Recent SMSF Announcements – June 2010

Following on from the Henry Release, Federal Budget and preliminary Cooper Review, some further announcements and changes with respect to superannuation have recently been publicised.

Superannuation Borrowing – Is Property Favoured Over Equities?

The ability for superannuation funds to borrow to invest is reasonably new. There have always been questions with respect to the operation of such structures, and on 26 May 2010 new regulations were released to clarify these rules.

Below are the rules that have **not** changed with respect to borrowings:

- A superannuation fund can only borrow to acquire an asset that is in accordance with the investment restrictions that apply to superannuation – the fund can't borrow to purchase an asset it would be unable to purchase if it had access to the full purchase price;
- The fund will only acquire a beneficial interest in the asset, with legal title to be transferred upon the loan being repaid;
- The fund is unable to charge existing assets, and is only able to borrow for the acquisition of a new asset;
- The rights of the lender are limited to the asset being acquired (limited recourse).

The new requirements to be met with respect to super fund borrowings are now as follows (from Royal Assent):

- Each borrowing undertaken by a fund must relate to only one asset, or if shares, the parcel of shares must be in the same company;
- This eliminates the ability to borrow to invest in a portfolio of shares without requiring a separate borrowing for each company share parcel;
- If the fund wishes to sell shares in a company that are subject to a borrowing, they are only able to replace those shares with new shares in the original company or shares in another company if the original shares were the subject of a takeover, merger, demerger or restructure;
- The fund is unable to borrow to acquire land and subsequently subdivide, as the new titles to replace the single title would not meet the requirements to be a "replacement asset";
- The fund is able to borrow to cover the costs incurred in connection with the borrowing (for example, transfer duty, legal fees), as well as expenses with respect to the maintenance or repair of the asset;
- The fund is unable to borrow to renovate or improve the asset being acquired;
- Borrowings are able to be refinanced without the fund breaching the rules;
- The lender is able to obtain a guarantee from another related entity, however the rights of the guarantor are limited to the asset.

This significantly limits the use of the borrowing arrangements for the acquisition of shares, as the fund would need to put in place a new borrowing each time it acquires a parcel of shares in a new company.

From a CGT perspective, another recent change is that the fund will always be treated as the owner, which means there will be no CGT implications upon the loan being repaid and the fund obtaining legal ownership. This change clarifies our view prior to this announcement

These rules will apply from Royal Assent. Accordingly, care and a thorough analysis should be undertaken before any super borrowing is considered to ensure such a strategy is appropriate, fits with your investment strategy and investment horizon and anticipated exit date.

Artwork in Superannuation

The Cooper Review into Superannuation in Australia released a preliminary report in late April with respect to their view on SMSFs. One of the recommendations was to eliminate the ability for superannuation funds to invest in exotic assets.

It is expected that exotic assets will include:

- Artwork
- Wine collections
- Racehorses
- Vintage cars
- Antiques
- Precious stones

Assets where it is unclear whether they would be classified as exotic or not include gold bullion and other commodities. Of the above, artwork is the most commonly seen asset of SMSFs that may fall within the above definition.

If such a change were implemented, it is proposed that funds with existing exotic assets would be able to retain the investment for a ten year transitional period, being required to dispose of it by 2020. The issues we envisage with such transactions include:

- As the fund is required to transact on an arm’s length basis, it may have to sell the artwork if another entity within the family group is unable to fund the purchase from the fund;
- If the members are over age 55, depending on their personal circumstances they could transfer the artwork as a lump-sum payment. However, there may be a tax liability on such a payment;

An interesting statistic is that a quarter of all Indigenous art is currently purchased for investment by SMSFS. Accordingly this change will likely result in a substantial impact on this market, particularly emerging artists.

Additionally, from 9 June 2010, the Federal Government Art Resale Royalty Scheme comes into place, which:

- Will provide a 5% royalty on artworks valued at greater than $1,000 upon commercial resale;
- The royalty is to be paid to the artist and / or their estate (for a period of 70 years after death);
- The royalty will only apply to the second and subsequent sale / transfer of artwork after the commencement of the scheme;

The idea behind artists’ resale royalties is to create an ongoing economic interest in the work beyond the initial sale transaction, and enable the artist and their families to benefit from future sales of their work.

This royalty scheme may impact SMSFs as it may act as a disincentive for funds to acquire new artwork in the short to medium term. The purchaser of any artwork will be jointly and severally liable to pay the royalty, which is also not assisted by the uncertainty surrounding the Cooper Review and the ability for funds to own artwork.

The Next Step

The introduction of new legislation with respect to superannuation fund borrowings is a positive indicator that the Government supports this strategy. In our experience most of these arrangements have been with respect to property investments, where the new rules have a positive impact. If it is desired to borrow within your superannuation fund to acquire shares, the best time to implement such a strategy would be prior to the new legislation receiving Royal Assent.

With respect to artwork and other exotic assets, we await the final release of the Cooper Review and the Government’s response, particularly with respect to the assets considered to be exotic. It is also important to bear in mind the new Resale Royalty Scheme when purchasing art works.

If you have any queries, or would like advice in relation to any matters outlined above, please contact either Jemma Sanderson, Michelle Saunders or Marissa Bechta on (08) 6311 6900.

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