



4 March 2015

Our Ref: JH: 1529827

The Trustee
The HB and AP Superannuation Fund
C/- Ms Heather Byrne
Heather Byrne Accountant
PO BOX 832
BOWRAL NSW 2576

by email only: heatherbyrne@bigpond.com

Dear Trustee

THE HB AND AP SUPERANNUATION FUND – LIMITED RECOURSE BORROWING – COMPLIANCE ADVICE

| | |
|---------------------------------|--|
| Name of Trust: | The HB and AP Superannuation Fund |
| ABN of Fund: | 64 675 349 412 |
| Name of Fund Trustee: | How Heavenly Pty Ltd ACN 169 433 587 |
| Name of Holding Trustee: | Mews Bowral Pty Ltd ACN 603 671 487 |
| Address of Property: | 8/11 Bundaroo Street, Bowral NSW (Folio Identifier 8/SP49134) |
| Name of Vendor: | Anthony Philip Glenn and Julie Ann Glenn as trustees for Glenn Superannuation Fund |
| Name of Lender: | Westpac Banking Corporation |

1. Instructions

- 1.1 You seek our advice in relation to the superannuation, taxation and stamp duties implications of the transaction described in section 2 of this letter. We note that if we have not reviewed the trust deed and investment strategy of the Fund then our advice is general in nature and not specific to the Fund. You should ensure all matters dealt with here are checked against the Fund's specific circumstances and not proceed with the transaction until that check is complete.
- 1.2 Our advice in relation to the transaction is set out as follows:
 - (a) section 3 – governing rules issues;
 - (b) section 4 – *Superannuation Industry (Supervision) Act 1993* (Cth) ("SIS Act") issues;
 - (c) section 5 – income tax issues;
 - (d) section 6 – GST issues;
 - (e) section 7 – investment strategy issues.

2. The transaction

- 2.1 For the purposes of this advice we have assumed the facts set out below in this Section 2. It is vital that all these facts are correct so please read them carefully and contact us urgently if any of them are not correct.
- 2.2 The transaction is the purchase by the Fund of the Property using in part money that has been borrowed.
- 2.3 The Property is being purchased for an 'arm's length' price.
- 2.4 The Fund is a regulated superannuation fund and satisfies the definition of a "self managed superannuation fund" under s 17A of the SIS Act.

- 2.5 The Fund was duly and properly established by a trust deed which was duly and properly executed and dated by the Trustee.
- 2.6 The Fund is regulated by the governing rules set out in or referred to in the trust deed.
- 2.7 The Property will be leased to earn income for the Fund.
- 2.8 The Fund has provided or will provide the total purchase price of the Property including any so-called 'good faith' deposit prior to exchange, the remainder of the deposit payable on formal exchange and the total amount due on settlement. The Fund will provide all these amounts either from its own funds or from the borrowed funds.
- 2.9 The Fund has or will enter into a loan agreement ("Loan") to borrow a portion of the purchase price.
- 2.10 On settlement, the Property will be held by the Holding Trustee in a Holding Trust for the Fund.
- 2.11 The Lender's security rights against the Fund under the Loan will be limited to the mortgage or security over the Property. In particular, the Lender will have no right of recourse against any other asset of the Fund.
- 2.12 The Vendor is not a relative, associate or related party of any member of the Fund or if they are then the Property is business real property as that phrase is defined within the SIS Act and which satisfies the views of the Commissioner of Taxation as set out in SMSFR 2009/1.
- 2.13 If the Lender is a company in which a member is a shareholder or is a trust with a corporate beneficiary in which a member is a shareholder then the loan agreement may need to comply with Division 7A of the *Tax Act 1936*.

3. Governing rules

Do the governing rules of the fund permit the trustee to enter into the transaction?

- 3.1 The governing rules of the Fund must confer on the Trustee:
 - (a) the right to be the beneficiary of a Holding Trust
 - (b) the right to borrow under arrangements of the kind contemplated by s 67A of the SIS Act
 - (c) the right to grant a security over property
 - (d) the right to purchase real estate
 - (e) the right to lease property.
- 3.2 Without these powers the Fund Trustee lacks the necessary capacity to enter the transaction.
- 3.3 If the Fund is governed by the governing rules provided by SUPERCentral Pty Limited then all of these issues and many more empowering provisions as well apply to the Fund.

Does the transaction breach the trustee's covenants of due care and best interest?

- 3.4 Often the governing rules of super funds impose covenants on the Trustee to, among other things:
 - (a) exercise due care and diligence;
 - (b) ensure that the Trustee's powers are exercised in the best interest of the beneficiaries; and
 - (c) not mix fund assets with other assets.
- 3.5 In our opinion the due care and diligence covenant, in the context of the transaction, requires the Fund Trustee to exercise proper care in carrying out the transaction (eg engaging suitably qualified advisers, entering into transactions which are properly documented and obtaining the appropriate advices and sign offs). In this respect you should ensure that the Trustee has instructed suitably qualified advisers and that the transaction will be legally documented. Provided those steps are taken then, in our opinion, the Fund Trustee should satisfy this covenant.

- 3.6 The best interests covenant, in the context of the transaction, requires the Fund Trustee to only consider the interests of the beneficiaries when considering whether to enter into the transaction and the terms upon which the transaction is entered into. In this respect, you should ensure that the Fund Trustee has engaged with third parties on an arm's length basis with the objective to obtain investment returns for the beneficiaries. If this is done then, in our opinion, the Fund Trustee should be able to satisfy this covenant.
- 3.7 The obligation not to mix trust assets with the assets of other funds or the Fund Trustee's personal assets will be satisfied as the Property will be held by the Holding Trustee exclusively for the Fund.

4. Superannuation Industry (Supervision) Act 1993 (Cth)

Does the transaction breach of the SMSF trustee's statutory covenants?

- 4.1 The SIS Act imposes an obligation on trustees of regulated superannuation funds to exercise the degree of care, skill and diligence that an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide. Our instructions are that the Property has been purchased at an arm's length price. If it is plausible that the Fund Trustee believes that the Property will appreciate in capital value over the longer term, then the Fund Trustee would not be in breach of this statutory obligation.
- 4.2 If the Lender is a related party of the Fund, s 109 of the SIS Act provides an exception. In this instance, the terms of the transaction can be "no more favourable to the other party than those which is reasonable to expect as if the parties were dealing at arm's length." This means that in a related party transaction, the terms of the loan can be more favourable to the Fund. However, the arrangement, including establishing the borrowing, has to be documented and conducted in a business-like manner in the same way as an arrangement when dealing with an arm's length lender (ATO ID 2010/162).
- 4.3 Generally, it is recommended that the terms of the transaction should be conducted on arm's length terms even though the parties may not be dealing at arm's length. Conducting a transaction on terms more favourable to the Fund involves value shifting to the Fund which may give rise to deemed contribution and special income consequences.
- 4.4 The SIS Act also imposes the obligation on trustees of regulated superannuation funds to ensure that the trustees' powers are exercised in the best interests of the beneficiaries of the Fund. It is our opinion that if the Fund Trustee genuinely believes that the Property will provide a reasonable return over the longer term then the Fund Trustee would not be in breach of this statutory obligation.

Does the transaction breach of the sole purpose test?

- 4.5 The SIS Act imposes an obligation on the Fund Trustee to maintain the Fund solely for the provision of approved benefits for the members and their beneficiaries.
- 4.6 In our opinion, the Fund Trustee will not be in breach of this obligation if the Fund Trustee's principal and predominant reason for entering into the transaction is to obtain revenue and capital appreciation in order to finance the payment to benefits of members.

Does the transaction breach the financial assistance prohibition?

- 4.7 The SIS Act imposes an obligation upon the Fund Trustee not to lend or provide financial assistance to a member (or a relative of a member) using the resources of the Fund. Clearly the transaction does not involve a loan by the Fund Trustee to a member or a relative of a member and so there is no breach of the first limb of the statutory prohibition. Nor does the transaction involve any member obtaining any separate interest in the Property or give them any separate benefit.

- 4.8 If the Vendor is not a member or a relative of a member of the Fund and is an unrelated third party, there is no basis on which to conclude that the purchase of the Property is the provision of financial assistance to a member or a relative of a member. Consequently, there is no breach of the second limb of the statutory prohibition.
- 4.9 If the Vendor is a member or a relative of a member of the Fund but the transaction is otherwise at arm's length and conducted on normal business principles and for normal business reasons then the purpose of the transaction is to benefit the Fund and the purchase of the property of the related party is not in the nature of providing financial assistance to that related party.

Does the transaction breach the related parties' prohibition?

- 4.10 The SIS Act imposes an obligation upon the Fund Trustee not to acquire (whether by purchase or gift) an asset from a related party of the Fund. There are certain exceptions to this prohibition.
- 4.11 The term "related party" of a superannuation fund is defined to include (among others) a member of that fund and each associate (which is very widely defined) of a member.
- 4.12 If the Vendor is not a member or an associate of a member of the Fund (and not otherwise within the definition) then it is our opinion that the Vendor is not a related party of the Fund and so the transaction does not breach this statutory prohibition.
- 4.13 If the Vendor is a member or an associate of a member and therefore a related party, it is necessary to see whether the transaction comes within any of the exceptions to the related party prohibition. The most relevant exception in these circumstances would be the exception contained in s 66(2)(b) which permits a fund with less than 5 members to acquire the "business real property" of the related party provided the fund pays market value.
- 4.14 The definition of business real property includes a freehold or leasehold interest in the land and requires that the land is being used wholly and exclusively in one or more businesses (whether or not those businesses are carried on by the related party selling the land).
- 4.15 You should ensure that the Property complies with this definition if the Vendor is a related party. Self Managed Superannuation Funds Ruling 2009/1 issued by the ATO provides particular guidance as to the views of the ATO as to what constitutes business real property. Our firm has also written extensively on it and a copy of our technical paper is available on request.
- 4.16 There is no prohibition under the SIS Act which prevents a related party acting as the Holding Trustee. Nonetheless the Holding Trustee must not be a disqualified person and must comply with the arm's length requirements in how it deals with the Fund under the SIS Act.

Does the transaction breach the borrowing prohibition?

- 4.17 The SIS Act imposes an obligation upon the trustee not to borrow or to maintain an existing borrowing. There are a number of exceptions to this prohibition of which one exception set out in s 67A of the SIS Act.
- 4.18 The transaction as it has been outlined to us and confirmed in this letter will, if implemented in the manner instructed, comply with the exception allowed by s 67A.

- 4.19 There are five elements that an SMSF should adhere to for an effective and lawful borrowing:
- (a) the borrowed money is used to acquire a single acquirable asset ("the acquired asset") including paying the expenses in connection with the purchase or borrowing or paying repairs and maintenance;
 - (b) the acquired asset must be one which the trustee could have acquired on an un-gearred basis without breach of the SIS Act;
 - (c) the acquired asset must be held on trust by a distinct holding trustee for the fund trustee;
 - (d) the fund trustee has the right to acquire legal ownership of the acquired asset by making one or more payments after obtaining the beneficial interest; and
 - (e) the rights of the lender or any other person against the fund trustee for default on the borrowing are limited to rights relating to the acquired asset.

- 4.20 **The first element** – the first element will be satisfied in respect of the transaction if the loan money has been entirely applied in the payment (or part payment) of the amount due on settlement of the purchase of the Property. The loan money will still be applied in the acquisition of the Property whether it is paid to the Vendor, or at the Vendor's direction is used to pay Vendor obligations such as unpaid rates or outgoing mortgagee's fees. The loan money can also be used to pay the expenses of the purchase or borrowing and repairs and maintenance on the Property. However, if the loan money was used (even in part) for other purposes not associated with the acquisition of the Property then this element would not be satisfied.

In accordance with normal conveyancing practice we understand that with respect to the transaction the entire loan amount will be released by the Lender on settlement and will be entirely applied in payments to, or at the direction of, the Vendor. If this is the case then, in our opinion, this element of the exception has been satisfied.

- 4.21 **The second element** – the second element will be satisfied if either the Property is not owned by a related party and is being acquired on an arm's length basis or if the Property is owned by a related party but is business real property (as defined in the SIS Act and discussed earlier in this advice) and is acquired for market value.

- 4.22 **The third element** – the third element will be satisfied if the Fund Trustee supplies all the purchase money (including the deposit) but the Holding Trustee is the legal title holder. Unless more formal arrangements are entered into then, under general trust principles, the Holding Trustee would hold the Property on a resulting trust for the provider of the purchase money, namely the Fund Trustee.

However we advise that the Fund Trustee should not rely on general trust principles but rather should require the execution by the Holding Trustee of the formal Holding Trust deed which confirms the existence of the Holding Trust of the kind envisaged by the legislation. We note that you have instructed us to provide that deed and that has been done under separate letter.

If the Holding Trust deed of the kind referred to above is signed by both the Holding Trustee and the Fund Trustee and the Fund Trustee and/or the Lender provide all the purchase moneys then in our opinion the third element will be satisfied because the Holding Trustee as purchaser will hold the beneficial interest in the Property for the Fund Trustee.

We are instructed that the Lender has or will take a registered first mortgage over the Property. This will not detract from the Fund Trustee's beneficial interest even though the Lender will be entitled to hold the duplicate certificate of title and the Holding Trustee as purchaser will be the registered proprietor of the Property.

- 4.23 **The fourth element** – the fourth element will be satisfied if the Fund's arrangements with the Lender entitle the Holding Trustee to transfer title to the Property to the Fund Trustee on payment of the last instalment due to the Lender under the Loan. The Holding Trust deed referred to above gives the Trustee the right to require the Holding Trustee to transfer title to the Property to the Fund Trustee at any time.

- 4.24 **The fifth element** – the fifth element will be satisfied provided the Loan agreement does not contain any personal covenant on the Fund Trustee to discharge the Loan. The Lender must

be restricted to its right to foreclose on the Property and or to require the Property to be sold if there is default by the Fund Trustee. The Lender must have no right to require the Fund Trustee to make good any shortfall if the sale proceeds of the Property are insufficient to discharge the amount outstanding on the Loan.

Further, the Lender must have no rights against any other assets of the Fund. It is therefore imperative that you check the terms of the Loan agreement carefully to ensure that there is no right of the Lender to access any Fund property except against the Property and to ensure that personal guarantees do not extend to give the Lender or the guarantor recourse over other assets of the Fund

The Lender may take personal guarantees from third parties including members. Such a guarantee should specifically carve-out any right the Lender has against the guarantor's benefits in the Fund and have no right of indemnity against the other assets of the Fund.

Does the transaction breach the in-house asset rules?

- 4.25 The SIS Act requires that the value of the "in-house assets" of a superannuation fund does not exceed 5%. An asset will be treated as an "in-house asset" where it is a loan to or an investment in a related party or related trust of the superannuation fund. As earlier stated, the concept of "related party" and "related trust" is widely defined.
- 4.26 In our opinion, the Property will not constitute an "in-house asset" of the Fund by reason of express exclusion; s 71(8) of the SIS Act. The exclusion sets out that the Property will only be an in house asset if the asset would have been an in house asset had it been acquired and held directly by the Fund rather than by a Holding Trustee under a borrowing arrangement.
- 4.27 The *Self Managed Superannuation Funds (Limited Recourse Borrowing Arrangements – In-house Asset Exclusion) Determination 2014* ('Legislative Instrument'), a legislative instrument made under s71(1)(f) of the SIS Act now provides clarification of the timeframe that an exception to the in-house asset rules can apply.
- 4.28 The Legislative Instrument now makes clear that the investment is not an in-house asset at the following times:
- (a) between deposit and settlement; or
 - (b) if the loan has been repaid (and the property remains in the Holding Trust)
- provided that all other requirements of limited recourse borrowing in the SIS Act are satisfied.
- 4.29 If the asset is leased to a related party (eg a member of the Fund or an entity controlled by a member of the Fund) then the asset will be treated as an in-house asset unless the asset was (wholly and exclusively) used for business purposes and meets the requirements of the definition of business real property.
- 4.30 We note that once the Lender's debt has been discharged, the Fund Trustee should consider requiring legal title to the Property be transferred to the Fund Trustee. Other options are to sell the Property or to continue to hold the Property in the Holding Trust.

Does the transaction breach the rule against charging the fund's assets?

- 4.31 The SIS Act imposes an obligation on trustees of regulated superannuation funds not to give a charge over or in relation to an asset of a fund. The transaction will give to the Lender a charge/mortgage over the Property. However, in our opinion, the circumstances of the charge/mortgage would fall within a specific exception to the prohibition. This exception applies where the charge/mortgage is permitted expressly or by necessary implication by the SIS Act.
- 4.32 In our opinion the charge/mortgage provided over the Property to the Lender is expressly permitted by s 67A of the SIS Act and would therefore fall within the exception to the no-charging prohibition.

Does the transaction breach the arm's length investment rule?

- 4.33 The SIS Act imposes an obligation upon trustees of regulated superannuation funds to invest on arm's length terms. An 'arm's length' dealing under s 109 of the SIS Act can be achieved in one of two ways –
- (a) EITHER because the trustee is dealing with the other party to the transaction at arm's length
 - (b) OR because even though the parties are not dealing with one another at arm's length, the terms and conditions of the transaction are no more favourable to the other party than those which it is reasonable to expect would apply if the trustee were dealing with the other party at arm's length.
- 4.34 It is crucial that the Fund Trustee deals with the Vendor at 'arm's length' or, if that is not possible given the relationship between the parties, that the final terms and conditions of the transaction are no more favourable to the Vendor than they would have been if the parties had been dealing with one another at arm's length. If either of those conditions is met then the obligation in s 109 will not be breached.

5. Income Tax Assessment Acts 1936 and 1997 (Cth) ("ITAA")

Will interest payments be deductible to the fund?

- 5.1 It is not the purpose of this letter to provide detailed income tax advice. Our firm are not tax specialists and any action taken which could result in tax consequences should be checked with an appropriate tax specialist before implementation. The following is therefore simply a general overview for your interest but not to be relied upon.
- 5.2 Interest payments on the Loan to the Lender will be deductible to the Fund under the general deduction provision so long as the Property is used for income producing purposes. Even during periods when the Property is untenanted a deduction can still be sustained if, during that period, the Fund Trustee is committed to and searches for a new tenant, however note the following.
- (a) If the Property is designated as a segregated current pension asset, then interest payments will not be deductible.
 - (b) Even if the Property is not designated as a segregated current pension asset the deduction for interest may be reduced if the Fund commences to pay current pensions. In this case a proportion of the interest payments will not be deductible. This proportion will be related to the value of current pension liabilities to all benefit liabilities.

Will non-interest outgoings in relation to the property be deductible to the fund?

- 5.3 Outgoings of a day-to-day nature which are not reflected in the capital value of the Property including interest will be deductible to the Fund, however outgoings of a capital nature incurred in respect of the Property including:
- (a) any capital improvements such as initial repairs;
 - (b) outgoings associated with the acquisition and disposal of the Property such as legal fees, stamp duty and registration fees associated with the purchase;
- will not be deductible but will generally form part of the cost base of the Property for the purposes of determining any CGT liability arising on a CGT event occasioned by the disposal of the Property by the Trustee.

What are the income tax consequences of the transaction fees?

- 5.4 Borrowing expenses (such as loan establishment fees, mortgage protection insurance, legal fees relating to the borrowing, duty relating to the borrowing) will generally be deductible. However the deduction is not available where the Property is designated as a segregated current pension asset or where the Fund commences to pay current pensions (and the Property is used to support the payment of current pensions). In this situation, the deduction will cease to apply (if the Property is designated as a segregated current pension asset) or will be proportionately reduced (if the Property is used to support the payment of current pensions but is not designated as a segregated current pension asset). If the deduction is available it will

be spread over the duration of the loan or over 5 years (whichever is the lesser).

Will lease/rental payments be assessable?

- 5.5 Income generated from the use of the Property is generally assessable income of the Fund and is not income of the Custodian/Holding Trust. However lease and rental income is exempt income when the Property is designated as a segregated current pension asset.
- 5.6 When the Fund is providing both current pension benefits and non-pension benefits and the Property is supporting both types of benefits in these cases a proportion of the rental and lease payments will be exempt.

What are the capital gains tax (CGT) consequences of the transaction?

- 5.7 It is not the purpose of this letter to provide detailed capital gains tax advice. Our firm are not tax specialists and any action taken which could result in tax consequences should be checked with an appropriate tax specialist before implementation. The following is therefore simply a general overview for your interest but not to be relied upon.
- 5.8 Capital gains tax in the context of a borrowing by an SMSF can be looked at from the following perspectives:
 - (a) the acquisition by the Fund;
 - (b) the sale by the Holding Trustee to a third party;
 - (c) the transfer of the Property from the Holding Trustee to the Fund; and
 - (d) a subsequent sale of the Property by the Fund.
- 5.9 If the Fund is absolutely entitled to the Property then the Holding Trust is ignored for CGT purposes and the actions of the Holding Trustee will be attributed to the Fund. If a person is absolutely entitled to a CGT asset, as against the trustee of a trust, then the CGT rules apply to any act done by the Fund Trustee in relation to the asset as if the person who is absolutely entitled to the asset had done it.
- 5.10 The arrangements in the Holding Trust deed fit this description which is, in turn, consistent with the specification in s 67A of the SIS Act. The Holding Trust is a "holding trust" which is the kind of trust to which the above attribution applies. Further, the transfer of an asset to an existing trust gives rise to CGT event E2 however CGT event E2 does not arise if "you", the Fund in this context, are (is) the sole beneficiaries(y) and absolutely entitled to the asset against the Holding Trustee.
- 5.11 So for CGT purposes the first transfer to the Holding Trustee by the Vendor is taken to be a disposal to the Fund Trustee and a CGT event while the second transfer (from the Holding Trustee to the Fund Trustee after repayment of the Loan) would not give rise to a CGT event because the Fund, as the absolutely entitled beneficiary, already holds the CGT asset that will be transferred to them with the second transfer.
- 5.12 Admittedly the position is complicated slightly by the fact that the absolutely entitled beneficiary is a superannuation fund rather than an individual. Nonetheless the relationship between the Holding Trustee and the Fund Trustee is consistent with ss 106-50 of the *Income Tax Assessment Act 1997* (Cth) given the rights of the Fund Trustee set out in the Holding Trust deed.
- 5.13 Consequently, if and when the Holding Trustee disposes of the Property to a third party, this transaction will be treated as a CGT event of the Fund and a capital gain or loss will be attributed to the Fund.
- 5.14 The transfer of the Property from the Holding Trustee to the Fund will not give rise to either a capital gain or loss as the Fund is absolutely entitled to the Property. The Fund will acquire the Property with the cost base or reduced cost base which applied to the Holding Trustee.
- 5.15 The subsequent sale of the Property by the Fund will be a capital gains event and will give rise to either a capital gain or loss. The amount of the gain or loss will be determined having regard

to the cost base or reduced cost base compared to the disposal proceeds.

- 5.16 If at the time of disposal of the Property to a third party, the Property has been designated as a segregated current pension asset, any capital gain will not be taxable and any capital loss cannot be offset against other capital gains.
- 5.17 If at the time of disposal the Property has not been designated as a segregated current pension asset then the capital gain or loss, if any, will be taxable or offsettable, as the case may be. The proportion of the gain or loss which will be taxable/offsettable will be determined in accordance with a formula (see ss 295-390 of the ITAA 1997). Essentially this formula allocates capital gains or losses in proportion that the non-segregated pension liabilities bears to all non-segregated benefit liabilities.
- 5.18 Where the Property is disposed of to a third party within 12 months of acquisition by the Holding Trustee no CGT discount will apply and any taxable capital gain will be subject to tax at 15%. If the Property is disposed of more than 12 months after its acquisition by the Holding Trustee, any taxable gain will be subject to the 1/3rd CGT discount resulting in a tax rate of 10% applying to the taxable gain.

Does the holding trustee file a tax return?

- 5.19 The Holding Trustee is not required to lodge trust estate tax returns. All income and outgoings in respect of the Property will be received / incurred by the Fund and will need to be accounted for in the tax return of the Fund.

Proposed legislation to confirm look through taxation treatment

- 5.20 The Government has announced that it intends to amend the income tax law to provide a look-through income tax treatment for limited recourse borrowing arrangements which satisfy the requirements of s67A. The effect of the look-through treatment will be that income generated by the Property will be attributed to the Fund (and not the Holding Trust) and any capital gain or loss arising from the disposal of the Property by the Holding Trust will be attributed as a capital gain or loss of the Fund. Additionally, any capital gain or loss arising on the disposal of the Property by the Holding Trust to the Fund will be ignored.
- 5.21 The intention of the Government is that the legislation will be retrospective and apply to the 2007/08 and subsequent financial years.

6. Goods and services tax (GST) advice

What are the GST consequences of leasing the property?

- 6.1 The Commissioner of Taxation has released Goods and Services Tax Ruling GSTR 2008/3 "Goods and services tax: dealings in real property by Holding Trusts". Paragraph 45 states:

"45. The outcomes applying in the circumstances described in this Ruling may be summarised as follows:

Outcome 1

The beneficiary (B) of a Bare Trust including trusts where the trustee has minor duties to perform but has to act at the direction of the beneficiary when dealing with the property may carry on an enterprise involving the use or exploitation of real property even though title to the property is registered in the name of a Holding Trustee (T).

Outcome 2

B may make supplies and acquisitions of real property in the course or furtherance of its enterprise even though title to the property is transferred or received by T.

Outcome 3

B may make supplies in the course or furtherance of its enterprise for consideration even though the consideration is received by T who is bound to pay the consideration to B or at B's direction. Therefore B, not T, has the liability for GST if the supply is a taxable supply.

Likewise, B may make acquisitions in the course or furtherance of its enterprise for consideration even

though T provides the consideration (furnished to T by B) to the supplier. Therefore B, not T, has the entitlement to an input tax credit if the acquisition is a creditable acquisition.

Outcome 4

Such a trust involving a trustee holding real property on behalf of a beneficiary does not carry on an enterprise, merely by the trustee dealing with the property at the direction of the beneficiary.”

The Holding Trust deed we have prepared for you is compliant with the trust requirements of GSTR 2008/3 and the above GST outcome will be applicable to the Holding Trust and the Fund.

- 6.2 Hence the ATO accepts that the beneficiary of a Holding Trust would carry on the relevant enterprise, if any, for GST purposes. It is for the Fund to determine whether the Fund is carrying on an enterprise and whether its turnover is above the relevant threshold thereby requiring the Fund to be registered for GST.
- 6.3 Any tax invoice that issues to the tenant of the Property should be issued by the Fund and it is the ABN of the Fund that should be provided for the purposes of GST and otherwise in respect of the Property.
- 6.4 The Holding Trustee simply holds the title to the property and attends to those actions that only the registered proprietor of land can do (such as enter into a lease or a mortgage) and then only on the direction of the Fund Trustee. In other respects, such as in the context of the considered federal taxes, it is as if the Fund Trustee owns the Property.
- 6.5 As the relevant going concern would need to be a continuing one of the leasing enterprise then there is no going concern unless the Vendor is involved in a lease at the time of the supply/acquisition of the Property, which will ordinarily be settlement of the purchase, and the Holding Trustee as purchaser assumes that lease.

What are the GST consequences of the acquisition of the property?

- 6.6 If the Vendor of the Property is registered or is required to be registered for GST and the Property is supplied in the course of the vendor's enterprise then the following apply.
 - (a) If the Property is a commercial property, the Vendor would be required to include GST in the sale of commercial property otherwise the Vendor would have to pay the GST itself. The GST does not apply if the going concern exemption is applicable.
 - (b) If the Property is a residential property then if the Property is being acquired to earn residential rent, the acquisition is input taxed and so no GST is payable unless the Property is new residential premises for GST purposes. Residential premises are not new residential premises if they have been used only for making input taxed supplies of residential rent for a continuous period of five years since the residential property either first became residential premises, were last substantially renovated or were built.

7. Investment strategy

Trustee obligations

- 7.1 The SIS Act imposes various investment strategy obligations upon trustees of regulated superannuation funds. These obligations can be summarised as:
 - (a) an obligation to formulate an appropriate investment strategy for the superannuation fund;
 - (b) an obligation to consider when formulating an appropriate investment strategy the circumstances of the superannuation fund including the following factors:
 - (i) the risk/return on the investments;
 - (ii) investment diversity;
 - (iii) liquidity; and
 - (iv) cashflow requirements of the fund; and
 - (c) an obligation to implement the formulated investment strategy.
- 7.2 Additionally, trustees must document and approve (eg by formal resolution or at a meeting) the

investment strategy.

Expressing the investment strategy

7.3 In order to arrive at an investment strategy, trustees must first identify the investment objective to be achieved with the investment strategy which is the plan by which the objective is to be achieved. Normally investment objectives are expressed as a desired rate of return to be achieved by the superannuation fund. The desired rate of return is usually expressed in quantitative terms so that it is objectively possible to determine whether the stated objective has been achieved.

7.4 For example, the investment objective could be expressed as:

"a rate of return matching or exceeding by a specified percentage (eg 200 basis points) a nominated benchmark (eg All Ordinaries Accumulation Index or CPI) over a specified period (eg 5 years)"

OR

"to provide real long-term (eg over 7 years or more) capital growth of at least x% pa and a level of income of at least z%"

7.5 It follows that the Fund Trustee could adopt an investment objective similar to the second example above which is consistent with its investment strategy formulation. In our view it is open to the Fund Trustee to adopt an investment strategy (in order to achieve the stated objective) of purchasing and retaining the Property.

7.6 It is necessary to ensure that the ultimate mix of assets in the Fund is appropriate for the Fund having regard to the listed factors which the Fund Trustee must consider.

7.7 The statutory obligation of a trustee of a regulated superannuation fund in formulating an appropriate investment strategy has two aspects. The first aspect is the requirement to have regard to the whole of the circumstances of the superannuation fund. The second aspect is the requirement to expressly consider the four issues set out in paragraph 7.1(b).

Taking account of the circumstances of the superannuation fund

7.8 The circumstances of a superannuation fund which are relevant to the investment covenants include:

- (a) the amount of the money available for investment (a certain amount of money will not be investible but will have to be retained in order to pay fund expenses and liabilities such as audit fees, account preparation fees, government charges and tax liabilities);
- (b) the likely increase in the amount of money available for investment (ie amount of future contributions or transfers/rollovers to the fund, less a margin for tax liabilities and expenses arising in respect of such contributions, transfers and rollovers);
- (c) the investment horizon of each member (ie the period of time before which the member is likely to require their benefit to be cashed out);
- (d) the risk profile of each member;
- (e) whether the members form age groups (eg likely to access their benefits at the same time);
- (f) whether the members are likely to take their benefits as lump sums or in pension form; and
- (g) whether any member currently is or soon will be in pension phase.

7.9 Further the financial/investment circumstances of the members of a fund are also relevant to the circumstances of that fund. They include:

- (a) whether a member has other superannuation investments and, if so, the amount of those investments and the investment strategies which currently apply to those investments; and
- (b) whether a member has non-superannuation investments and, if so, the amount of those investments and the current investment strategies which apply to those investments.

7.10 Therefore it is feasible that an investment strategy that would otherwise be inappropriate without having regard to the external circumstances of members may be appropriate for the

fund after consideration of those external circumstances. Equally the reverse is true.

- 7.11 The statutory obligation imposed on a trustee of a regulated superannuation fund is to have regard to the listed factors when formulating the investment strategy. The statutory obligation is not that every investment strategy must exhibit or satisfy each listed factor.
- 7.12 In our view, an investment strategy of investing in one or two asset classes may still be an appropriate investment strategy if the trustee has considered the need for diversification and has a reasoned position as to why the investment strategy is not diversified. That reasoned position may be that the current level of investible funds is too small for diversification or that the members of the superannuation fund have other investments (whether in superannuation or not) which provide sufficient diversification.
- 7.13 The proposed investment strategy is to invest, on a geared basis, a material proportion of the investible funds of the Fund in the acquisition of the Property. The Trustee in our view will be able to justify the proposed investment strategy where:
- (a) they have grounds to believe that the expected return on the Property is reasonable given the risk associated with real estate investments of the nature of the Property;
 - (b) they have grounds to believe that the members have investments in other superannuation funds or non-superannuation investments which when considered with the investment in the Property provides a sufficient degree of asset class diversification;
 - (c) they have grounds to believe that the Fund will be able to pay (either from current assets, future earnings and/or future contributions) all debts of the Fund (including interest repayments on the borrowing) as and when they fall due;
 - (d) they have grounds to believe that the Fund will not be adversely impacted by the need to pay benefits of the members (ie that holding a substantial illiquid asset like real estate will not preclude them being able to readily liquidate the investment in order to pay benefits); and
 - (e) there is a specific plan to diversify investments over time as part of the investment strategy.
- 7.14 Generally the following information/documents would provide reasonable grounds for the Fund Trustee in respect of the matters identified:
- (a) market information as to the likely capital appreciation of the Property;
 - (b) statements/representations from the members as to their other investments (whether in superannuation funds or not);
 - (c) cashflow projections for the Fund which show the Fund being cash positive after payment of all expected outgoings;
 - (d) statements from the members as to their retirement intentions (when they are likely to access their benefits and the form in which they will access their benefits);
 - (e) contingency arrangements (eg risk insurance cover) in respect of unexpected benefit claims (eg death, disability); and
 - (f) risk management control or mechanisms to manage borrowing risks.

If you or your accountant have any questions or comments in relation to the enclosed documents please do not hesitate to let us know.

Yours faithfully,
TOWNSENDS BUSINESS & CORPORATE LAWYERS



PETER TOWNSEND BA, LLB, FAICD, FCLA
Principal