

Australian SMSF Audits

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Much has been said recently about the proposed changes to superannuation that were announced in the 2016 Federal budget. Most of those changes will not take effect until the 2018 financial year, and even then will be dependent upon the result of the forthcoming Federal election and then whether the changes are eventually passed by Parliament.

There are, however, changes to superannuation laws and procedures that will take effect on 1 July 2016. The following topics highlight a number of these changes. Trustees need to be aware of these to ensure the fund they control is complying with the SIS Act and Regulations.

Artwork and other collectables

Rules relating to the ownership of assets defined as Collectables and Personal Use (CPU) assets were changed, effective from 1 July 2011. At that time, assets that were already owned by SMSFs were exempt from the changes until 1 July 2016. Those changes will now also apply to all existing assets in this class. Assets in this class include, but are not limited to, artwork, jewellery, coins, vehicles, boats and wine. Trustee must ensure that all pre-July 2011 CPU assets comply with the following:

- They cannot be leased to, or be a part of a lease arrangement, with a related party of the SMSF;
- They cannot be used by, or provide a benefit to, a related party of the SMSF for any reason. An example of use provided by the ATO could include the driving of a vintage car owned by an SMSF to a mechanic for maintenance. That is classed as personal use and is not allowed;

- They cannot be displayed, or even stored, in a private residence of a related party of the SMSF;
- The investment must comply with all relevant investment restrictions, including the SISA sole purpose test and the fund's own investment strategy;
- Any decision made by trustees on where the item is to be stored must be documented, such as in a minute of a trustee meeting and that written record kept;
- The item must be specifically insured in the SMSF's name. Having the item included in a general policy held by the trustee, such as their household policy, is not acceptable;
- Where an asset in this class is to be transferred or sold to a related party, it must be at the market value determined by a qualified, independent valuer.

If you have an asset in this class, you need to ensure that you comply with these changes before 1 July 2016.

Limited Recourse Borrowing

Limited Recourse Borrowing Arrangements (LRBAs) have been available to SMSFs for a number of years. These enable the SMSF to borrow funds to acquire assets for the future benefit of members. Generally, these assets consist of either real property or listed equities. There is no restriction on where the SMSF may borrow the money from, including from related parties of the SMSF. Historically, this has allowed funds to borrow at low rates, or even interest free, as this did not provide a benefit to that other party. There has been concern for a number of years as to whether loans that are below commercial rates, including interest free, comply with the requirement that all SMSF dealings must be at arm's length. It has now been decided that such low cost loans are not consistent with that requirement.

In April, 2016, the ATO released Practical Compliance Guideline 2016/5 (PCG) that details the arm's length terms for LRBA borrowings. The ATO have stated that all borrowings must be at arm's length. Within the PCG, the ATO has defined "Safe Harbour" options and where any borrowing that complies with these guidelines will be deemed to be at arm's length.

Borrowings that do not fully comply with the guidelines may still be at arm's length, but in those situations, the trustees may be required to justify the case. That may involve obtaining evidence an arm's length or unrelated lender is offering a loan under the same terms and conditions of the one established between the SMSF and the related party.

The ATO has also, within the PCG, stated that where any borrowings are at arm's length and comply with the

guidelines before 30 June, 2016, then they will not review any borrowings in relation to the 2015 financial year, or earlier. Funds will need to comply for the 2016 financial year. In May, the ATO extended the June 2016 deadline to January, 2017. That extension has not changed the fact that the interest etc. paid during the 2016 financial year must comply with the guideline.

As an example of what is required to comply with the PCG, for a loan to acquire real property, the trustees will need comply with the following:

- The interest rate is the RBA Indicator Lending Rates for banks for May prior to the commencement of the year of the loan. For the 2016 financial year, the rate is 5.75%;
- The rate can be variable or fixed, but fixed rate borrowings must be for a specified period and no more than 5 years;
- The term of the loan must be no more than 15 years. Any re-financed loan period must include the duration of any previous loans;
- The loan to market value ratio must not exceed 70%. The market value is established at the time the original loan is taken out or 1 July 2015;
- The loan must have a registered mortgage over the property;
- Payments must be made monthly and each payment must consist of both principal and interest;
- A written and executed loan agreement must be in place.

The guidelines for market listed equities are similar to those above for real property, but interest rates, terms etc. vary. Trustee can refer to the PCG for more details.

It is recommended trustees seek professional advice in this matter.