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SMSFs & related party acquisitions

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A trustee or investment manager of a SMSF is prohibited from intentionally acquiring an asset from a related party of the fund, subject to certain exceptions (section 66 of the *Superannuation Industry (Supervision) Act* 1993 (Cth) (**SIS Act**)).

In the recently issued draft SMSFR 2008/D2, the ATO explains the effect of section 66(1) of the SIS Act. This article discusses the ATO's views.

Statutory basis

The Government introduced section 66(1) to ensure that concessionally taxed superannuation is used solely for retirement purposes and not as a source of pre-retirement financing for members. Specifically, the section is designed to prevent members from selling their private assets or contributing their assets in a way that does not necessarily increase members' retirement income (SMSFR 2008/D2, paragraphs 27 to 28).

In broad terms, the section requires:

- the SMSF "to acquire an asset";
- from a "related party" of the fund.

We will now consider the meaning of the above two expressions.

To acquire an asset

The phrase "acquire an asset" has a wide meaning, encompassing the acceptance of a contribution of an asset (SMSFR 2008/D2, paragraph 6).

The ATO's view is that the acquisition of an asset by way of acceptance of a contribution can be viewed as an investment within section 66(2A)(a) of the SIS Act (SMSFR 2008/D2, paragraph 22).

However, the phrase "acquire an asset" does not cover the acceptance of money (section 66(5) of the SIS Act). Acceptance of money includes contributions of cash, or a money order, or an electronic funds transfer, or a cheque, or a promissory note. However, if a promissory note is traded as a commodity in its own right it is considered to be an object of exchange, rather than a medium of exchange. Therefore, it will not be considered a contribution of money.

Collectible bank notes and coins or trade or barter dollars are not considered to be a contribution of money for the purposes of the related party acquisitions rule (SMSFR 2008/D2, paragraphs 13 to 16).

It should be noted that there is no contravention if a monetary payment is made by a related party of a SMSF to a third party to extinguish a liability the SMSF has with that third party (SMSFR 2008/D2, paragraph 17).

Related party

For the purposes of the rule, the expression "related party" is defined to include:

- any member of the fund or employer-sponsor of the fund; and
- an associate of either a member or an employer-sponsor of the fund (section 66(5) of the SIS Act).

Conduct constituting breach

A contravention of the related party acquisitions rule in section 66(1) of the SIS Act requires both a physical element and a fault element.

If the physical element is the conduct of acquiring related party assets; then the corresponding fault element is the intent to acquire those assets (SMSFR 2008/D2, paragraphs 76).

The contravener of the rule is not necessarily the person/entity that acquires the legal ownership of the assets, but rather the person/entity that accepts or obtains the asset.

Direct proof or inferential reasoning is required to show a breach of section 66(1). To have inferential reasoning one has to consider all the facts and circumstances of the case such as the awareness or likelihood that the asset acquired is that of a related party (SMSFR 2008/D2, paragraphs 9 to 10).

Below is a non-exhaustive list of factors that need to be considered in assessing whether there has been a breach of the related party acquisitions rule:

- a SMSF is invariably a small closely held fund such that the trustee or investment manager is likely to know of the relationship between a contributing person or entity and the SMSF;
- whether the trustee or investment manager has had any previous dealings with the contributing person or entity; and
- the nature of the asset and whether it is likely to be contributed by an unrelated party of the SMSF (SMSFR 2008/D2, paragraph 10).

Exceptions

There are number of exceptions to the prohibition on related party acquisitions. Examples follow:

- listed securities acquired at market value;
- business real property acquired at market value;

- asset acquired under a merger of regulated superannuation funds; and
- the asset is the member's own interest in the transferring fund or is that member's entitlements as determined under Part VIIIB of the *Family Law* Act 1975 where the other person's interests in the transferring fund are that of the member's spouse or former spouse; and the transfer or roll over occurs as a result of that member's marriage breakdown (section 66(2) of the SIS Act and *Self-managed Superannuation Funds (Assets Acquired on Marriage Breakdown) Determination* 2006 SPR 2006/MB1).

The ATO is of the view that the assets listed above may be acquired from a related party of the SMSF, if the asset is partly purchased by and partly contributed to the SMSF.

However, where the market value condition needs to be met, the sum of the purchase consideration and the amount recorded as the contribution must equal the market value of the asset (SMSFR 2008/D2, paragraph 20).

Under section 66(2A) of the SIS Act, a SMSF may acquire an asset which constitutes an investment from a related party in certain circumstances if the asset is acquired at market value and the acquisition of the asset does not result in the level of in-house assets of the fund exceeding the 5% market value ratio limit of the SMSF.

The ATO notes that only the exception in section 66(2)(b) and in-house assets subject to a lease or lease arrangement between the SMSF and a related party within the exception in section 66(2A)(a)(i) of the SIS Act apply to interests in real property acquired by an SMSF as tenants in common with a related party of the SMSF (SMSFR 2008/D2, paragraph 24).

Conclusion

SMSFR 2008/D2 outlines the effect of section 66(1) of the SIS Act on SMSFs. It is clear from SMSFR 2008/D2 that the purposive approach has been taken by the ATO in its application of the legislation. Its approach is mainly to prevent SMSFs from using the fund as pre-retirement funding. It also further prevents members from moving their private assets into a concessionally taxed environment in a manner that does not necessarily increase the net value of the SMSF. As a result, it places an onerous duty on SMSFs in the way assets are acquired by the fund.