

# In-House Asset Compliance

## What is an In-house Asset?

The definition of an in-house asset (IHA) is found in s71 SIS and includes:

1. An asset of the fund that is a loan to a related party of the fund
2. An investment in a related party or trust of the fund
3. An asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund

A fund can invest in any of these IHAs if the market value ratio of the fund's IHA is 5% or less, calculated by the following formula:

$$\left[ \text{Market value ratio of fund's in-house assets as at the end of that year of income} - 5\% \right] \times \text{Value of fund's assets as at the end of that year of income}$$

The in-house asset formula utilises total fund assets rather than net fund assets, which may lead to a higher IHA ratio than necessary if incorrectly applied.

Assets listed below are specifically not considered to be IHAs as per s71 SIS:

- a) A life insurance policy
- b) A deposit with an approved deposit-taking institution
- c) Business real property leased to a related party under a lease or lease arrangement
- d) An investment in a widely held trust
- e) An investment in a related entity that meets the requirements of r13.22C

## Who is a Related Party?

The definition of a related party ([subsection 10\(1\) SIS](#)) is any one of the following:

1. All members of the fund (as defined by the governing rules)
2. Standard employer sponsors (who contribute under an arrangement between the employer and trustee)
3. Part 8 associates of the members or standard employer sponsors (defined under Part 8 SIS – the IHA rules)

While the first two conditions are reasonably straightforward, the definition of a Part 8 associate can confuse even the most experienced SMSF professional with sections 70B, 70C, and 70D applying under Part 8.



## Section 70B SIS

Section 70B provides the answers to who is a Part 8 associate of individuals (who are the fund members), and these include:

1. Relatives of each member and their spouses
2. All other members of the SMSF
3. All other trustees, both individual trustees or directors of the corporate trustee
4. A partner in partnership with each member
5. Any spouse or child of those business partners
6. Any company the member or their Part 8 associates control or influence
7. Any trust the member or their Part 8 associates control

Control of an entity occurs when the SMSF and its related parties own more than 50% of the voting power of a company or more than 50% of the unit capital of the trust.

The SMSF can also control an entity when it is sufficiently influenced by the member and/or a Part 8 associate of that member.

Determining control and influence is challenging and requires understanding the relevant facts, circumstances, and practical testing. It also depends on how each entity makes decisions and reviewing documents such as minutes, the trust deed and the constitution.

## Sections 70C & 70D SIS

Section 70C refers explicitly to a standard employer-sponsor, and s70D covers partnerships.

Unless an SMSF has a standard employer-sponsor, they are irrelevant in identifying related parties of members.

## Applying the In-House Assets Rules

The reportable rules set down by the ATO that apply to IHA breaches are s82, s83 and s84 SIS. The following provides an overview of how each rule applies to IHA.

### s82 SIS

Where the IHA level exceeds 5% at the end of the income year, the fund triggers s82 SIS and the trustees must prepare a written plan that:

- a. Specifies the excess IHA amount.
- b. Set out the steps to reduce the limit of the fund's IHA ratio to 5% or less during the following year of income.
- c. Each trustee must ensure that the steps in the plan are carried out.



## Timing

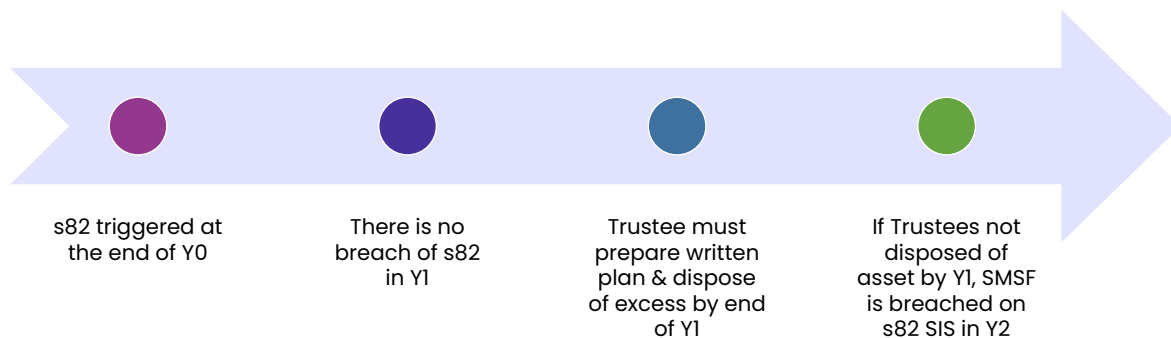
When a s82 breach is identified at the end of the income year (“Y0”), the trustees are required to take action in the following year of income (“Y1”).

Where the trustees meet the requirements of s82, no breach of s82 is reported to the ATO.

The reason is that s82 only requires the trustee to prepare a plan and reduce the level of IHA down to 5% or less by Y1.

If the trustees have not provided a written plan year to the SMSF auditor by Y1 OR the trustees have not reduced the IHA level to 5% or less in the year of income year after Y1 (“Y2”), the s82 breach is reported to the ATO.

The following timeline visually represents how s82 breaches get reported to the ATO:



## What if Market Value Changes Next Year?

Where an SMSF triggers a s82 breach in Y0, the trustee must meet the requirements of s82 in Y1 to avoid a reportable breach in Y2.

When the market value of fund assets changes so that the excess value in Y1 no longer exceeds the 5% allowable limit, the trustees must still meet the requirements of s82 triggered in Y0 and dispose of the asset.

The reason is that any subsequent change to the IHA value in Y1 onwards does not affect the breach in Y0 and the trustee’s requirements to comply with s82.

## s83 & s84 SIS

Where the IHA level exceeds 5% at any time during the year or the end of the income year, s83 and s84 will be reportable breaches.

The difference is that s83 and s84 is a reportable breach at any time during the year, whereas s82 is triggered at a point in time at the end of the income year (30 June).

It means that when an asset becomes an in-house asset at any time during the income year but is reduced to 5% or less or is disposed of before the end of the income year (30 June), the fund has breached s83 and s84.



## How Does a Lease Arrangement Work?

Where a lease to a related party exceeds the 5% IHA level during an income year, it is the value of the asset that counts towards the IHA value. Not the value of the lease.

In line with s71 SIS, the definition says it is “an asset subject to a lease or lease arrangement”, meaning the asset is the IHA, not the lease.

## During the Year

When the asset is used by a related party during the income year, such as residential property used by a member, the asset is an IHA during the period where the related party uses the property.

Assume the fund owns a residential property rented to a related party on 1 September, which is vacated on 31 December. The property is an IHA of the fund during those dates.

Where the value of the IHA asset ratio exceeds 5% during that period, the fund breaches s83 and s84, which is reported to the ATO.

## At the End of the The Year

If the IHA exceeds the 5% level at the end of the year, the fund still breaches s83 and s84 because they apply at any time of the year.

Essentially, the fund will trigger the requirements under s82 (which is not reportable in that year of income, Y0) but will breach s83 and s84, which are reportable to the ATO in Y0.

## Checklist for Identifying Related Entities & IHA Breaches

The gateway to understanding whether there is a related entity and a potential in-house breach requires the following steps:

1. Identify who the related parties are
2. Calculate the proportion of shares or units held in the related entity
3. Check whether the fund or related parties hold a controlling interest or can sufficiently influence the decisions of the entity – such as by having a casting vote
4. Once identified, related party entities require further procedures:
  - a. Review the entity’s financial statements for borrowings, non-arm’s length dealings and that all distributions paid at the end of the financial year
  - b. Determine whether there are loans, investments, or leases to related parties and do any IHA exemptions apply (such as r13.22c entities)
  - c. Identify IHA, calculate the % and obtain a written plan by the trustees to dispose of the excess down to 5% or less by the next financial year where necessary.