

# ***SMSFR 2008/1EC - Compendium***

 This cover sheet is provided for information only. It does not form part of *SMSFR 2008/1EC - Compendium*

## **Ruling Compendium – SMSFR 2008/1**

A compendium of responses to the issues raised by external parties to SMSFR 2007/D2 – Self Managed Superannuation Funds: giving financial assistance using the resources of a self managed superannuation fund to a member or relative of a member that is prohibited for the purposes of paragraph 65(1)(b) of the *Superannuation Industry (Supervision) Act 1993*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

### **Summary of issues raised and responses**

| <b>Issue No.</b>         | <b>Entity/s commenting</b> | <b>Issue raised</b><br><small>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)</small>   | <b>Response</b><br><small>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)</small>   |
|--------------------------|----------------------------|--|---|
| <b>External comments</b> |                            |  |   |
| 1                        | Entity 1                   | <p><i>Application of SISA standards to rental properties</i></p> <p>From the contents of the ruling, it can be inferred that residential property owned by a superannuation fund can be rented out to a member or relative of a member provided the rent is a properly managed commercial level of rent. It should be made clear in the Ruling whether this is the case.</p> | <p><i>Change made - New example 15 at paragraphs 172 to 174</i></p> <p>Example 15 deals with the leasing of a residential property by an SMSF to a family member. The scenario described in this example does not amount to the giving of financial assistance, however paragraph 173 states that the residential property is most likely an in-house asset and therefore subject to the provisions in Part 8.</p> <p>Trustees also need to consider the sole purpose test in section 62 – see footnote 129, paragraph 173.</p> <p>Other than noting the potential for other provisions to apply, the application or contravention of other provisions is beyond the scope of this Ruling. This Ruling focuses on when a trustee or investment manager provides a member or their relative with financial assistance using the resources of the SMSF.</p> <p>ATO ID 2002/659 and ATOID 2004/92 are also relevant to this issue.</p> <p>ATOID 2004/92 states that a contravention of section 66 occurs if an SMSF purchases residential property, which is managed by a property manager, from a member of the SMSF.</p> <p>ATOID 2002/659 states that a contravention of Division 3 occurs if an SMSF leases residential property to a member/s of the SMSF and the value of that leased property compared to the total assets of the SMSF exceeds the in-house asset limits.</p> <p>See also draft SMSF Ruling SMSFR 2008/D3 which discusses residential property in the business real property context.</p> |

| Issue No. | Entity/s commenting | Issue raised<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)  | Response<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)  |
|-----------|---------------------|---|--|
| 2         | Entity 2            | <p><i>Example 9 (paragraphs 114-116): release from an obligation</i></p> <p>With regard to Example 9 and the comment 'Paragraph 65(1)(b) would also be contravened....if the rent is allowed to fall into arrears'.</p> <p>In commercial practice with non-related parties rent can and does fall into arrears. Further explanation maybe required with the amount and period of arrears relevant to a breach of 65(1)(b). Additionally, s109 would appear to be the more appropriate section for reporting of such arrears.</p>  | <p><i>Change made – paragraph 111 and Example 5 (formerly Example 9) at paragraphs 112 to 115</i></p> <p>Paragraph 111 explains that delay in taking recovery action for a debt owed by a member or relative of a member is financial assistance to that member or relative whereas pursuing the member or relative for the debt would not be the giving of financial assistance even though there is an amount outstanding. See also paragraphs 114 and 115 of Example 5.</p> <p>These changes to the Ruling make it clear that the mere fact rent has fallen into arrears does not mean that the trustee or investment manager is giving the member or relative financial assistance. Rather, financial assistance is given by the trustee or investment manager if they in effect <i>permit</i> the rent to remain unpaid.</p>  |
| 3         | Entity 2            | <p><i>Example 13 (paragraph 139-140): acquisition of equipment and lease to family partnership</i></p> <p>With regard to example 13 the facts appear to be:</p> <ol style="list-style-type: none"> <li>1. The fund purchases stoves etcetera from an unrelated party – appears to be no breach of SISA (investment strategy permitting).</li> <li>2. The fund leases these items at commercial rates to the member's partnership – appears to be no breach provided less than 5% of the fund's in house assets.</li> <li>3. Sale to related party at end of lease on arms length terms – appears to be no breach.</li> </ol> <p>The example indicates that these facts together cause a breach of 65(1)(b). Accordingly, the issue is at what point does the breach of 65(1)(b) occur and should be reported.</p> <p>[Note: Example 13 is now Example 12 at paragraphs 163 to 165 of SMSFR 2008/1.]</p> | <p><i>Change made – footnote 35, paragraph 31</i></p> <p>Footnote 35 has been expanded to further explain the reporting requirements for auditors contained in section 129. That is, an auditor of an SMSF is required to report contraventions <i>immediately after forming the opinion</i> that it is likely that a contravention may have occurred, may be occurring or may occur in relation to the SMSF.</p> <p>Currently, the 2007 instructions on how to complete the auditor/actuary contravention report (ACR) (NAT 11299-06) state:</p> <p><b>Date when contravention first occurred</b></p> <p>Complete the date when the contravention first occurred. This may be in an earlier financial year than the one being audited. For example, if the fund borrowed money in an earlier financial year and the borrowing may have continued into the financial year being audited. In this situation you must include the date from the earlier financial year.</p> <p>It is not considered appropriate to deal further in this Ruling with the issue of when an auditor is required to report a contravention. However, the Tax Office is considering this comment.</p> |

| Issue No. | Entity/s commenting | Issue raised<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)   | Response<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)  |
|-----------|---------------------|--|--|
| 4         | Entity 2            | <p><i>Example 20 (paragraphs 158 to 161) and indirect financial assistance</i></p> <p>Paragraphs 67-72 provide guidance on how and why the Commissioner considers financial assistance can be given indirectly. However, these paragraphs do not appear to support the lifting of the corporate veil in Example 20.</p> <p>Example 20 indicates where a SMSF loans money to a related company, the shareholders are considered recipients of the financial assistance. While we are aware that nothing in part 8 limits the operation of section 65, this reasoning would appear to severely restrict the operation of the 5% limit on in-house assets.</p> <p>Extending the reasoning, any loan to a related company of which the members are shareholders would be a breach of 65(1)(b), despite being on commercial terms and less than 5% of fund assets. Further justification is required to explain why the corporate veil is lifted.</p> | <p><i>Change in view - Examples 14 and 20, as they were in the published draft Ruling SMSFR 2007/D2, have been deleted as the view expressed in those examples has changed.</i></p> <p>The change in view is now reflected at paragraphs 211 to 213 and illustrated by Example 24 (paragraphs 214 to 216). Financial assistance is not indirectly given to members, or relatives of members, of an SMSF that are shareholders in a company merely because the SMSF gives financial assistance to that company. Although an SMSF giving financial assistance to a company may not contravene paragraph 65(1)(b), other relevant considerations include the sole purpose test in section 62, the investment strategy requirements in section 52 and regulation 4.09 of the SISR, the restriction on acquiring assets from a related party in section 66, the provisions concerning the in-house asset limits in Part 8 and the arm's length requirements in section 109 – see paragraph 212.</p> <p>Further guidance is also given to determining whether financial assistance is given indirectly by an SMSF to a member or a relative of a member. See the indirect financial assistance section of the Ruling at paragraphs 187 to 216 and, in particular, paragraphs 190 to 194.</p> |
| 5         | Entity 3            | <p><i>Format and language</i></p> <p>The form of the information is clearly targeted at practitioners who are familiar with this form of guidance. There may be a need to communicate it in a different format for use by others.</p>  | <p><i>Changes made</i></p> <p>The Tax Office is considering this comment.</p> <p>However, in this Ruling the following changes have been made:</p> <ul style="list-style-type: none"> <li>• additional examples added to assist people in understanding the views expressed in the Ruling (see issue 15 below);</li> <li>• minor revisions made to other examples to improve the explanation and clarify the facts;</li> <li>• a table summarising all the Examples in the Ruling has been added (see Appendix 1);</li> <li>• a Glossary has been added (see Appendix 3) to explain certain terms used in the Ruling; and</li> <li>• more generally, the Ruling has been revised to improve its structure and readability.</li> </ul>  |

| Issue No.   | Entity/s commenting | Issue raised<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)  | Response<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)  |
|---|---------------------|---|--|
| 6   | Entity 3            | <p><i>Application of other SISA standards to examples</i></p> <p>The ruling discusses the single issue of giving financial assistance using the assets of the fund and has failed to address other matters which may result in breaches of the SISA.</p> <p>The ruling needs to clearly state that only paragraph 65(1)(b) has been considered and that the cases presented may be prohibited by other areas of the legislation. For example, Example 21 (paragraphs 163 to 165 of SMSFR 2007/D2) does not set out sufficient information for the user of the ruling to understand that the loan is only possible if the investment in the related company does not exceed 5% of the fund assets.</p> | <p><i>Changes made to further highlight that other provisions may also apply to the Examples given. Example 21 (of SMSFR 2007/D2) has been deleted. Given the change in view as explained at issue 4 above this example is redundant.</i></p> <p>Paragraph 2 states that the Ruling does not provide the Commissioner's views on how other SISA or SISR provisions apply to any of the arrangements discussed in the Ruling.</p> <p>Other provisions that may apply to a particular example are noted throughout the Ruling either in the text or as footnotes. The new summary table of examples (Appendix 1) also highlights other provisions that may be applicable. However, as this Ruling is about the application of paragraph 65(1)(b) only see also the cautions that have been added at paragraphs 28 and 85.</p> <p>Examples given in the Ruling are not restricted to examples that contravene only paragraph 65(1)(b) as an arrangement can contravene more than one provision of the SISA and the SISR. It is also useful to make it clear when paragraph 65(1)(b) is not contravened even though the arrangement may contravene another provision(s), for example, see paragraphs 211 to 216.</p> |
| 7   | Entity 3            | <p><i>Value of loan</i></p> <p>The ruling does not address the issue of how to value a financial benefit. For example is it the value of the loan or the loan plus accrued interest?</p>  | <p><i>No Change</i></p> <p>This issue is beyond the scope of the Ruling. The Tax Office is considering this comment.</p>   |
| <b>Other changes made to the ruling that are not reflected in the above responses to the issues</b> |                     |   |  |
| 8   |                     | <p><i>The meaning of 'relative' at paragraph 66 is incorrect</i></p>  | <p>The meaning of relative was incorrect in SMSFR 2007/D2 as it omitted parties related to the member's spouse, for example the spouse's bother. This has been corrected. See paragraph 74.</p>  |

| Issue No. | Entity/s commenting | Issue raised<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)  | Response<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)   |
|-----------|---------------------|---|---|
| 9         |                     | <i>Gift of assets at paragraphs 78 to 82</i>  | A footnote has been added (see footnote 95, paragraph 87) to note that the comments of Holland J in <i>North Sydney-Apollo Printing (1976)</i> 1 ACLR 392 (a company law case) lend support to the view that gifting an asset can be financial assistance. In that case, Holland J found the argument that financial assistance should be limited to the giving of money or moneys worth untenable.   |
| 10        |                     | <i>Belmont Finance Corp v William Furniture Ltd &amp; Ors [1980] 1 All ER 393 (Belmont Finance) at paragraph 87</i>   | The discussion of <i>Belmont Finance</i> has been revised. Paragraph 98 discusses <i>Belmont Finance</i> to the extent that it provides support for the view that purchasing an asset at an inflated price is financial assistance.<br>To the extent that <i>Belmont Finance</i> discusses the purchase of an asset by a company that it does not genuinely need or want in order to provide the vendor with funds being financial assistance, the case is now discussed at paragraph 183. It is more relevant at this point in the Ruling where the discussion concerns the acquisition of an asset by the SMSF in circumstances that do not reflect a usual or normal commercial arrangement. |
| 11        |                     | <i>Non-arm's length terms at paragraphs 93, 94-96 (Example 4) and 121</i>   | The Ruling has been adjusted to clarify that it is financial assistance if the non-arm's length terms are favourable to a member or relative of a member as opposed to situations where the non-arm's length terms are favourable to the SMSF. See, for example, paragraphs 15 (2 <sup>nd</sup> bullet point), 103, 137 (2 <sup>nd</sup> bullet point).   |
| 12        |                     | <i>Factors that indicate that an arrangement or transaction is in substance a financing arrangement providing financial assistance to a member or a relative of a member using the resources of an SMSF at paragraphs 14 and 120.</i>   | The Ruling has been adjusted to remove references to 'purpose' where the Ruling lists the factors that indicate that an arrangement may be a financing arrangement. This is to avoid any confusion as between the reference to purpose and the listed factors. See, for example, paragraphs 15 and 137.   |
| 13        |                     | <i>One of the factors indicating that an arrangement may be financial assistance was as follows:<br/>...under the arrangement or transaction an amount is paid by the SMSF, and later repaid to the SMSF, in amounts or in a manner that may be equated in a commercial sense with the repayment of a loan with interest<br/>(paragraphs 14 and 121, 5<sup>th</sup> bullet point)</i> | This factor has been adjusted to make it clear it is a relevant factor if there is repayment of an amount to the SMSF <i>whether with or without an interest component</i> . See paragraphs 15 and 137, 5 <sup>th</sup> bullet point.   |

| Issue No. | Entity/s commenting | Issue raised<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)   | Response<br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)  |
|-----------|---------------------|--|--|
| 14        |                     | <i>Arrangements which concern a sole trader or a partnership</i>   | <p><i>See paragraph 9 and footnote 6; and paragraph 75 and footnote 74</i></p> <p>The Ruling explains that financial assistance is given to a member or relative of a member if the member or relative is: a partner in a partnership that is financially assisted (as a partnership is generally not a separate legal entity from its partners); or the sole trader that is financially assisted.</p> <p>However, if the partnership has been incorporated with legal personality separate from that of the partners, it is necessary to consider whether there is indirect financial assistance to a member or a relative of a member.</p>   |
| 15        |                     | <i>New examples added to the Ruling (other than those already mentioned above) illustrating contraventions of paragraph 65(1)(b)</i>   | <ul style="list-style-type: none"> <li>• Example 8 (paragraphs 131 to 133) illustrates an indemnity given using the resources of an SMSF for the benefit of a member or relative of a member.</li> <li>• Example 10 (paragraphs 153 to 158) illustrates an arrangement where the member of an SMSF uses the resources of the SMSF to liquidate shares held by the member, which were somewhat illiquid, in order to finance the member's business venture.</li> <li>• Example 20 (paragraphs 196 to 200) illustrates a loan from an SMSF to a company and subsequently a loan from the company to its member shareholders.</li> <li>• Example 21 (paragraphs 201 to 204) illustrates a gift from an SMSF to a discretionary trust which the trust then distributes to beneficiaries who are SMSF members.</li> <li>• Example 22 (paragraphs 205 to 207) illustrates an SMSF investing in a business so that SMSF members can access goods at cost price.</li> <li>• Example 23 (paragraphs 208 to 210) illustrates an SMSF buying equipment from a company, leasing it back to the company and the company lending the proceeds of sale to its member shareholders.</li> </ul> |
| 16        |                     | <p><i>Examples that have been deleted from the Ruling to avoid unnecessary repetition (other those already mentioned above)</i></p> <p>Example 6, paragraphs 105 and 106; Example 7, paragraphs 107 and 108; Example 8, paragraphs 109 and 110</p> | <p>Examples 6, 7 and 8, which dealt with an SMSF giving a guarantee or a charge over SMSF assets, are not included in SMSFR 2008/1 to avoid unnecessary repetition.</p> <p>The view concerning guarantees and charges is now comprehensively illustrated by Example 7 (paragraphs 126 to 129), which replaces Example 5 of SMSFR 2007/D2 (paragraphs 103 and 105).</p>   |

| <b>Issue No.</b> | <b>Entity/s commenting</b> | <b>Issue raised</b><br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2007/D2)  | <b>Response</b><br>(Unless otherwise noted, references are to Examples and paragraphs in SMSFR 2008/1)   |
|------------------|----------------------------|--|--|
| 17               |                            | <p><i>Examples that have been more significantly adjusted</i></p> <p>Example 10, paragraphs 118 and 119 – now Example 6</p> <p>Example 11, paragraphs 133 to 135 – now Example 9</p> | <p>Example 6 (paragraphs 119 and 120) has been adjusted to more closely align the facts with the recent Federal Court case <i>Deputy Commissioner of Taxation (Superannuation) v. Fitzgeralds</i> [2007] FCA 1602; [2007] ATC 5105.</p> <p>Example 9 (paragraphs 149 to 152) has been adjusted to reflect a planned arrangement.</p> |