

## Frequently Asked Questions

### SMSF Investments in Related Unit Trusts

#### 1. Pre-1999 Unit Trust undertakes additional borrowing to fund improvements

##### Question

The ABC SMSF owns 100% of the units in the DEF Unit Trust, a pre-1999 unit trust whose only asset is a rundown warehouse. Can the unit trust borrow additional funds to provide substantial renovations to the warehouse? In the course of borrowing funds the unit trust will allow a mortgage to be placed over the warehouse.

##### Response

Section 71A of the SIS Act provides for exceptions for pre-11 August 1999 investments and loans in related companies and trusts with regard to the in-house asset provisions. Section 71A(1) provides that where an asset of a superannuation fund (the unit in a unit trust) consists of a loan to or investment in a company or trust made before 11 August 1999, this asset is not an in-house asset of the fund after this date.

**Refer Section 71A** [http://www.austlii.edu.au/au/legis/cth/consol\\_act/sia1993473/s71a.html](http://www.austlii.edu.au/au/legis/cth/consol_act/sia1993473/s71a.html)

However, in addition to section 71A, section 71(1)(j)(ii) provides for the SIS Regulations to also exempt an investment in a related unit trust from being an in-house asset of the SMSF. Specifically SIS Regulations 13.22B and 13.22C provide for investments in related unit trusts to be exempt from being an in-house asset provided certain criteria are met.

Two provisions contained in 13.22B and 13.22C ((2)(e) and (2)(f)(iii)) prohibit the unit trust from having outstanding borrowings, and from holding an asset to which a charge applies.

This therefore leads to the following dilemma. Section 71A exempts a pre-1999 unit trust from being an in-house asset, and so too do Regulations 13.22B and C, provided the unit trust has no borrowings or charge over the assets. So can a trust borrow or not?

The answer is that section 71A applies to the fund's initial investment in the pre-1999 unit trust. Therefore, the good news is that based purely on the facts contained above, the pre-1999 unit trust is permitted to have outstanding borrowings, and it can take out additional borrowings to fund the improvements.

However, as stated in ATOID 2012/53, any additional units the SMSF acquires in the pre-1999 unit trust after 28 June 2000 will not be afforded the in-house asset exemption found in Regulation 13.22B or C because of Regulation 13.22D(1)(c).

For example, suppose the ABC SMSF owned 100 units in the DEF Unit Trust at 11 August 1999. In accordance with Section 71A, the 100 units are exempt from being an in-house asset meaning the unit trust can have outstanding borrowings. Fifteen years later section 71A continues to apply to the initial 100 units and the unit trust, meaning the unit trust can still have outstanding borrowings and undertake further borrowings.

However, rather than the DEF Unit Trust borrowing to fund the renovations, the ABC SMSF acquires an additional 50 units in DEF Unit Trust for \$200,000 on 1 January 2014. As the additional acquisition is post 28 June 2000, SISR 13.22C potentially applies rather than 13.22B. However because these additional units are in a geared unit trust which has a charge over its assets, 13.22C does not apply to the new units.

##### Conclusion

***In conclusion, a pre 11 August 1999 unit trust is permitted to have outstanding borrowings, and to undertake additional borrowings, as it is afforded an exemption under section 71A of the SISA from being an in-house asset. However any new units the fund acquires after 28 June 2000 lose their exemption found in Regulation 13.22B and C if any of the items found in 13.22D are found to exist.***