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# WHO IS YOUR RELATIVE FOR SMSF PURPOSES AND WHY IS THIS RELEVANT?

Joseph Cheung and David Oon

It is important to understand who is an individual's relative for superannuation law purposes as the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA') imposes certain boundaries on an SMSF's activities in relation to an individual's relative or related party. There are two definitions of the term relative in the SISA. Oddly, in some circumstances, an individual's relative may not be their relative under the SISA. This article considers the two definitions of relative in the SISA and the main circumstances where these definitions are relevant.

## Definition under section 10 of the SISA

Broadly, section 10(1) of the SISA states that the term relative of an individual means:

- a parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the individual or of his or her spouse;
- a spouse of the individual or of any other individual referred to above.

## Main circumstances where the definition in section 10 of the SISA is relevant

We consider three main circumstances where the definition under section 10 of the SISA is relevant. These are:

1. Section 65(1) of the SISA contains a general prohibition on the trustee of an SMSF lending money of the SMSF or giving any other financial assistance using the resources of the SMSF to a member of the SMSF or a relative of the member of the SMSF.

2. Section 66(1) of the SISA contains a general prohibition on the trustee of an SMSF acquiring an asset from a related party of the SMSF.
3. The in-house asset rules in Part 8 of the SISA broadly defines an in-house asset to be 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. We illustrate the first circumstance below.

### Example

Thomas is the sole member of the Thomas SMSF. The trustee of the Thomas SMSF is Thomas SMSF Pty Ltd and Thomas is the sole director. Thomas's brother, Albert, is in financial difficulty and asks Thomas to lend him some money. Thomas knows that the Thomas SMSF has the necessary amount of cash to lend to Thomas.

However, section 65(1) prohibits the trustee of the Thomas SMSF from lending money or giving any other financial assistance using the resources of the Thomas SMSF to a relative of a member of the Thomas SMSF. None of the exceptions in section 65 apply. According to the definition of relative in section 10 of the SISA, Albert is a relative of Thomas as he is the brother of Thomas. Therefore, the trustee of the Thomas SMSF must not lend money or provide financial assistance using the resources of the Thomas SMSF to Albert.

If Thomas has enough cash in his personal bank account, he could consider lending money to Albert in his personal capacity.

As can be seen from the first circumstance, section 65(1) (the no financial assistance rule) makes a direct reference to the term relative. For the second and third circumstance (prohibition on acquiring assets from related parties and in-house asset rules), there is no direct reference to the term relative. However, the term relative is connected because of the definition of related party.

Section 10(1) of the SISA states that related party, of a superannuation fund, means any of the following:

- a) a member of the fund;
- b) a standard employer sponsor of the fund;
- c) a Part 8 associate of an entity referred to in paragraph (a) or (b).

Section 70B of the SISA contains the definition of a Part 8 associate of individuals. It states:

For the purposes of this Part, each of the following is a Part 8 associate of an individual (the primary entity), whether or not the primary entity is in the capacity of trustee:

- (a) a relative of the primary entity;

...

Tracing through these extracted provisions, a relative (as defined in section 10 of the SISA) of an individual is also a related party of an individual.

The following example illustrates the relevance of the term relative in the context of working out whether an individual is a related party.

This example shows that in certain circumstances someone who is an individual's relative in the usual sense of the word may not be their relative for superannuation law purposes.

### Example

Thomas is the sole member of the Thomas SMSF. The trustee of the Thomas SMSF is Thomas SMSF Pty Ltd and Thomas is the sole director. Thomas is seeking to use his SMSF to purchase a residential property. Thomas's aunt, Jennifer, has recently placed her residential property in Sydney on the market. Thomas's first cousin, Peter, has also recently placed his residential property in Melbourne on the market. Thomas is considering purchasing either Jennifer's property or Peter's property.

Section 66(1) states that the trustee of the Thomas SMSF must not intentionally acquire an asset from a related party of the SMSF. None of the exceptions in section 66 apply. For example, neither property is business real property.

Applying the definition of relative in section 10 of the SISA, Jennifer is a relative of Thomas as she is the aunt of Thomas. Accordingly, she is also a Part 8 associate of Thomas (as per section 70B of the SISA). She is also a related party of the Thomas SMSF (as per section 10(1) of the SISA). Therefore, the trustee of the Thomas SMSF must not acquire Jennifer's property.

The definition of relative in section 10 of the SISA does not include a cousin. Accordingly, Peter is not a Part 8 associate of Thomas and he is not a related party of the Thomas SMSF. Accordingly, the trustee of the Thomas SMSF can likely choose to acquire Peter's property at market value and on arm's length terms.

It is interesting to note that the definition in section 10(1) is not exhaustive. Broadly, the definition does not include, in relation to an individual:

- their great-grandparents, great-aunts, great-uncles or any earlier generation
- their cousins (such as first cousins and second cousins) and lineal descendants of cousins;
- the lineal descendants of their nephews;
- the lineal descendants of their nieces; and
- former spouses.

### Definition under section 17A of the SISA

The meaning of the term SMSF is defined in section 17A of the SISA. Broadly, section 17A(1) of the SISA states that the term relative, in relation to an individual means:

- a parent, child, grandparent, grandchild, sibling, aunt, uncle, great aunt, great uncle, niece, nephew, first cousin or second cousin of the individual or of his or her spouse or former spouse; or
- a spouse or former spouse of the individual, or of an individual referred to above.

Unlike the other definition of 'relative', this definition of relative casts a wider net and includes cousins.

### Main circumstances where the definition in section 17A of the SISA is relevant

Broadly, the relevance of the term relative is as follows:

- For funds with more than one member, no member of the fund can be an employee of another member of the fund, unless the members concerned are relatives. This would include cousins.
- Similarly, for single member funds with more than one trustee/director, the member must not be an employee of the non-member trustee/director, unless the member and the non-member trustee/director are relatives.

The definition in section 17A is different to the definition in section 10. Some key differences include:

- The definition in section 10 refers to 'lineal descendant'. However, the definition in section 17A refers to 'child' and 'grandchild'. This suggests that the definition in section 17A does not extend to great-grandchildren or subsequent generations. For example, an SMSF trustee may be prohibited from lending to the SMSF member's great-grandchild. On a separate analysis, if the individual employed their great-grandchild they could not both be members of the same SMSF.
- The definition in section 17A includes 'great-aunt' and 'great-uncle'. Accordingly, if a 'great-aunt' or 'great-uncle' employed the individual, they could both still be members of the same SMSF.
- Both definitions refer to 'spouse'. However, the definition in section 17A also includes 'former spouse', meaning the former spouses can share an SMSF even if one employs the other.

### Conclusion

While there is some overlap, the definitions of relative in sections 10 and 17A of the SISA do not totally match. It is important to consider whether there are any relatives involved in certain courses of action such as acquiring an asset or establishing an SMSF. This is a complex area of law and where in doubt, expert advice should be obtained. **FS**