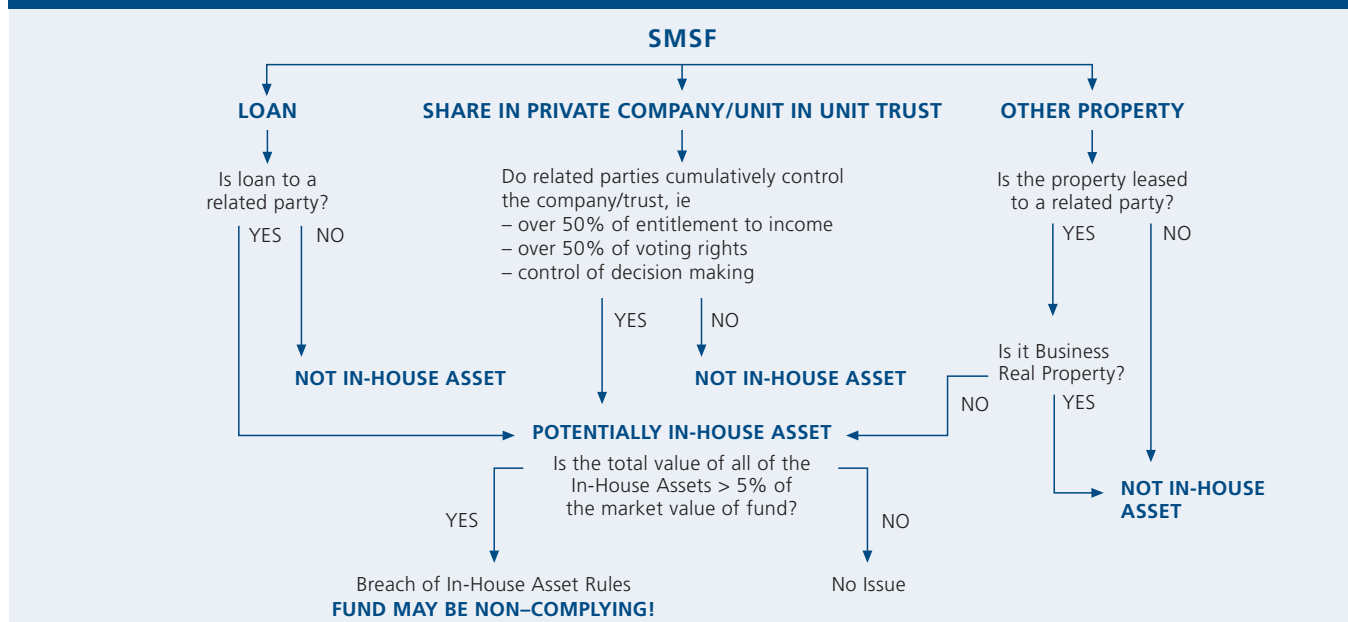
in a related unit trust of a super fund will not be considered an in-house asset if the units in the trust were purchased before 11 August 1999 (at this date the definition of in-house assets was extended). This is regardless of whether or not this trust had borrowings.

Another exclusion relates to investments in business real property – an investment in business real property will generally never be considered an in-house asset even if the property is leased to a related party of the fund. On the other hand, residential property will become an in-house asset as soon as it is leased or rented by a related party of the fund.

The term 'related party' is very broad – it includes all relatives, business partners, companies controlled, and related unit trusts of the members and the standard employer sponsor of a fund. Furthermore, it includes certain relatives of the business partners of a member or the employer sponsor, and any companies controlled by business partners or relatives of a member or the employer sponsor!

As you can see, the definition of 'related party' can create a confusing yet comprehensive web of entities considered to be a related party of a super fund. If there is any sort of connection between a member of a super fund and the investment of the super fund, no matter how remote, there is a chance that an asset may be considered an in-house asset.

IN-HOUSE ASSETS FLOWCHART



So what does this all mean?

The value of a super fund's in-house assets must never exceed 5% of the total market value of the funds assets. If the 5% threshold is exceeded, the fund can be considered non-complying. A non-complying super fund is taxed at 47%, and can potentially lose 47% of the value of its assets up front.

Below is a simple case study highlighting some common in-house asset considerations:

Case Study – Pat

Year one:

Pat's SMSF purchases a piece of artwork from a gallery, valued at \$20,000. The SMSF decides to lease it to Pat's business on commercial terms. Pat's SMSF has a total asset value of \$420,000.

The artwork is leased to a related party of the fund, therefore is considered an in-house asset. However, the artwork only comprises 4.76% of the total market value of the SMSF. The investment fits within the threshold for in-house assets and therefore remains compliant.

Year two:

Pat's SMSF decides to purchase a second piece of artwork from the gallery, valued at \$15,000. The Trustees of the SMSF decide to store this piece of artwork in a secure safe, have it insured, with the intention of the artwork appreciating in value. At the end of year two, the market value of the SMSF is \$450,000, with the total artwork valued by an independent appraiser at its total cost of \$35,000 (\$20,000 for piece one and \$15,000 for the second piece).

As the second piece of artwork is not leased to a related party of the SMSF, it is not considered to be an in-house asset. The market value of all in-house assets as a percentage of the market value of the entire SMSF is now 4.4%, still within the in-house asset threshold.

Year three:

The artist who painted both pieces of artwork passes away, resulting in all of the artwork tripling in value. At the end of year three, the market value of the SMSF is \$600,000. The market value of the initial piece of art (being leased to Pat's business) is now \$60,000.

As the market value of the art is now worth 10% of the total market value of all of the SMSF's assets, the SMSF now breaches the in-house asset threshold of 5%. The SMSF is no longer complying and may be subject to the hefty rates of tax.

Year four:

Due to the in-house asset restrictions, Pat's SMSF decides to sell the artwork at its market value of \$60,000.

Pat's business partner, Neville, decides to set up a new business through a company of which Neville is the sole director. Pat has nothing at all to do with the new business and is not a relative of Neville, nor a shareholder of the new company.

Pat decides that his SMSF will loan Neville's new company \$60,000 on the basis that Neville's company will repay the principal within a year and accrue interest at 15% per annum - an attractive investment. At the end of year four, the market value of Pat's SMSF is still \$600,000.

As Neville is in an existing partnership with Pat, any company controlled by Neville is considered to be a related party of Pat's SMSF under the in-house asset definition. Therefore, this investment is caught under the in-house asset rules. The market value of the asset exceeds 5% of the total market value of the SMSF's assets. Therefore the fund remains non-complying in year four.

Year five:

The \$60,000 plus interest is repaid to the SMSF. Pat's SMSF then decides to invest this money in a private unit trust which is going to borrow money and develop a residential apartment complex. Pat is to own less than 50% of the units, and other totally unrelated parties are to own the remainder.

As Pat and related parties of Pat do not have a total of over 50% of the entitlement to income or capital of the trust, and given the fact that Pat has no other control over the trust, then this investment is not considered an in-house asset of the SMSF.

Tips when investing

- ✓ If your super fund owns a holiday house – don't use it or rent it to a related party.
- ✓ Seek advice when loaning money from your SMSF to a business you own or operate.
- ✓ Be cautious when investing in residential property within a SMSF.
- ✓ You cannot buy a residential property from a member or related party.
- ✓ You cannot loan money from your super fund to a family member.
- ✓ When investing in unusual assets within a SMSF, such as a vintage car, artwork or antiques – ensure they are stored appropriately and not at your house so they cannot be considered as providing a benefit to a member of the fund.
- ✓ Take care when investing in a business – if you have an influence over the decision making of the business – seek professional advice.
- ✓ If you are considering leasing any SMSF assets other than business real property to a member or related party ensure you seek advice.
- ✓ Finally, if you have any doubts about assets you wish your SMSF to purchase, always seek advice!

If you have any in-house asset queries, or for more information relating to in-house assets, call **Phil Jaquillard** or **Ed Bernard** of our office on **1300 787 576**.

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