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Technically Speaking…

Joint Ventures by SMSFs

Whether an arrangement qualifies as a joint venture or is a partnership for taxation purposes is important for purposes of the Superannuation Industry (Supervision) Act (SISA) and Regulations. Many are under the misconception that just because they think the arrangement in which they are participating is a joint venture and it is supported by documentation then it must be so. If it is in fact a joint venture and is not a partnership for taxation and SISA purposes it will bring with it certain advantages, especially in relation to the operation of the in-house assets rules. However, if it is not, the fund may be lead down the rocky road to face compliance issues and expose it to the new penalties and potentially treatment as a non-complying fund.

Under the SIS legislation the term 'partnership' is used in:

- the definition of entity in section 10(1),
- the definition of a self-managed superannuation fund (SMSF) in section 17A;
- section 66 relating to the acquisition of assets from related parties; and
- Part 8 relating to the in-house asset rules.

'Partnership' is defined in section 70E of SIS to refer to its definition as used for taxation purposes. Under the income tax law, and therefore SIS purposes, it is important to note that a partnership is broader than the general law definition. It includes persons who are in receipt of income jointly meaning that there is no requirement that the parties are in business for a partnership to exist. This concept is important where a joint venture is in operation as many joint venture arrangements may, in fact, be partnerships under the definition in section 995-1 of the Income Tax Assessment Act 1997.

There is no technical legal meaning to the term 'joint venture' as it is used to describe a number of business arrangements where two or more parties are undertaking a joint activity with a view to each party mutually benefiting from the arrangement. As a general rule the participants in a joint venture hold property and other resources as tenants in common rather than via an entity that owns the property. The most common joint venture arrangements include those in the mining industry where different resources are contributed by each joint venturer. Those resources may relate to rights over property, skills and capital being contributed to the arrangement. When it comes to SMSFs it is possible to come across arrangements which are claimed to be joint ventures for development or building of a property or in one case a 'joint venture' was in relation to mail boxes at a post office agency. Whether or not some of these arrangements meet the requirements of a joint venture rather than a partnership is debateable.

The main characteristics of a joint venture are:

- Participants hold property as tenants in common;

- Money, property or skills may be contributed by the joint venturers but the contribution of each may not be equal;
- Any liabilities for the debts of each participant are several rather than joint. The extent of any liability is usually limited to the respective share of each owner of the joint property;
- Joint control is usually exercised by each participant over the joint venture activity;
- An operator or manager is usually appointed by the joint venture participants to conduct the joint venture activities;
- The 'product' of the joint venture is taken by each participant as agreed rather than determining profits and each venturer taking their share of profit.

The joint venture arrangement is a contractual relationship and can be created in a number of ways, for example, by conduct, verbally or documented. However, the usual practice is to incorporate the terms of the joint venture in a written agreement.

The advantage of a joint venture is in its flexibility in structuring the arrangement and providing different rights and obligations to each participant. It may also be able to distribute the risks in different ways to each of the members of the joint venture so that each party can mutually benefit.

If an arrangement is seen as a joint venture, rather than a partnership, there are a number of advantages. These are:

- In a partnership each partner is jointly and severally liable for the debts of the partnership and for the acts of the other partners. In contrast in a joint venture the liability is several and the liabilities are determined under the agreement. However, some liabilities may be joint liabilities of the participants in the joint venture.
- Each participant in the joint venture claims their own tax deductions and makes their own tax elections, which, in the case of a partnership may be required to be made at the partnership level and in other cases at the level of each partner.
- Each joint venture participant may account for the transactions of the joint venture in a different way.
- In a partnership the partners are bound by other partners, however, this is not the case with a joint venture unless agreed.
- Joint venture participants may enter into their own financial arrangements in relation to their joint venture interests.
- Partners have a fiduciary relationship whereas this is not usually the case in a joint venture.
- Greater flexibility is available in a joint venture as it is not subject to some rules and regulations such as the partnership legislation in each State and Territory.

Distinguishing a joint venture from a partnership is important for taxation, the SIS Act and other purposes. However, the main distinguishing features are:

- There is no receipt of income jointly so there is no joint profit determined or calculated.
- Carrying on the business venture severally rather than jointly. This may involve separate taxation and accounting treatments and also making it clear to third parties that the interests of the joint venture participants is several rather than joint.
- A manager may be appointed for the joint venture operations as agent.
- Participants will not have rights that bind each other, as is the case with a partnership.

- Ensuring the joint venture agreement has express statements that the arrangement is a joint venture – this may be indicative and is not conclusive.

In relation to SMSFs and joint ventures the ATO has published a determination, ATOID 2006/335, which has been archived and the issue has been included in SMSF Ruling SMSFR 2009/4 at paragraphs 91 to 94 as one of the examples of what is meant by 'asset', 'loan', 'investment in', 'lease' and 'lease arrangement' in the definition of an 'in-house asset'. The determination and the ruling do not refer to 'joint venture' but refer to 'contractual arrangements' probably because of the fact that there is no technical meaning of the word joint venture at law as indicated above.

The example in paragraphs 91 to 94 of SMSFR 2009/4 describes a situation where an SMSF has contributed money towards the acquisition of an asset which is to be acquired by a company related to a member of the fund. The contract with between the SMSF and the related company stipulates that the company controls and manages the asset and receives all the receipts in relation to the asset. Also, the SMSF is not required to guarantee or indemnify the repayment of borrowings or other obligations of the related company. The SMSF acquires no legal, equitable or other interest in the asset and any interest is limited to its entitlement to receive contractual payments from the related company.

In paragraph 93 of the SMSFR 2009/4 the SMSF has the right to receive payments from the related company which is calculated as a proportion of the proceeds from the sale of the property, lease or other use of the asset for which the SMSF has made the contribution.

The ATO considers that such an arrangement is considered to be an investment by the SMSF in the related company as capital has been contributed to the related company and used for its benefit. In exchange the SMSF has certain rights to 'a share of profits' from the use of the asset (para 94 of SMSF 2009/4). Any return on the investment is reliant on the actions of the related company and the financial risk that goes with the investment. It is concluded that the contribution made by the SMSF is an investment in the related party.

Whether this is correct depends on other information which is not available from either SMSFR 2009/4 or ATOID 2006/335. However, while the amount provided to the related company for its purposes would most likely be an investment in the related party as envisaged by section 71(1) of SISA. It would appear in any case that the arrangement would not be a joint venture arrangement because the ruling indicates that the related company provides a share of profits to the SMSF due to the contribution it has made. This is not regarded as a characteristic of a joint venture but fall under the income tax definition of partnership. This seems to conflict with other statements in the example in the ruling that the SMSF is entitled to a proportion of the proceeds from the sale of the property etc. (para 93 of SMSFR 2009/4).

The ATO also issued Taxpayer Alert 2009/16: Circumvention of in-house asset rules by self-managed superannuation funds using related party agreements. TA 2009/16 describes an arrangement where an SMSF enters into an agreement with a related trust in a joint venture agreement type arrangement to acquire assets such as rental property in order to obtain taxation and superannuation benefits. The ATO expresses concerns that such an arrangement may breach the superannuation in-house asset rules.

APRA have also mentioned the term joint venture in paragraphs 31 to 33 of APRA Circular III.A.4 as it relates to the operation of the sole purpose test and the joint ownership of property. Just like the ATOID this Circular has also been archived. The Circular says at para 33:

> *'the sole purpose test is unlikely to be satisfied in situations where the investments of the fund and those of the employer-sponsor or some other associated person become intertwined. For example, joint ventures where trustees invest in a particular asset or assets with the fund's employer sponsor (such as an investment in real estate as tenant in common) may not, in certain circumstances, comply with the sole purpose test.'*

Unfortunately, APRA does not provide examples of types of investments which would be unacceptable in these circumstances and cause the fund to breach the sole purpose test, possibly because it is determined on a case by case basis.

This statement is consistent with a number of court cases where particular superannuation funds were used by employers as a mere extension of their business operations and it was co-incidence that employees actually benefited from the fund. These cases mainly relate to the operation of the law prior to the introduction of the SISA in 1994.

Whether there is a joint venture or partnership in existence for taxation and SISA proposes comes down the facts of the case and the relationship of the parties. In many case what may be considered a joint venture may in effect be a partnership for those purposes. In all cases legal advice should be obtained to confirm that the arrangement entered into satisfies the required purpose as failure to do so may result in penalties being imposed on the fund. Where doubt remains the client may consider obtaining a ruling from the ATO to give some peace of mind in relation to the relevant arrangement.
