

## **SMSFs & financial assistance**

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In general, a self-managed superannuation fund (**SMSF**) is prohibited from providing financial assistance to members or relatives of members of the SMSF (section 65(1)(b) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**)).

Since the SIS Act does not define the expression “financial assistance”, it is not clear what types of activity are covered by the prohibition. *SMSF Ruling SMSFR 2008/1* sets out the ATO’s views on the issue. This article discusses the ATO’s views.

### **Statutory basis**

The SIS Act sets out certain rules that need to be met by a SMSF to ensure that the fund is a complying superannuation fund. One of these rules is the rule against the provision of financial assistance in section 65(1)(b) of the SIS Act.

A SMSF may not lend money to members or relatives of members (section 65(1)(a) of the SIS Act). The rule that the ATO considers in SMSFR 2008/1, however, is the rule preventing the provision of financial assistance, other than actual lending of money (section 65(1)(b) of the SIS Act).

### **Financial assistance**

The expression “financial assistance” is not defined in the SIS Act. It, therefore, takes on its ordinary meaning in the context of the SIS Act. The ATO’s attitude is that the term “financial assistance” having regard to its context means the taking of actions by SMSF trustees that diminish or may diminish the worth of the fund in favour of members or relatives who do not meet a condition of release, to the

prejudice of members' retirement savings.

### ***Assistance***

The term "assistance" connotes the providing of something that is needed or wanted by the assisted party constituting a benefit, aid or help. It can cover assistance given even if the assisted party did not request it (SMSFR 2008/1, paragraphs 50 to 51).

### ***Financial***

The assistance must be "financial assistance" for a contravention of the SIS Act to occur. The ATO sets out various transactions that constitute financial assistance, such as the making of a gift, the forgiveness of a debt or the giving of a guarantee or indemnity (SMSFR 2008/1, paragraph 57).

### ***Using resources of fund***

Finally, the assistance must use the resources of the fund. Clearly if the assets of a SMSF are reduced as a result of the giving of financial assistance, the assistance has made use of the resources of the fund (SMSFR 2008/1, paragraph 62).

However, the resources of the fund can also count as being "used" even if they are in no way reduced. Arrangements may count as using the resources of the fund even with a nil or positive effect on the net assets of the SMSF (SMSFR 2008/1, paragraph 71).

### **Members or relatives of members**

The financial assistance in question must be given to a member or relative of a member of the SMSF.

"Member" under the SIS Act covers anyone who receives a pension from the SMSF or has a deferred entitlement to receive a benefit from the SMSF (section 10(3) of the SIS Act).

“Relative” means the member’s spouse as well as the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendent and adopted child (or their spouses) of the member or the member’s spouse (section 65(6) of the SIS Act).

The ATO states that if a relative of the member is a partner or sole trader, then financial assistance to the partnership or sole trader counts as being given to the relative of the member (SMSFR 2008/1, paragraph 75).

### **Particular arrangements**

Although the question of whether a given arrangement breaches the prohibition on the provision of financial assistance depends on the circumstances of each case, the ATO provides the following list of instances of where financial assistance may be given:

- gifting an SMSF asset;
- selling an SMSF asset for less than market value;
- purchasing an asset for greater than market value;
- acquiring services in excess of requirements;
- acquiring services at inflated prices;
- forgiving debts;
- releasing someone from a financial obligation, even where the amount is not yet due and payable;
- delaying recovery of a debt;
- satisfying or taking on a financial obligation;
- giving a guarantee or indemnity; and
- giving a security or charge over SMSF assets (SMSFR 2008/1, paragraph 86).

### **Other arrangements**

Some arrangements other than those listed above may or may not breach the prohibition, depending on whether, objectively in light of the commercial reality and the facts of the case, the arrangement or transaction in substance provides financial assistance to a member using the resources of the SMSF (SMSFR 2008/1, paragraph 136).

Factors that assist in determining whether such assistance arises include the following:

- the SMSF is exposed to a credit risk or the financial risk of a member or relative;
- the arrangement is not at arm's length and is favourable to a member or relative;
- the arrangement is outside usual commercial arrangements for SMSFs;
- the arrangement is inconsistent with the investment strategy of the SMSF;
- an amount is paid by the SMSF and then repaid to the SMSF in a manner similar to the repayment of a loan; and
- there is diminution of the assets of the SMSF, whether immediately or not (SMSFR 2008/1, paragraph 137).

It should be noted that, even though the SIS Act allows SMSFs to acquire certain assets from members or relatives or lease certain assets to members or relatives (eg under the business real property exemption in section 66(2)), the ATO considers that such arrangements must **still** not contravene the prohibition on the provision of financial assistance (SMSFR 2008/1, paragraph 147).

### **Indirect assistance**

According to the ATO, even **indirect** financial assistance to relatives counts as being financial assistance, given that the purpose of the SIS Act is to ensure that the resources of SMSFs are used only for retirement purposes (SMSFR 2008/1, paragraph 187).

Indirect assistance may be provided, for instance, where a third party provides financial assistance to the member or relative upon the condition that the SMSF enter into some arrangement with the third party (SMSFR 2008/1, paragraph 188).

Indirect assistance may also arise where an entity such as a company or trustee of a trust receives financial assistance from the SMSF and then in effect passes on that assistance to the member or relative (SMSFR 2008/1, paragraph 191).

### ***Determining indirect assistance***

However, in order to determine whether indirect assistance has been provided, it must be proved that, in the facts and circumstances of the case, the financial assistance given by the third party is sufficiently connected to the use of SMSF resources to effect the assistance.

The following elements can indicate indirect assistance:

- the financial assistance is such that it would not have been given by the third party entity had the SMSF not entered into an arrangement with that entity that uses SMSF resources;
- the third party entity, in effect, passes on the financial assistance given to it by the SMSF, including the situation where the financial assistance passes through a chain of third party entities before reaching the member or relative; or
- there is some other factor that indicates that financial assistance given by the third party entity was in some way reliant, conditional or dependent on SMSF resources (SMSFR 2008/1, paragraph 194).

### ***Form of assistance***

The form of financial assistance by the third party can be of any of the different types listed above, such as gifts and indemnities. A lending of money by the third party might not fall within section 65(1)(a), as the funds are not lent by the SMSF directly, but the lending might still fall within section 65(1)(b) (SMSFR 2008/1, paragraph 141).

### ***Permitted arrangements***

However, not all assistance is forbidden by section 65(1)(b) of the SIS Act. The following arrangements, for example, are permitted:

- if the SMSF invests on commercial terms in an unrelated entity, and the entity gives financial assistance to the member or relative independently of the SMSF and in its own right, there is no contravention of section 65(1)(b); and

- if the payment is a pension or lump sum to the member that is in accordance with the payment standards and sole purpose test, this also does not count as a contravention of section 65(1)(b) (SMSFR 2008/1, paragraphs 217 to 222).

## **Conclusion**

*SMSF Ruling* SMSFR 2008/1 places significant pressure upon SMSF trustee/members to be cautious about giving any form of benefit to themselves and/or their relatives. According to the ATO, even indirect financial assistance, or arrangements that seem to avoid the exact meaning of the provision can contravene section 65(1)(b) of the SIS Act.

The wide interpretation given to the scope of the prohibition by the ATO, arguably, places many ordinary commercial arrangements between SMSFs and members and/or their relatives within the ambit of the financial assistance prohibition. Given the consequences of the breach of the prohibition, however, a narrower interpretation may have been preferable.