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LAWYERS

DISCUSSION PAPER

SELF-MANAGED  
SUPER FUNDS  
AND  
RELATED PARTY  
TRANSACTIONS

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## 1. INTRODUCTION

- 1.1. The rules surrounding superannuation funds are complex and ever evolving. This applies equally to a self-managed superannuation fund (“SMSF”).
- 1.2. One area which is particularly problematic is “related party transactions”. This paper examines related party transactions, and when the trustee of your SMSF can and cannot invest in a related party.

## 2. WHAT DISTINGUISHES A SMSF FROM OTHER SUPERANNUATION FUNDS?

- 2.1. A SMSF is a superannuation fund in which one or more members of the fund are appointed as the SMSF’s trustees (either as themselves or through companies controlled by one or more members). As trustee, the member(s) make decisions about the investments entered into by the SMSF and how the SMSF is managed.
- 2.2. In contrast, an industry superannuation fund or retail superannuation fund are controlled by third party entities and have much more limited investment options and associated costs of running the funds.
- 2.3. A SMSF does require the appointed trustees to have a basic understanding of the superannuation legislation. There are also a number of rules and regulations (including auditing and reporting requirements) imposed on SMSFs to ensure the funds are run to best benefit its members.

## 3. CAN A SMSF INVEST IN A RELATED PARTY?

- 3.1. A SMSF is prohibited from investing in related parties, except in a very limited number of circumstances.
- 3.2. The purpose of this prohibition is to ensure compliance by the trustee of the “sole purpose test”, being providing retirement benefits to the members of the SMSF as and when they become entitled.

## 4. WHAT IS A RELATED PARTY?

- 4.1. A related party is defined in section 10 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (“Act”).



- 4.2. A related party includes any of the following:
- (a) a member of the SMSF;
  - (b) a relative of a member of the SMSF (including spouses, children, parents, grandparents, grandchildren, aunts and uncles);
  - (c) if a member is in a partnership, the other partners in the partnership;
  - (d) any trust or trustee entity which is controlled by a member;
  - (e) a company in which a member has the majority vote;
  - (f) an employer sponsor (employer who pays superannuation contributions into the SMSF on behalf of the members); and
  - (g) an associated entity of an employer sponsor (subsidiary, parent company, or other related entity).
- 4.3. The scope of who is a related party is wide to ensure parties do not use corporate or other structures as a way in which to defeat the rules governing investment in related parties.

## 5. WHAT ARE THE EXCEPTIONS?

- 5.1. A SMSF can invest in a related party if:
- (a) **Listed Shares** – If a related party has its shares publicly listed on a stock exchange, then it is possible for the SMSF to purchase shares in the related party. These shares must be purchased at market value.
  - (b) **Business Real Property** – If the related party has an interest in land, such land being wholly and exclusively used in the operation of one or more businesses. There is no requirement for your SMSF to be running the business (e.g. can be leasing the commercial property to a third party to run a bakery). The property must be transferred at market value.
  - (c) **Investments in a widely held unit trust** – For this exemption to apply, the entitlements of the investors must be fixed (provide a set return as with unit trusts) and less than twenty (20) investors have less than 75% or more entitlement to the income or capital of the trust. An example of a widely-held trust is a managed fund. Investment in the widely-held unit trust must be done at market value.
  - (d) **Acquisition of an in-house asset** – A SMSF can acquire assets from a related party which do not meet the other exemptions provided that, on acquiring the asset, the in-house assets owned by the SMSF do not exceed five percent (5%) of the total asset value held by the SMSF. The purchase of the in-house assets must be done at market value. Acquisition of in-house assets is the most common exception used.



- 5.2. An “**in-house asset**” is an investment in, or a loan to, a related party of a SMSF.
- 5.3. Care is needed with investing in in-house assets. Ongoing care and revision of investments (particularly in respect of change in value of the investments themselves) to ensure the combined market value of the in-house assets do not exceed the 5% threshold.

## 6. WHAT ARE THE RISKS ASSOCIATED WITH RELATED PARTY TRANSACTIONS

- 6.1. There are significant consequences for a SMSF if its trustee invests in a related party and none of the exemptions apply which operate to permit such investment. The Australian Taxation Office (“**ATO**”) can impose higher tax rates on the income of the SMSF and the penalties can apply back to the date of the breach, even if the breach is not discovered until much later.
- 6.2. The ATO can also force the SMSF to sever its connection with the related party, including but not limited to winding up the related party or reducing the investment the SMSF has in the related party so it no longer breaches the 5% in-house asset test.

## 7. SUMMARY

- 7.1. There are considerable consequences if the Trustee fails to comply with the related party and in-house assets rules.
- 7.2. Trustees need to ensure at all times that the SMSF complies with the related party transactions and in-house asset rules by regularly reviewing the market value of all investments and obtaining financial and legal advice on any intended investments.

For further information in relation to the issues discussed in this paper, please contact either Alicia Pelham or Roger Curtis.

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