TAX TALKS

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SIS Act NANI is an important part of the sole purpose test.

SIS Act NANI

The sole purpose test is the cornerstone of Australia's superannuation system. But one fundamental issue within the sole purpose test is non-length arm's income. So the SIS Act got plenty to say about just that. And it does that in s109.

In this episode Peter Bobbin of Argyle Lawyers in Sydney discusses SIS Act NANI and its implications. With SIS Act NANI we mean non-arm's length income as per s109 SIS Act. Here is what we learned from this episode.

Sole Purpose

SIS Act NANI features in pretty much every sole purpose test court case. Every finding of a sole purpose test failure so far has involved non-arm's length dealings. Here are four landmark court cases around non-arm's length dealings.

#1 Scott's Case No. 2 in 1966

In *Scott v Federal Commissioner of Taxation (No 2); Associated Provident Funds Pty Limited v Federal Commissioner Of taxation; Belvidere Investments Pty Limited v Federal Commissioner Of Taxation* the High Court of Australia set the first landmark finding on 07 October 1966 (1966) 14 ATD 333.

#2 Raymor Contractors Pty Ltd in 1991

Raymore Contractors Pty Ltd v FCT 91 Hill J ATC 4259 is famous for having introduced the sole purpose contribution test.

#3 Pincus J in FCT v Roche and Ors in 1991

Pincus J in FCT v Roche and Ors extended the sole purpose contribution test.

#4 Triway Superannuation Fund in 2011

In *Triway Superannuation Fund and Commissioner of Taxation [2011] AATA 302,* a husband, wife and son rolled-over $41,002.91 to the SMSF. The son had introduced his parents to advisers who recommended the rollover. Unfortunately, the son subsequently took the funds from the SMSF to fuel a drug addiction.

Sole Purpose Changed Over Time

The sole purpose test started in the *Income Tax and Social Services Contribution Assessment Act 1936 – 1962* under section 23.

> *The following income shall be exempt from income tax: (j) the incomes of the following funds, provided that the particular fund is being applied for the purpose for which it was established: a provident, benefit or superannuation fund established for the benefit of the employees.*

The wording changed slightly in the *Superannuation Industry (Supervision) Act 1993 – Sect 62* which made it possible for an SMSF to run a business.

> *Each trustee of a regulated superannuation fund must ensure that the fund is maintained solely: (a) for one or more of the following purposes (the core purposes)… or (b) for one or more of the core purposes and for one or more of the following purposes (the ancillary purpose)*

So before the SIS Act it was necessary that "*the particular fund is being applied for the purpose for which it was established".* In 1992 it changed to an outcomes approach. It is now necessary that"*the fund is maintained solely:* …" for a core and possibly also an ancillary purpose.

Learnings from Scott's Case No. 2

We can learn 4 lessons from Scott's Case No. 2, which are:

1 – Keep the purpose (retirement outcome) in mind. Preservation restrictions help.

2 – When talking to clients, do not emphasis tax benefits, tax advantages, tax arbitrage and tax strategy (note also Spotless & Pt IVA), but focus on the retirement outcome.

3 – Advise SMSF trustees to put effort into paperwork.

> *"The better it looks, the less the ATO looks."*
> *Peter Bobbin in this episode*

4 – Keep the paperwork safe to prove it is true and at arm's length and the strategy matches the retirement plan.

SIS Act Section 109

Section 109 has three parts. The first part says

> *must not invest … unless the trustee… and the other party to the relevant transaction are dealing with each other at arm's length in respect of the transaction*

The second part says:

> *must not invest … if not dealing with each other at arm's length in respect of the transaction and the transaction is…more favourable to the other party than if were dealing at arm's length in the same circumstances*

And the third part says:

> *If a trustee… during the term of the investment…is required to deal … with another party that is not at arm's length … the trustee… must deal.. as if the other party were at arm's length with the trustee*

A contravention of s109 carries civil and criminal consequences, but a contravention does not affect the validity of a transaction.

Definition of NANI

The SIS Act does not define arm's length or non-arm's length. It is one-layer thick – only the trustee's non-arm's length activity is relevant as became obvious in *Montgomery Wools [2012] AATA 61*. But also see ATO Taxpayer Alert 2010/5 for more insights.

OK if Benefit

If there is non-arm's length but the super fund benefits from the transaction, then there is no breach of s109 SIS Act, but then there is still s295-550 ITAA97 to contend with, which Peter Bobbin covers in the next episode.

All this is just our brief take on the issue. Please listen to the episode above. Peter Bobbin explains all this in a much better way than we ever could.

MORE

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