

SMSFs & sole purpose test

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13 September 2008

In the new SMSFR 2008/2, the ATO discusses the application of the sole purpose test to the provision of benefits by a SMSF to its members. In particular, the ATO outlines the factors that need to be taken into account in determining whether trustees of a SMSF have maintained their fund solely for the purposes specified in section 62(1) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**).

Sole purpose test

The sole purpose test prohibits a trustee of a SMSF from maintaining a fund for purposes other than the provision of the benefits specified in section 62(1) of the SIS Act. In that section, there are two permissible purposes, as follows:

- **core purposes** - mainly for the provision of benefits relating to retirement or death benefits for, or in relation to, a member; and
- **ancillary purposes** - mainly for the provision of benefits on the cessation of a member's employment or other death benefits and approved benefits not specified in the core purposes.

The trustee must maintain the SMSF either:

- for one or more of the core purposes; or
- for one or more of the core purposes **and** one or more of the ancillary purposes.

However, the sole purpose test does not require a trustee of a SMSF to maintain a fund so that the same types of benefits are provided:

- to each member of the fund; or
- in respect of each member of the fund (section 62(1A) of the SIS Act).

Any trustee that maintains a SMSF for a purpose other than that mentioned above is in contravention of the sole purpose test (SMSFR 2008/2, paragraph 4).

Administering the sole purpose test

The ATO is of the view that the sole purpose test requires strict compliance. In particular, the test requires exclusivity of purposes in which a higher standard is applied than the dominant or principal purpose test (SMSFR 2008/2, paragraph 7).

The determination of whether a SMSF is being maintained for any purposes within the sole purpose test involves an objective assessment and thus requires an assessment of all the events and circumstances surrounding the operation of the SMSF (SMSFR 2008/2, paragraph 5).

During the entire existence of a SMSF, a trustee is required to maintain the SMSF in a manner that complies with the sole purpose test at all times. The sole purpose test extends to all activities undertaken by the SMSF during its life cycle and broadly encompasses the following:

- accepting contributions;
- acquiring and investing fund assets;
- administration of the SMSF, including maintenance of the structure of the SMSF;
- employing and using fund assets; and
- payment of benefits, including benefits on or after retirement (SMSFR 2008/2, paragraph 6).

Even the provision of benefits by a SMSF to members that are incidental, remote or insignificant may breach the sole purpose test. The determination of whether such benefits are incidental, remote or insignificant requires an objective and holistic assessment of all the facts and circumstances of the case. In general, benefits, other than those covered by the sole purpose test, which are not inherent or unavoidable consequences of legitimate activities of a SMSF will contravene the sole purpose test (SMSFR 2008/2, paragraph 9).

The following table outlines the factors that may be relevant to a particular case in determining whether the provision of benefits, other than those specified in section 62(1) of the SIS Act, contravene the sole purpose test. It is important to

note that the list is not exhaustive and each factor should not be viewed in isolation of all the facts surrounding the case in determining whether the sole purpose test has been complied with (SMSFR 2008/2, paragraphs 12 and 13).

Maintenance not in accordance with sole purpose test	Maintenance in accordance with sole purpose test
The trustee negotiated for or sought out the benefit.	When assessed together, the benefit is remote, isolated or insignificant.
The benefit has influenced the decision-making of the trustee to favour one course of action over another.	The benefit is an inherent and unavoidable part of other activities undertaken by the trustee that are consistent with the provision of benefits under section 62 of the SIS Act.
The benefit is provided by the SMSF to the member or another party at a cost or financial detriment to the SMSF. This may include expenses incurred in providing the benefit or foregoing income in providing the benefit.	The benefit is provided by the SMSF on arm's length commercial terms and is consistent with the financial interest of the SMSF and at no cost or financial detriment to the SMSF.
There is a pattern of events that when viewed in its entirety amount to a material benefit.	All of the activities of the trustee are in accordance with the covenants set out in section 52 of the SIS Act.
	All of the SMSF's investment and activities are properly documented and considered in accordance with properly formulated investment strategies.

Other issues

The provision of current day benefits may contravene the sole purpose test.

Current day benefits may consist of the following:

- benefits provided before a member's retirement; or
- benefits provided before an employment termination or death to the member or a related party.

The provision of a current day benefit may not necessarily contravene the sole purpose test as persons may not necessarily operate in the dual capacity of trustee and member. As such, the entity deriving the benefit and the timing of the benefit

will have an impact on the determination of whether the SMSF is maintained in accordance with the sole purpose test.

Other issues of concern relate to investments in collectables and other boutique items such as works of art, antiques, jewellery, classic cars and wines, as these assets may confer a personal benefit and thus provide significant current day enjoyment by use or access to these assets. The ATO is of the view that, in some circumstances, it is sufficient if the trustee can demonstrate that the acquisition of the assets represent a reasonable investment of the SMSF (by relying, for example, on an independent expert opinion in support of the acquisition of the asset) (SMSFR 2008/2, paragraph 15).

Each SMSF has different investment strategies and its own peculiar set of facts and circumstances. According to the ATO, the sole purpose test is not to be applied rigidly to each investment activity of a SMSF. In addition, the ATO maintains the view that the sole purpose test mainly concerns how the trustee of a SMSF makes an investment or undertakes an activity. Thus, the ATO's approach, in applying the sole purpose test, takes into consideration the varied circumstances of each trustee of a SMSF when making investment decisions for the fund (SMSFR 2008/2, paragraph 16).

Conclusion

Although not legally binding on the ATO, the new SMSFR 2008/2 nevertheless provides a positive indication of the ATO's position on how it will apply the sole purpose test. In certain circumstances, it may appear that the ATO will require strict compliance with the sole purpose test. However, its holistic approach, in certain cases, will reduce the need for the otherwise strict and rigid application of the test. Since SMSFs are generally family operated funds and thus often not adequately resourced, the risk of losing complying status will have serious ramifications for the SMSF and its trustee if the contravention is in fact only minor.