

Can an SMSF lease residential property to a related party?

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“No” is probably the first answer that comes to mind but it is actually “maybe”, if we are to believe the full Federal Court in the judgement it handed down in the *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation* [2018] case last month.

One of the issues the Court examined is whether the leasing of a student accommodation unit owned by a related sub-trust of the fund to the daughter of the sole member would cause the trustee to breach the sole purpose test.

According to the Court such an arrangement, if conducted in the right manner and circumstances, will not breach the sole purpose test. While this is the latest judicial decision on this issue, the position may still change in the future if the ATO decides to appeal the decision to the High Court.

So what are the right circumstances?

The sole purpose test is concerned with the purposes for which assets are maintained by the fund. This means that if acquiring the property is a prudent investment that will provide returns for the provision of membership benefits in the future, then it is consistent with the core and/or ancillary purposes set out in the legislation.

A fund is prohibited from providing a present benefit to members or their relatives. However, provided the fund can show the tenant could have obtained accommodation elsewhere (i.e. they were not an unsuitable tenant) and the fund could have leased the property to an unrelated tenant (i.e. the property was not unsuitable), then leasing the property to a related party who pays market rent will not generally confer any financial or other non-incidental benefits to the related party or the member.

It is crucial that the arrangement is conducted at arms' length (and the fund can show supporting evidence) and the relative pays market rent (ideally supported by rental history, though valuation may be enough).

For example, some of the key factors in the case were that the property had been rented out twice to unrelated students for a period of one year each, the rent paid by the daughter matched the rent paid by the unrelated former tenants (noting that the Court did not expect the rent to have increased over that

period), and the leasing of the property was handled by an unrelated third party without any direct involvement by the director/member of the fund.

The Court took the view that, in the above circumstances, the identity of the tenant was irrelevant in determining whether the fund had complied with the sole purpose test or not.

It was noted that the failure to pay market rent would most likely result in the trustee breaching the sole purpose test as it could be inferred that the fund was instead maintained for the collateral purpose of providing accommodation to a related party at a discounted rate.

Such an inference could also be drawn if the arrangement had impacted the investment strategy of the fund. Similarly, a breach may occur if there is evidence of a collateral purpose to the arrangement.

So it is unlikely that the arrangement would comply if it could be shown that the main purpose of the fund buying the property was to provide accommodation to the related party.

One of the judges did caution that the purpose of the trustee in entering into the transaction (i.e. diversifying its asset pool for the purpose of deriving income and capital growth) is not to be confused with the subjective factors motivating the person(s) controlling the trustee.

The argument that the fund fails the sole purpose test simply by virtue of entering into a transaction with a related party is not supported by the wording of the Superannuation Industry (Supervision) Act 1993 (Cth).

However it is important to keep in mind that while the arrangement may not breach the sole purpose test, it may still be in breach of other limitations in the SIS Act (such as in-house asset rules for instance).

So as always, whether this can be done or not depends on the facts and circumstances of each particular case and it is best to seek professional advice before acting.

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