Transferring Victorian property out of trusts and into SMSFs without duty

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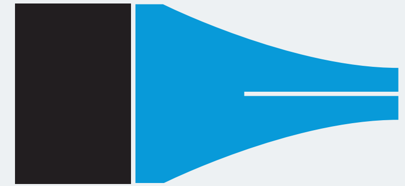

This article examines the ability to transfer Victorian real property out of trusts and into self-managed superannuation funds without triggering duty under the *Duties Act 2000* (Vic).

Moving business real property out of trusts and into a self-managed superannuation fund (SMSF)[1] can have significant tax advantages.[2] Despite the significant potential of these tax advantages, there are often impediments to moving business real property into an SMSF, in the form of possible tax and duty consequences of the transfer, especially where the property is held in a unit trust or a discretionary trust and limits are imposed by the non-concessional caps.

Legislative references are to the *Duties Act 2000* (Vic) (Duties Act), unless specified otherwise.

Background

In this article, we examine the ability to transfer Victorian business real property out of trusts and into an SMSF without triggering duty. This can include the transfer of a property from a unit trust to a unit holding discretionary trust, then from that discretionary trust to an individual beneficiary, and finally from an individual beneficiary to an SMSF as a contribution.

Although we have concentrated on the duty exemptions, we have also briefly examined some of the other considerations that need to be taken into account for such transfers.

It should be noted that the application of the duty exemptions discussed in this article are complex, and that the Victorian State Revenue Office (SRO) has strict evidentiary requirements when determining whether the exemptions apply. This article only provides a high-level overview of the exemptions and only as they are relevant for the purposes of this article, that is, moving business real property out of trusts into SMSFs.

Transfer of property from a unit trust to beneficiary unit holder who is a trustee of a discretionary trust

Section 36B sets out a number of exemptions that apply to transfers from a unit trust to certain classes of unit holders without consideration (ie a capital distribution rather than a sale), including to unit holders who are individuals or trustees of SMSFs. There are a number of preconditions that must be satisfied in order to obtain the exemption, which are broadly set out as follows:

- duty was paid by the trustee of the unit trust in relation to the property when the property was first acquired by the unit trust;
- at the time when the property was acquired by the unit trust, the relevant unit holder held units in the unit trust;
- the dutiable value of the property transferred does not exceed the value of the units held by the unit holder;
- as a result of the transfer, the value of the unitholder's unit holding in the unit trust is reduced by the same amount as the dutiable value of the property transferred; and
- the Commissioner is satisfied that the transfer is not part of a sale or other arrangement under which there exists any consideration for the transfer.

It should be noted that if, at the time of the distribution of the property, the unit holder holds more units than it did when the unit trust acquired the property, then that unit holder will only receive a duty exemption proportionate to the units it held at the time when the unit trust acquired the property.

It is also important that no consideration passes between the parties in relation to the transfer. The Duties Act specifically provides that, if a unit holder gives a mortgage over the property, or assumes any liability under an existing mortgage, this will not be treated as a form of consideration under s 36B.[3]

One of the most common unit trust structures is where the unit holder is a discretionary trust. If that is the case, pursuant to s 36B(2), the duty exemption can still apply for a distribution to a unit holding discretionary trust, although the application of the duty exemption in such circumstances is restricted. In particular, there is a requirement that the beneficiaries of the unit holding discretionary trust must be restricted to:

- natural persons who were beneficiaries of the discretionary trust when the property was acquired by the unit trust; or
- a corporation, all of the shareholders of which are natural persons who were shareholders of the corporation at the time when the unit trust acquired the property.

These natural persons or corporate beneficiaries of the discretionary trust must hold their rights or interests in the discretionary trust in their own right (ie they cannot hold these rights or interests as a trustee of another trust), and they must have been a beneficiary at the time when the unit trust acquired the property. However, an exception from the latter requirement arises when individual beneficiaries subsequently become beneficiaries of the discretionary trust because they either marry, or become a child of (including an adopted child), an existing beneficiary.[4]

Often the typical discretionary trust will not satisfy these restricted beneficiary

requirements. Therefore, the discretionary trust deed will need to be amended, prior to the transfer of the property, to specifically exclude beneficiaries that do not fall within the s 36B requirements. The provisions of the trust deed must be carefully considered prior to making any amendments to ensure that such amendments are not prohibited by the trust deed. In our experience, the SRO will grant this exemption even if the discretionary trust deed is amended shortly before the distribution.

Transfer of property from a discretionary trust to an individual beneficiary

Again, like the unit trust exemption, s 36A provides for a number of exemptions that apply in relation to transfers from a discretionary trust to a beneficiary without consideration. These requirements are similar to those contained in s 36B as discussed above.

Although there are a number of beneficiaries to which the exemption will apply, the most common, and, for the purposes of making superannuation contributions, the most important, is the exemption for transfers to individuals. There are a number of requirements required to be satisfied in order to receive this exemption, including that the beneficiary must have been a beneficiary of the discretionary trust when the discretionary trust acquired the property.[5] This requirement extends to certain beneficiaries who subsequently become beneficiaries by reason of becoming a spouse or domestic partner of an existing beneficiary or by being a lineal descendant, adopted child or step-child of an existing beneficiary.

When transferring property to an individual beneficiary, s 36A(1)(e) requires that the transfer must be to an individual absolutely and there must be no consideration for the transfer.[6] In relation to the latter requirement, there may be potential issues if loans, or unpaid present entitlements (UPEs), exist between the discretionary trust and the relevant beneficiary, and those loans or UPEs are forgiven as a result of the transfer.

Contribution of property from an individual to their SMSF

The final exemption examined in this article is the exemption for transfers from an individual to their SMSF.

In contrast to the requirements for the above exemptions, the requirements for transfers from individuals to their SMSFs are relatively simple and are set out in s 41(1). That section broadly states that no duty will be chargeable in respect of a transfer of dutiable property if:

- the transfer is made without monetary consideration (ie it is a contribution to the SMSF rather than a sale);
- the contribution is made to a complying superannuation fund;[7] and
- there is no change in the beneficial ownership of the property.

It is worth noting that the SRO has accepted that a contribution of property to an SMSF where the benefit of the property is allocated to the member account will not result in a change in beneficial ownership.

Other considerations

Aside from duty, other notable considerations in relation to the distribution and contribution of real property from trusts and to SMSFs include the following:

Breaches of fiduciary duties

In the recent Victorian Court of Appeal decision of *Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd*,[8] the director of a corporate trustee of a discretionary trust was found to have breached his fiduciary duties to the corporate trustee when he effected a distribution from a discretionary trust to himself as a beneficiary (and which funds were ultimately contributed to an SMSF). It is therefore important to consider a director's and a trustee's fiduciary obligations before a capital distribution is effected.

Trust deed requirements

It is important to ensure that the trust deeds, and SMSF deeds, have the necessary provisions and powers to make capital distributions and to accept transfers of property as contributions. This includes that the relevant persons are beneficiaries of the trust, that the trust has the necessary power to make capital distributions and transfers of assets, and that the discretionary trust satisfies the unit trust duty exemption requirement (if applicable, as discussed above).

Before any changes are made to the trust deeds, any resettlement consequences should be considered. In addition, the effect that these changes may have to the administration of the trust in the future ought to be contemplated (for example, if the classes of beneficiaries of the discretionary trust are reduced).

Will the distribution put the trust into deficit?

As a practical consideration, the distribution of property from a trust will often put that trust into a technical (if not a real) deficit. It is therefore important to consider how this can be rectified, especially in light of the SRO's view that a transfer made in conjunction with the payment/forgiveness of a UPE may be consideration (and, therefore, the duty exemption may not apply).

Tax

The distribution of property from trusts, or the contribution of property to SMSFs, will trigger CGT consequences where, assuming that the property is on capital account, the property's market value exceeds its cost base. Where applicable, such tax consequences could be reduced using the small business tax concessions.[9]

Where CGT is payable, the cost of such a tax is a factor when making a cost benefit analysis of undertaking the transaction (especially in light of the concessional tax treatment for the property in the SMSF). That is, will the upfront cost of paying CGT be offset over time by the tax savings of having the property in the SMSF?

GST

Where the transferor of non-residential property is registered for GST, then GST must be considered. Where the recipient is not registered for GST and the transfer is treated as a taxable supply, then 1/11th of the market value of the property will be payable by the transferor as GST, while the unregistered recipient will not be able to claim it back. In such situations, the GST will be a sunk cost of the transfer.

In scenarios like this, it should be considered whether the transferor can deregister (after taking into account any adjustments), or whether the recipient can register for GST. In cases involving the latter, potentially no GST will be triggered on the basis that the transfer is not a taxable supply, or the going concern exemption applies.

Contribution caps

From 1 July 2014, the non-concessional contributions cap increased, as a result of indexation, to $180,000 per year. For individuals who are able to exercise the

"bring-forward rule", they can bring forward three years' worth of contributions in the one year.[10] For example, they could make non-concessional contributions of $540,000 for the 2014-15 year (meaning they could not make any further non-concessional contributions for the 2014-15 to 2016-17 years).

Therefore, a member can effectively stagger the contribution of a property over the 2014-15 and 2015-16 financial years (ie make a $180,000 non-concessional contribution prior to/on 30 June 2015 and a $540,000 non-concessional contribution on or after 1 July 2015), which will allow for total non-concessional contribution transfers of the property of up to $720,000 for an individual, or $1,440,000 for a couple.

If the value of the property is more than $720,000 (or, where couples are making the contributions, $1,440,000), the SMSF could buy the excess amount from the member(s) (noting that any part of the property purchased will be subject to duty).

In addition, the member may be able to utilise the small business tax concession contribution caps, allowing the member to make further contributions of up to $1,355,000 for the 2014-15 year.

Acceptance of contributions

Contributions can only be accepted by an SMSF if permitted under the *Superannuation Industry (Supervision) Regulations 1994* (Cth). Those regulations restrict the acceptance of contributions by members aged 65 and over. For members aged between 65 and 75, non-concessional contributions can only be accepted if they satisfy the "work test", that is, during the financial year, members in that age group must work for 40 hours during a 30-day period. Members aged 75 cannot make non-concessional contributions.

Conclusion

This article has briefly considered the potential to transfer Victorian properties from trusts to SMSFs without duty. However, it is important to note that such transfers involve a number of complex considerations. Therefore, anyone contemplating such transfers must review all of the relevant issues, and requirements, before effecting such a transaction.

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References

1 References to trusts and SMSFs in this article include, where applicable, the trustees of those trusts and SMSFs in their capacities as trustees.

2 Concessional tax treatment applies to the SMSF on rental income of 15%, and CGT on the sale of the property at the rate of 10% (if the property is held by the SMSF for 12 months). Further, if the SMSF is in pension phase, any income and capital gains generated in the SMSF will be tax-free and an SMSF member who is over 60 years of age will also receive tax-free payments from the SMSF.

3 This exception is set out in s 36C. However, under that section, the Commissioner may impose duty on a transfer if he is satisfied that the giving of the mortgage or the assumption of the liability under an existing mortgage is part of a sale or other arrangement designed to take advantage of an exemption or concession under s 36, 36A or 36B.

4 S 36B(2)(c)(i)(A), (B) and (C).

5 S 36A(1)(b).

6 Section 36C also applies here so that any mortgage given over the property or an assumption of a liability of an existing mortgage over the property will not be treated as a sale or an arrangement.

7 A complying superannuation fund is a fund that complies with either s 42 or 42A of the *Superannuation Industry (Supervision) Act 1993* (Cth).

8 [2015] VSCA 9.

9 The concessions contained in Div 152 of the *Income Tax Assessment Act 1997* (Cth), including the 15-year exemption, the retirement exemption, the active assets 50% reduction and the small business roll-over, may be able to be applied so that any capital gain may be effectively reduced to nil.

10 An individual is eligible to exercise the "bring-forward rule" under reg 7.04(3) of the *Superannuation Industry (Supervision) Regulations 1994* if they are 64 years or less on 1 July of that financial year (ie its operation can be triggered in the financial year in which the member turns 65).