

COVID -19 RENT RELIEF BY SMSFs – COMPLIANCE ISSUES FOR YOUR CONSIDERATION

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COVID -19 Rent Relief by SMSFs – compliance issues for your consideration

The ATO has published in the FAQ section of their website that their compliance approach for the 2019-20 and 2020-21 financial years is that *they will not take action if a SMSF gives a tenant (even if a related party to the fund) a temporary rent reduction, waiver or deferral because of financial effects of COVID-19.*

Trustees should note that the ATO's announcement is not in the form of a binding advice and there has been no formal change in the relevant requirements in *the Superannuation Industry (Supervision) Act 1993 (Cth)* ("the SIS Act") or *the Superannuation Industry (Supervision) Regulations 1994 (Cth)* ("the SIS Regulations").

This information/checklist has been prepared as a reference material for SMSF trustees and to highlight the importance of ensuring any rent relief is on arm's length commercial terms in order to meet the key compliance requirements.

The information provided is for your consideration only and is provided to assist you in deciding whether you require a formal opinion on the issue. These comments cannot be relied upon as legal advice by either you or any of your clients.

1. SIS Act compliance requirements (sole purpose test, arm's length requirement and prohibition of financial assistance to members and their relatives).

S62 of the SIS Act requires the trustee to ensure the fund is maintained for the core purpose of providing retirement benefits to the members. Nevertheless, provision of benefits (i.e. providing rent relief to tenants) that are incidental to the core purpose may still satisfy the test in certain circumstances including where the benefit is an inherent or unavoidable part of other activities undertaken by the trustee for the core purpose and/or where the benefit is provided by the SMSF on arm's length commercial terms consistent with the financial interests of the SMSF.

In light of the Federal Government's COVID measures relating to existing tenancies including the moratorium on tenancy eviction and the requirement for good faith negotiation of rent relief for most tenancies, providing rent relief can be an unavoidable part of the trustee's genuine investment activity.

At minimum, the trustee's decision to grant rent relief should be:

- incidental to having an existing lease arrangement that is consistent with a properly considered and formulated investment strategy to provide retirement benefits to the members;
- consistent with the financial interests of the SMSF; and
- on arm's length commercial terms.

Ensuring any rent relief is on arm's length commercial terms is also important for the fund's compliance with the arm's length requirement and prohibition of financial assistance rule. Under s109 of the SIS Act, a trustee of the fund and the other party to the relevant transaction must deal with each other at arm's length or in the same manner as if the other party were at arm's length with the trustee. Additionally, s65 of the SIS Act prohibits a trustee of the fund from giving any financial assistance to a member of the fund or their relative.

To satisfy the above requirements, particularly where the tenant is a related party to the fund, any negotiation between the trustee and the tenant should be:

- on arm's length commercial terms taking into account their particular circumstances;
- consistent with any leasing laws currently applicable to the tenancy (including any mandatory code of conduct enacted through relevant state and territory legislation); and
- commensurate with the tenant's income loss (taking into account any government support payments the tenant receives)

2. Non Arm's Length Income (NALI) under section 295-550 of the Income Tax Assessment Act 1997 (Cth)

The ATO's practical compliance approach for the 19/20 and 20/21 financial years does not extend to application of NALI rules. Therefore it is important that the fund observes the NALI rules when agreeing on any rent relief with the tenant to ensure it doesn't taint the fund's rental income as NALI.

In relation to SMSFs, NALI is broadly defined and could potentially capture any income derived from an arrangement that is not on arm's length commercial terms. S295-550 of the ITAA refers to the NALI of a complying superannuation fund as income derived from an arrangement between parties not dealing with each other at arm's length where one of the following applies:

- the amount of the income is more than the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme;
- in gaining or producing the income, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme; or
- in gaining or producing the income, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

3. Summary and practical checklist

In summary, there has been no formal change in the relevant requirements in *the Superannuation Industry (Supervision) Act 1993 (Cth)* or *the Superannuation Industry (Supervision) Regulations 1994 (Cth)*, and the ATO's practical compliance approach for the 2019-20 and 2020-21 financial years is not a legally binding excuse for trustees to deviate from their ongoing responsibilities and obligations under the superannuation and tax laws.

Among other things, ensuring temporary rent relief is on arm's length commercial terms between the SMSF and the tenant is fundamental to all of the superannuation compliance and NALI issues discussed above. A practical checklist for SMSF trustees is provided below.

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Practical Checklist

No.	Steps	(Yes/No)	Comments
1	Collate and review leasing documentation and check the type/terms of the existing lease		
2	Check relevant leasing laws applicable to the fund's lease		- Advisable to check with the fund's leasing lawyer of the applicable leasing laws
3	Check if rent relief negotiation is required by law or is appropriate and in the financial interest of the fund given the COVID-19 circumstances.		<p>- Consider moratorium on tenancy eviction and inability to find a new tenant in short term.</p> <p>- If the tenant is a related party suffering financial stress as a result of the COVID-19, disregarding rent relief to the tenant may give rise to NALI (i.e. income higher than otherwise expected if the parties were dealing at arm's length)</p>
4	Initiate rent relief negotiation and request sufficient and accurate information about the financial stress suffered by the tenant as a result of COVID-19		- take into account any government support payments the Tenant receives (either directly or as passed on to the Tenant from the landlord i.e. land tax relief)
5	Conduct due diligence on comparable market to determine structure/amount of rent relief commensurate with the tenant's financial stress as a result of COVID-19		<p>- on arm's length commercial terms taking into account their particular circumstances</p> <p>- should be determined on a case by case basis and there is no set structure/amount/percentage that broadly suits all circumstances</p>
6	Implement rent reduction in accordance with the lease agreement		- advisable to formally implement the change with the fund's leasing lawyer
7	Document trustee's decision in relation to the rent relief. This should include: - details of the agreed rent reduction - reasons for the change - request/supporting evidence relied on (i.e. evidence of financial stress suffered by the tenant)		- SUPERCentral offers a general template of trustee's resolution/rent reduction request form, entitled 'COVID-19 SMSF Temporary Rent Reduction for Lease Property' and available in the toolkit section.

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