SUPERCENTRAL

Back-door benefits from super not permitted

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The rules relating to what a self-managed superannuation fund can and cannot invest in are complex and for the uninitiated appear confusing and alien. But there is a basic logic to them.

The purpose of superannuation is to provide money for the member to live on in retirement, thereby taking pressure off the Government age pension. Because the Commonwealth Government provides substantial tax concessions to super funds in an effort to attract people to invest in their super, it sets very strict rules to ensure that the funds and the members are doing everything necessary to achieve the goal of maximising retirement benefits, and not jeopardising that goal by using the super money prematurely or in a manner that could result in the super being lost.

Government regulation prohibits using your super to invest in your other businesses or investment schemes, your family's business structures or other investments where what you are doing is supporting the investment because of the relationship rather than adopting the independent and objective investment assessment that you would do if the investment were totally at arm's length.

An investment that is too closely connected to the member of the fund is called an 'in-house asset'. Assets controlled by people, companies or trusts that are 'associates' of the member are in-house assets. The definition of 'associate' in the legislation is eye-wateringly complex and designed to throw the net as wide as possible to avoid the ability to side-step the rules. A super fund cannot invest more than 5% of its total value in 'in-house assets'.

Having said that, there are ways that you can use your super to support your other investments. Which brings us to Ted and Alice.

Ted and Alice have an SMSF. Their close friends, Roger and Diane, have a family trust. The two families are considering a property development where the super fund and the family trust provide the capital to buy the land and carry out the building work. The advice from their accountant is to use a unit trust as the vehicle for the development.

Will that unit trust be an in-house asset? Yes, if the unit trust is a so-called "related trust." The unit trust will be a related trust if the super fund controls the unit trust. The concept of 'control' is very strictly and broadly defined as well.

So if the super fund holds more than half of the units or has more than half the votes at unitholder meetings it will be said to control the unit trust.

Alternatively, if Roger is Ted's business partner, then they would be 'associates' and together would control the unit trust, again making the unit trust an in-house asset. The super fund could not then invest more than 5% of its worth in the unit trust.

The Government will allow an investment into what might otherwise be an in-house asset but prescribes the eligibility criteria in such a way as to try to ensure that the investment is as 'safe' as possible. The rules are set out in Superannuation Regulation 13.22C and so naturally the trust is called a 1322C trust.

A super fund can invest in a 13.22C trust like any other investment by the fund but qualifying as a 13.22C trust can be difficult for the parties involved and if at any time the unit trust fails to meet any of the qualifying criteria, it can never again be a 13.22C trust.

A 13.22C trust cannot operate a business, borrow money, mortgage its property, hold an interest in another entity, lease property to a related party (business real property excepted), loan money or acquire an asset from a related party and all of its dealings with other parties must be at arm's length.

A super fund wanting to partner with others in another legal entity to develop real estate or engage in some other investment must consider carefully whether that entity is an in-house asset and if so whether an alternate structure, including potentially a 13.22C trust, is necessary for the fund to remain compliant with the law and avoid the allegation of back-door benefits.

For more information on any aspect covered in this article, please call SUPERCentral on 02 8296 6266 or email info@supercentral.com.au.