

## Instructions : Rent Relief of SMSF property leased to Related Party due to COVID 19

### **Introduction:**

Trustees of SMSFs that own property leased to related parties may be finding that they are falling behind in paying rent to their SMSFs under the lease conditions due to the economic downturn affecting their business arising from COVID-19.

The tax office has provided a practical approach of broadly not applying compliance resources to this issue for FY2020 and FY2021 where the SMSF Trustee has offered rent relief to their tenants, including if the tenant is a related party of the SMSF. However from a legal perspective, if these matters are not carefully documented, SMSFs and their trustees/directors could potentially face the risk of significant penalties under the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA') and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('SISR').

### **Synopsis:**

Trustees of SMSF do not have to offer any rent relief to a related party tenant even if the tenant's business is affected due to COVID 19 and is eligible to claim job keeper payments from ATO. However, if the Trustees decide to offer any sort of rent relief, such as reduction in rent or deferment of rent etc for a certain period of lease, this offer should be, as if the SMSF is dealing with an arm's length tenant. This means that any reduction of rent or deferment of rent, should be on commercial basis and as per industry norms. All genuine relief should match and be according to "how other landlords are treating their tenants" in the area where the property is located.

**For example:** If the property is a restaurant and due to the pandemic is allowed to operate only as a take away due to restrictions imposed by the government. Before Trustees can determine the extent of relief to be provided to related party tenant, they must investigate what other owners, who own similar properties in the area where the property is located are offering to their tenants. Hence, if other property owners are offering 50% discount on rent for 6 months and 25% deferment and tenants are paying only 25% of the existing rent and if Trustees offer 100% rent discount, to a related tenant, they will be breaching SIS provisions.

If related tenant is not eligible for any job-keeper support and there is no reduction in the tenant's turnover due to COVID 19, any discount in rent, by the Trustees, will be categorised as a breach of Section 65 of the SIS Act - *providing financial assistance* and Section 62 -*Sole purpose test*. Auditors will be checking evidence collected by Trustees and may report any wrong doing in a contravention report to the ATO.

The federal government has issued a Leasing code of conduct which runs as long as the job-keeper initiative and expires on 20th December 2020. At the time of writing this document, it cannot be predicted on how long the current situation will last due to pandemic COVID 19 and any further extension will be granted by the government or not.

Any recovery of deferred rent can extend till the period of the existing lease term. If the pandemic lasts longer, the lease itself can be extended. At this point of time, it is recommended that any recovery of rent is finalized before 30th June 2021, the date which ATO has suggested for compliance exemption. The landlord (SMSF Trustee) can offer a shorter period of assistance to the tenant, say three months, with continuous monitoring of the situation, with a view of extending it further, if required.

If the rent relief is offered "at normal terms" - this document guides and provides Trustees the process to vary their existing lease.

## DETAILED EXPLANATION

### What are the main issues:

If the tenant is not related to SMSF Trustee (landlord), then the SMSF trustee may grant rent relief without contravening the SISA because the two parties are probably dealing at arm's length for reasons supporting a rent reduction or rent postponement. In this situation, we highly recommend that Trustees engage a solicitor to amend their commercial lease with their tenants.

Similarly, where the SMSF wants to grant any concession or deferment of rent under an existing lease to a related party, the Trustees should, after taking appropriate legal advice, take appropriate steps to ensure that it does not breach any law.

**Possible SIS Act breaches:** Some of the key legislative issues of SMSF Trustee dealing with a related party tenant are:

- **Section 71 - In-house Asset** : Any non-payment of rent will be considered as a loan by the SMSF to a related party and if that loan exceeds 5%, it will contravene in-house asset rules.
- **Section 65 - providing financial assistance to a member or relatives:** SMSF can breach this rule if the lease terms to a member or relative are not at arms' length basis.
- **Section 62 - Sole Purpose Test:** If a non-arm's length landlord grants an un-commercial concession to an related tenant, that act could be categorised as not in the SMSF's best interests.

Before deciding the amount of any concession to be offered to a related tenant, gathering evidence on "COVID 19 related offers" by other landlords in the area where the property is situated (prevailing market trend) is the key to avoiding any possible breaches. Discussions with local real estate agents, federal government announcements & any rebates offered by state government for land tax or discount in council rates etc should form part of the calculation - just to ensure that any rent terms negotiations with the related tenant were similar to an arm's length tenant.

Trustees should also review their existing lease to ensure all clauses for variation are picked for amendment to reflect any concession in rent that has to be granted. This variation to the existing lease agreement can be prepared by a qualified lawyer, however we have noticed many such leases are prepared in-house. Hence, in the following pages we have provided a template which can be used by Trustees.

### Property owned via a Non - Geared Unit Trust

ATO have also announced that they will offer similar treatment, that is not applying compliance resources for FY2020 and FY2021 where the Trust which owns the property has offered rent relief to their tenants if the property is leased to a related party affected due to COVID 19. This trust is generally known as 13.22C SISR trust - typically where the SMSF is a unit holder with other related parties and the trust has not borrowed.

One of the strict guidelines of this type of trust is that the trust should not borrow and Under SISR 13.22 D if the related party, who cannot afford to pay normal rent due to COVID 19 will owe rent to the trust - this amount becomes a loan to a related party by the trust and breaches SISR 13.22C trust conditions and the unit trust will cease to comply with the criteria in div 13.3A of SISR. Once any of the conditions are breached, the unit trust becomes tainted and the SMSF then must dispose off their investment in the unit trust.

If the property is leased to a related party via this trust structure, it is important that the lease terms be varied so that the trust continues to comply with the reduced rent paid on time. Our documents below should be appropriately amended to reflect the correct landlord.

## **SMSFs with related party LRBA's**

If there is a Limited Recourse Borrowing Arrangement ('LRBA') in place (loan from a related party or from a bank) for purchase of the leased property and if the SMSF offers rent discount or deferment of rent to the tenant, it is possible that the SMSF has no cash in the bank account, there could be further issues:

- SMSF may not be able to pay principal and interest to the lender. If the lender is a related party and if the related party does not take any action against the SMSF for this non-payment, then this can cause breaches of Section 62, Section 65 and Section 109 of SIS Act as mentioned above.
- If the related party lender has lent under the 'safe harbour' terms and conditions as per PCG 2016/5, and if the SMSF does not pay interest and principal of the loan amount to the lender, the ATO may consider income from the underlying asset as non-arm's length income ('NALI') to the fund.

In this situation, the related lender must offer relief similar to that being offered by unrelated lenders (banks) to their borrowers, such as 6 months relief from repayments. However any such relief offered by related party lenders must be documented. We encourage you to see our documents relating to this type of relief.

## **What else can go wrong**

SMSF Trustees, who have lost their jobs and are cash strapped in these difficult times may:

- Withdraw money from SMSF without a valid condition of release;
- Use the SMSF assets as a security for a borrowing;
- Trustees move into a residential property owned by the SMSF.

It is highly recommended that the advisor communicates very clearly with the Trustees as there are criminal, civil and administrative penalties legislated in SISA and SISR for the above breaches.

## **Auditors Role in Rent Relief to related parties**

Although it is well documented that the ATO will not devote resources to a situation where the Trustees have offered rent relief to related party tenants who are affected by COVID 19, SMSF Auditors need to ensure that this relief is at arm's - length and not excessive and based on commercial terms.

Auditors need to stay vigilant and report any non-compliance to the ATO where they see any mischief by the Trustees. Trustees must ensure that any rent relief offered to related parties is within the industry standards and as per leases code of conduct issued by the government. Since there could be various types of properties affected, such as office, retail, industrial, etc and in different locations, there can be no one percentage discount which will fit all situations. For example if a SMSF owns two properties side by side, say - a restaurant and a grocery store leased to a related party. It is possible due to COVID - 19 a 50% discount is justified to the restaurant, however, and no discount is justified for the grocery store as their business is not been affected by COVID - 19.

SMSF Auditor needs to be commercially minded and based on subjective evidence provided by the Trustee make judgement if adequate or excessive discount was provided to the related party tenant. If the Auditor comes to the conclusion that actions of the Trustees was merely designed to assist a related party without any underlying evidence documenting that the actions were consistent with an arm's length dealing then the auditor is obliged to report to ATO.

Further, the auditor must also check if appropriate steps were taken to implement variation to the existing lease, hence merely a rent reduction without any paperwork will cause unnecessary alarm.

## **Advisors role to assist Trustees**

If SMSF trustees do not take appropriate steps, the ATO can take the following actions against the SMSF upon the Auditor lodging a Contravention report

1. Administrative penalties - this could be up to \$12,600 per Trustee;
2. Rental income from the asset be treated as NALI and taxed @ 45%.

## **By using our Templates below from [www.onlinesmsfaudit.com.au](http://www.onlinesmsfaudit.com.au) - is the SMSF safe from penalties?**

The amount of rent relief offered to a related party should be at arms' length basis - this entails that the Trustees and their advisors take the initiative to find out what other landlords are offering to tenants in the same industry in the same area where the SMSF owns the property. It will be up to each Trustee to demonstrate their efforts to collect appropriate audit evidence for their Auditors.

We highly recommend that Trustees and their advisors should engage with their auditors early and have them on-board before making any decisions to either offer a discount or a deferment of payment of rent, so that their auditors are comfortable with your process of implementation of reduced rent or deferment.

The below documents and spreadsheet is our understanding of the leasing code of conduct issued by the Government and announcements by ATO, where the related party is not able to afford to pay rent to the landlord due to COVID - 19 and is seeking a relief.

We strongly suggest that our spreadsheet should be used to demonstrate to the Auditor on how rent will be waived / deferred and then recovered in future. We have built our templates after consulting with several experienced SMSF Auditors, however no guarantee is given that it will replace any legal advice to reduce risk for any penalties to be applied by ATO or contravening any applicable SISA and /or *Income Tax Assessment Act 1997* (Cth) provisions.

Documents in this package are:

1. Request from the Tenant to the landlord for rent relief due to COVID 19
2. Calculation spreadsheet for rent relief
3. Minutes of the meeting agreeing to rent relief
4. Letter from the landlord (SMSF Trustee or 13.22C Trustee) to the tenant on varying the lease terms

## Application for Rent Relief

<Date>

<Trustee of the SMSF>

<Name of the SMSF>

<Address of the SMSF>

Dear Sir, Madam:

### Request for rent waiver and deferrment

We lease the below property from you on the following terms:

Lessee Address: <Address of property leased>

Lease commencement date: <Date when lease commenced>

Lease Termination date: <Date when the lease will end>

Lease term: <Number of Years>

Current Rent: <Current rent including GST>

Next Increment in rent as per Lease: <Month or date when next increment is due>

We pay you rent on <monthly basis> in accordance of the lease agreement dated <date of lease agreement>. As a result of the current situation and Government restriction of use of the commercial spaces due to Corona virus pandemic (COVID 19), we have suffered a significant downturn in our turnover and profitability. We cannot afford to pay the rent due as per the lease above.

Our turnover has reduced by more than 30% and we are eligible for Job Keeper cash boost which we will be applying / applied for. We request you to consider a rental adjustment as requested above for your property in line with the terms set out in the mandatory code of conduct for commercial tenancies to allow us to survive as a business and continue to lease the property after these crisis are over. We are willing to provide any financial information to support reduction of turnover due to COVID 19.

We request you for a rent adjustment from <Choose one or more Rental adjustment per mandatory code of conduct / Temporary cessation of rental payments / Temporary reduction of rental payments>) from the month of <Month from which adjusted rent is requested> for a period of <number of months> months.

We request that our above lease to be varied as per the attached spreadsheet with the below figures:

Rent waiver : <\$ Value>

Period of Reduced Rent: <6> Months:

Rent Deferment: <\$ Value>

Rent deferred for a period of: <number of months> months:

Total deferred rent: <\$ Value>

Recovery of rent to start from: After <number of months> months

Recovery of rent: <Number of months>

We are hopeful that the effect of the pandemic will be over in a period of <18> months and we will be able to pay the rent as per the original lease as normal. We have every intention to occupy the property during this time and will abide to all the other conditions mentioned in the lease.

Lastly, our next annual rent increase is due on <name of the month>. We request you to defer this rent increase by another year due to the current situation and the time it will take us to recover from the current trading conditions.

We request you to vary our current lease as per the below new terms

1. Monthly Rent of <\$ Value> Waived for a period of <number of months>
2. Monthly Rent of <\$Value> Deferred for a period of <number of months>
3. Total Rent Deferred <\$ Value of Total Rent which will be deferred>
4. Deferred rent to be recovered over a <number of months> months beginning the month of <Month>

and confirm the above terms by a letter of variation of the current lease as soon as possible.

We will endeavour to continue to pay rent as proposed in this letter, however if the conditions get better or deteriorate further, we will be in contact with you further to amend the lease further to reflect the conditions as at that time.

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Signed by <Director 1 of the Lessee>  
<Name of the Lessee Company>  
<ACN of the Lessee Company>

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Signed by:  
Signed by <Director 2 of the Lessee>  
<Name of the Lessee Company>  
<ACN of the Lessee Company>

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Signed by:  
Signed by <Director 3 of the Lessee>  
<Name of the Lessee Company>  
<ACN of the Lessee Company>

**Minutes of the Meeting of**  
**<Trustee of the SMSF>**  
**<Name of the SMSF>**

Date & Time of Meeting      <Date + 1> 9.00 AM

Held at                              <Address of the SMSF>

Present                              Trustee 1, Trustee 2, Trustee 3, Trustee 4

Chairperson                      Trustee 1

Tabled                              Letter from the tenant of property <address of property>  
Schedule of proposed Lease Amendment

Discussion                        The chairperson tabled a letter received from the tenant with request to reduce rent and defer rent of the property.

After considering the request the Trustees made investigations with neighbouring landlords of similar properties and held discussions with local agents who deal with leasing of similar properties in the area.

Based on the above discussion and the current economic downturn, the trustees agree that rent relief as requested by the tenant is justified. The rent relief requested is not excessive and is in line with what other landlords are offering to their tenants.

The tenant should also be offered reduction in outgoings as being offered by office of state revenue regarding land tax and any rebates in council rates by the local council.

Resolved                        It is hereby resolved that the request of the tenant to be accepted and the terms of the lease to be varied and the letter of variation to be executed by the Trustee of the <name of the SMSF>.

Since there were no other matters to be discussed, the meeting was closed.

Signed as a true record of the meeting.

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Trustee 1  
Chairperson

<Trustee of the SMSF>  
<Name of the SMSF>  
<Address of the SMSF>

<date + 1>

<Tenant Company Name>  
<Address of the tenant>

Dear <first name of Director>,

**Re: Your request to temporary rental relief due to COVID 19**

We as a landlord acknowledge receipt of your letter dated <date of the letter> regarding difficulties you are facing in paying our monthly rent for the property <address of the property>.

We have considered your request seriously and have agreed to your proposal of reduced rent including your proposal to defer the rent for a period <number of months> months. Considering the uncertainty of the pandemic COVID 19 and the uncertainty on how long it will last, your proposal is accepted for the time being and the lease is agreed to be varied as per Annexure A of this letter.

As you can see from this annexure that the rent has been adjusted from the month of <month> and the next rental payment of <amount> is due on <date>.

In addition to the reduced rent, we are pleased to offer reduction in outgoings as offered by office in state revenue for land tax and in council rates as offered by the local council. We have also decided to defer the rent increase for another year.

At this time, we do not want to see any evidence of reduction of your turnover. As the government unfolds its measures to slowly open the economy, we withhold the right to review the terms of your lease as we continue to monitor the situation. Hence, if the situation improves we may request you to revise the terms of Annexure A. Also, on the same token, we are willing to reconsider these terms should there be a second big drop in your turnover and if there are further announcements by the government on the commercial lease code of conduct.

Please note that besides the terms of the Annexure A as to the amount of lease, any deferment or waiving of rent, you are obliged to all the remaining terms of the lease including any special conditions. We strongly request you to communicate with us should you not be able to meet your commitments as per the varied terms.

We hope that your situation improves.

Kind Regards,

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<Name of Director 1>  
<Trustee Company of the SMSF>  
<Name of the SMSF>

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<Name of Director 2>  
<Trustee Company of the SMSF>  
<Name of the SMSF>

**Variation of the Current Lease**  
**<Address of Property>**

Current Lease Terms	Details
Start Date of the Lease	
Lease Period	
Lease Expiry Date	
Current Rent per Month Incl. GST	
Next Increased date	
Increase in rent (%)	

Revised Terms due to COVID 19	Details
Reduced Rent	
Amount of Rent waivers	
Amount of Rent Deferment	
Recovery of deferred rent (Amount) Over the number of Months	
Rent to be paid from Month Including Recovered Rent	
From Month	
Revised increase in rent Date	
Amount of rent to be paid after the recovery period	

We agree to the above variation to the existing lease:

Signed on behalf of the landlord	Signed on behalf of Tenant
<name of Director1 of Trustee of the SMSF>	<name of Director1 of Tenant>
<name of Director2 of Trustee of the SMSF>	<name of Director 2 of Tenant>

