



Self Managed Superannuation Funds Ruling

SMSFR 2009/4

Self Managed Superannuation Funds: the meaning of 'asset', 'loan', 'investment in', 'lease' and 'lease arrangement' in the definition of an 'in-house asset' in the Superannuation Industry (Supervision) Act 1993

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SMSFR 2009/4 history

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Contents	Para
What this Ruling is about	1
Ruling	4
Funds to which the Ruling applies	30
Date of effect	31
Appendix 1 Summary of examples	32
Appendix 2 Explanation	33
Appendix 3 Legislative framework	132
Appendix 4 Detailed contents list	194

Preamble

This publication represents the Commissioner's view about the way in which provisions of the *Superannuation Industry (Supervision) Act 1993*, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Rulings (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than this ruling indicates, the fact that you acted in accordance with this ruling would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law.

The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

What this Ruling is about

1. This Ruling explains the core concepts in the definition of 'in-house asset' of a self managed superannuation fund (SMSF) as defined in section 71 of the *Superannuation Industry (Supervision) Act 1993* (SISA).¹ The core concepts are 'asset', 'loan', 'investment in', 'lease' and 'lease arrangement'.

2. The meaning of 'in-house asset' also relies on the definition of a 'related party' and a 'related trust' and is subject to the exceptions in paragraphs 71(1)(a) to (j) and subsection 71(8). The precise nature of some of the exceptions is set out in regulations 13.22B, 13.22C and 13.22D in the Superannuation Industry (Supervision) Regulations 1994 (SISR). The meaning of 'in-house asset' is also subject to the transitional provisions in sections 71A to 71F of the SISA. This Ruling summarises these definitions, exceptions and transitional provisions in Appendix 3, but does not analyse them in detail.

3. This Ruling also does not provide the Commissioner's views on how other SISA and SISR provisions apply to any of the arrangements discussed in this Ruling.²

Ruling

4. Subsection 71(1) provides a basic definition of the term 'in-house asset' of a superannuation fund. There are several exclusions to this definition contained in paragraphs 71(1)(a) to (j). Further transitional exclusions are contained in sections 71A to 71E in respect of arrangements which were in place prior to the end of 11 August 1999. Finally, Part 8 contains anti-avoidance clauses specifically to counter arrangements which are designed to fall outside of the in-house assets provisions.

Basic definition of 'in-house asset'

5. 'In-house asset' is defined in subsection 71(1) as:

an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund, ...

6. This part of the definition contains many terms which are defined in the SISA and require further consideration.

The meaning of 'asset'

7. The term 'asset' is defined in subsection 10(1) to mean 'any form of property' and includes money whether Australian currency or foreign currency. The term property is not defined in the Act and therefore takes on its ordinary meaning.

8. It is the Commissioner's view that the phrase 'any form of property' has a very wide meaning. It includes every type of right, interest or thing of value that is legally capable of ownership and encompasses both real property and personal property. While assignability is generally a characteristic of a proprietary right it is not in all cases an essential characteristic.

9. Real property includes land and interests in land, for example an easement. Personal property includes all forms of property other than real property and includes tangible personal property such as gold bullion and intangible personal property that can be enforced by legal or equitable action such as a debt or an interest in a trust fund respectively. Other examples of assets include:

- a freehold interest in land;
- rights arising under a contract; and

- an option to acquire something; a boat; machinery; shares in a company; units in a unit trust; a mining exploration licence; a mining lease; patents; trademarks; copyright.

The meaning of 'loan'

10. Subsection 10(1) defines the term 'loan' as follows:

loan includes the provision of credit or any other form of financial accommodation, whether or not enforceable, or intended to be enforceable, by legal proceedings.

11. This definition is inclusive and expands the meaning of the term substantially beyond the traditional meaning of a 'loan' which involves a payment and repayment of an amount of money. The definition of the term 'loan' in subsection 10(1) extends the scope of arrangements covered to include arrangements that are in substance financing arrangements deferring the payment of an amount. Such arrangements would include but are not limited to:

- the lending of money;
- the sale of goods or land on credit;
- instalment payment arrangements; and
- arrangements for the deferral of payment of debts or entitlements.³

12. The formality and the legal enforceability of the arrangement does not affect whether it is a 'loan' as defined in subsection 10(1). In addition, it is the Commissioner's view that 'loan' also encompasses arrangements where there is no objective purpose of gaining interest, income, profit or gain, for example, an interest free loan. It therefore covers arrangements that may not be an 'investment' for the purposes of subsection 71(1).

13. Not every situation where a payment is deferred necessarily amounts to a 'loan' under the extended definition. The Commissioner accepts that payment for goods on normal commercial terms will not amount to a 'loan', nor will late payments which were not agreed to by the trustee of the superannuation fund.

The meaning of 'investment in'

14. The term 'investment' is not defined in the SISA. However the term 'invest' is defined in subsection 10(1) as follows:

invest means:

- (a) apply assets in any way; or
- (b) make a contract;

for the purpose of gaining interest, income, profit or gain.

15. In accordance with section 18A of the *Acts Interpretation Act 1901* the meaning of the term 'investment' can be derived from the meaning of the defined term 'invest'. In this context, the corresponding meaning of the term 'investment' is the asset resulting from applying the assets of the SMSF or entering into a contract for the purpose of gaining interest, income, profit or gain. This interpretation also aligns with the general meaning of 'investment' established by the courts.

16. Having identified that an asset of the SMSF is properly classified as an investment, it is necessary to determine whether that investment is 'in' a related party or a related trust. Whether an investment is 'in' a particular entity is determined by reference to the legal rights acquired by the SMSF in return for its expenditure.

17. The word 'in' requires a direct link between the investment and the related party or related trust to be

established. However the interest is not necessarily an interest in any particular asset of the other party.

18. It is the Commissioner's view that where money or assets are provided for the benefit of a related party or related trust for the purpose of receiving income, interest, profit or gain, a sufficiently close connection will be established between the investment and that entity to enable it to be described as an investment 'in' that entity. It is the reliance on the related party or the related trust for payment on the investment which will be determinative, as this is what gives rise to the financial risk that the rules in Part 8 are designed to reduce.

The meaning of 'lease' and 'lease arrangement'

19. The term 'lease' is not defined in the Act and therefore is given its ordinary meaning.

20. In respect of real property, a lease is a 'demise' that grants a leasehold estate in the property to the lessee for a term. That is, the lessee has an interest in the land (a 'chattel real'). This can be contrasted with a licence to enter land, which does not confer any interest in the real property. Of particular importance to determining whether an agreement amounts to a lease or a licence agreement, is whether exclusive possession is granted to the property. That is, the tenant has not only the right to occupy the premises, but to exclude access to all others, including the legal owner of the land.

21. It is the Commissioner's view therefore that a lease in respect of real property will occur where the lessee is granted exclusive possession of the property, generally in exchange for a rent.

22. A lease of non-real property is referred to as a lease of chattels. A key difference between a lease of real property and a lease of chattels is that no proprietary interest in the asset is created in respect of a chattel lease. However, the right of possession granted to the hirer under the agreement, although not referred to as 'exclusive possession', nonetheless includes the right to debar or exclude others, including the legal owner, from possession.

23. It is the Commissioner's view therefore that the term 'lease' in subsection 71(1) in respect of non-real property means a legally enforceable hiring agreement involving the payment of consideration by the hirer in exchange for enforceable temporary possession of the asset.

Lease arrangements

24. The term 'lease arrangement' is defined in subsection 10(1) as follows:

lease arrangement means any agreement, arrangement or understanding in the nature of a lease (other than a lease) between a trustee of a superannuation fund and another person, under which the other person is to use, or control the use of, property owned by the fund, whether or not the agreement, arrangement or understanding is enforceable, or intended to be enforceable, by legal proceedings.

25. An arrangement 'in the nature of' a lease will resemble a lease, that is it will have some, but not necessarily all, of the characteristics of a lease.

26. From the discussion above, it is apparent that for both real property and chattels, a lease involves the granting of possession of an asset in exchange for some form of rental. The quality of that possession must include the ability to control access to that asset as against other parties, including the legal owner of that asset. This must be contrasted to custodial arrangements, whereby the custodian is charged with holding the asset but without the requisite rights of possession and control over the asset, in particular, the right to exclude or debar the legal owner of the asset from taking possession of the asset.

27. It is the Commissioner's view therefore that the term 'lease arrangement' in subsection 71(1) expands the definition of in-house assets to include informal arrangements under which a person uses or controls the use of fund property. This includes arrangements where a related party gains possession of an asset of the superannuation fund, even where no rent is payable in exchange for that possession.

Lease or lease arrangement in respect of part of the property

28. It is possible for the SMSF trustee to lease only part of some forms of property, for example, one flat in a block of flats or part of a paddock. Where an SMSF trustee enters into a lease or lease arrangement with a related party in respect to part of some property, the in-house asset is the part of the property that is leased to the related party.

Asset subject to lease or lease arrangement for part of the year

29. Where an asset is leased or subject to a lease arrangement for part of the year, the full value is an in-house asset for the period that it is leased or subject to a lease arrangement with a related party.

Funds to which the Ruling applies

30. This Ruling applies to SMSFs⁴ and former SMSFs.⁵ References in the Ruling to SMSFs include former SMSFs unless otherwise indicated.


Date of effect

31. This Ruling applies both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling.

Commissioner of Taxation

24 June 2009


Appendix 1 - Explanation

 This Appendix is provided as information to help you understand how the Commissioner's view has been reached.

32. Summarised below are examples that are included in Appendix 2 and Appendix 3 of this Ruling. The examples illustrate how section 71 applies in a given situation. Reference should be made to the particular example to fully understand the section 71 outcome.

Example No.	Example Topic	Paragraph
1.	Late payment of rent	73
2.	Annuity arrangement	89
3.	Contractual funding arrangement	91
4.	Lease of machinery to an employer	110
5.	Use of machinery in a member's business	120
6.	Part of an asset subject to a lease	125
7.	Part year lease	127
8.	Employer sponsor	138
9.	Company a related party of an SMSF	144
10.	Company a related party of an SMSF	149
11.	Controlling entity of a company	153
12.	Members and associates control a trust together	159
13.	Members and associates control a trust together	161

Appendix 2 - Explanation

 This Appendix is provided as information to help you understand how the Commissioner's view has been reached.

Legislative history

33. A substantial revision of the in-house asset rules in Part 8 of the SISA was made with the passing of the *Superannuation Legislation Amendment Act (No. 4) 1999*. The Government's policy objective was explained in the Explanatory Memorandum to the Bill⁶ as:

The primary policy objective is to ensure that the investment practices of superannuation funds are

consistent with the Government's retirement incomes policy. That is, superannuation savings should be invested prudently, consistent with the SIS requirements, for the purpose of providing retirement income and not for providing current day benefits.

34. In pursuit of these objectives, the definition of 'in-house asset' was expanded and new limits on the market value of in-house assets that can be held by an SMSF were introduced. Specifically, from the year ended 30 June 2001 onwards section 82 limits the market value of in-house assets that may be held by an SMSF at the end of each financial year to 5% of the market value of the total assets. In the event that this limit is exceeded, section 82 provides procedures which must be followed by the trustees of the SMSF to reduce the level of in-house assets within 12 months. In addition, section 83 prohibits the acquisition of an in-house asset if the 5% limit on in-house assets is exceeded or if the acquisition will cause the 5% limit to be exceeded. Section 84 imposes civil penalties on trustees where these requirements are not met in addition to the potential for the SMSF to be given a notice of non-compliance.

35. The in-house asset restrictions in Part 8 of the SISA are complemented by other rules in the SISA which apply to dealings with members, their relatives and other related parties of the SMSF. For example:

- a trustee is prohibited from maintaining an SMSF for any purpose other than for the provision of retirement and certain related benefits (referred to as the sole purpose test) - section 62. All of the activities of maintaining an SMSF are subject to this test;⁷
- an SMSF trustee or investment manager is prohibited from lending money, or providing any other financial assistance using the resources of the SMSF, to a member of the SMSF or relative of a member of the SMSF - section 65;⁸
- subject to exceptions in relation to certain derivatives contracts, an SMSF trustee cannot recognise or in any way sanction an assignment of a superannuation interest or a charge over or in relation to a member's benefits or an SMSF asset - regulations 13.12, 13.13 and 13.14 of the SISR;
- subject to specific exceptions, an SMSF trustee is prohibited from borrowing or maintaining an existing borrowing of money - section 67;^{8A}
- all SMSF investment dealings must be at arm's length or must be conducted on arm's length terms and conditions - section 109; and
- subject to specific exceptions, an SMSF trustee is prohibited from acquiring assets from related parties of the SMSF - section 66.⁹

Basic definition of 'in-house asset'

36. 'In-house asset' is defined in subsection 71(1) as:

an asset of the fund that is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund, or an asset of the fund subject to a lease or lease arrangement between a trustee of the fund and a related party of the fund, but does not include...

37. This part of the definition contains many terms which are further defined in the SISA and which require further consideration.

The meaning of 'asset'

38. The term 'asset' is defined in subsection 10(1) to mean 'any form of property' and includes money whether Australian currency or foreign currency.

39. It is implicit that 'asset'¹⁰ refers to something of economic value and thus 'any form of property' refers to property

that has economic value. This also accords with the meaning that has been ascribed to 'property' being '[a]ny type of right (that is, a claim recognised by law), interest, or thing which is legally capable of ownership, and which has a value...'.¹¹

40. *Halsbury's Laws of Australia* ¹² explains 'property' as:

'Property' means every species of valuable right and interest including real and personal property, incorporeal hereditaments such as rents and services, rights of way, rights of profit or use in land of another and choses in action, but does not include mere personal licences which are not assignable: *Minister for the Army v. Dalziel* (1944) 68 CLR 261 at 290; [1944] ALR 89; (1944) 17 ALJ 405 per Starke J. 'Property' may denote the right of a person or an object itself: *Pacific Film Laboratories Pty Ltd v. Cmr of Taxation (Cth)* (1970) 121 CLR 154 at 168; 44 ALJR 376 per Windeyer J.

41. In *Smelting Company of Australia Ltd v. Commissioner of Inland Revenue* ¹³ Pollock B, in determining whether a licence was property in a stamp duty context, described the word 'property' as one of 'very general meaning and comprehensiveness'.

42. Similarly in *Jones v. Skinner* ¹⁴ Lord Langdale M.R. states:

...it is well known, that the word 'property' is the most comprehensive of all the terms which can be used, inasmuch as it is indicative and descriptive of every possible interest which the party can have.

43. A right or interest is also capable of being property even if the transfer of it can only be accomplished with the consent of some person or authority.¹⁵

44. It is therefore the Commissioner's view that the phrase 'any form of property' has a very wide meaning. It includes every type of right, interest or thing of value that is legally capable of ownership and encompasses both real property and personal property. While assignability is generally a characteristic of a proprietary right it is not in all cases an essential characteristic.¹⁶ Real property includes land and interests in land, for example an easement.¹⁷ Personal property includes all forms of property other than real property and includes tangible personal property such as gold bullion and intangible personal property that can be enforced by legal or equitable action such as a debt or an interest in a trust fund respectively.¹⁸

45. Other examples of assets include: a freehold interest in land; rights arising under a contract; an option to acquire something; a boat; machinery; shares in a company; units in a unit trust; a mining exploration licence; a mining lease; patents; trademarks; copyright.

Meaning of 'loan'

46. Subsection 10(1) defines the term 'loan' as follows:

loan includes the provision of credit or any other form of financial accommodation, whether or not enforceable, or intended to be enforceable, by legal proceedings.

47. As this definition is inclusive, a 'loan' can be any or all of the following:

- a loan according to the general or legal usage of the term;
- the provision of credit; and/or
- any other form of financial accommodation.

General meaning of 'loan'

48. The term 'loan' is defined in the *Macquarie Dictionary* ¹⁹ as:

1 . the act of lending; a grant of the use of something temporarily: *the loan of a book*. **2** .

something lent or furnished on condition of being returned, especially a sum of money lent at interest...

49. Similarly, the *Australian Oxford Dictionary*²⁰ defines 'loan' as:

1 . something lent, esp. a sum of money to be returned normally with interest. 2 . the act of lending or state of being lent...

50. In the Victorian Supreme Court case of *Brick and Pipe Industries Ltd. v. Occidental Life Nominees Pty. Ltd. and others*,²¹ Ormiston J noted at pages 321-322: