



## Art and Super - Can Self Managed Super Funds Invest in Art?

We have recently been asked to review the law in relation to investment in art by self managed super funds (SMSFs).

With the art market currently experiencing boom conditions, and with returns from share markets in recent times having been mixed, it is not surprising that trustees of SMSFs are considering alternate forms of investment.

### Art as an Investment

There is no doubt that art is a valid investment. Recent Australian sales indicate that returns - and risks - can be high, so trustees must proceed with caution, and, as with investment generally, should maintain a diversity so that art is one of several asset classes of the fund.

The Australian Taxation Office (ATO), which is responsible for regulating the SMSF sector, has confirmed that it has no objection to trustees of SMSFs investing in art.

However, there are a number of rules that SMSFs must follow, and, if the investment in art is outside of these rules, then the ATO may deem the fund to be 'non-complying' with potentially serious consequences.

### Rule 1 - The Sole Purpose Test

The first requirement that the trustees have to contend with is the "sole purpose" test. Put briefly, a superannuation fund must be maintained for the sole purpose of provision of benefits to members on their retirement.

An asset that is purchased to provide a **current** benefit to a member would not pass the sole purpose test. For example, a holiday house on the coast which is regularly used by a member of the fund could be seen as not having been purchased for the sole purpose of providing retirement benefits.

This area of the law is further discussed on page 2 under the heading 'Can I Hang It On The Wall?'

### Rule 2 - 'In-House' Assets

The second requirement is that the total market value of investments by a superannuation fund in what are termed 'in house assets' can not exceed 5% of the market value of the total assets of the fund.

'In-house' assets does not mean assets in your house! The term 'in-house' in this context means assets that are leased to people or other entities that are related to the SMSF.

For example, if a painting is purchased by a SMSF, and is then leased or rented to a company that is associated with a member of the fund, then that asset is an 'in-house' asset.

In summary, if the total cost of all 'in-house' assets, including the artwork, is less than 5% of the market value of all assets of the fund there will be no problem in passing the 'in-house' asset test.

#### Example:

*The Jones Super Fund purchases a bronze sculpture for \$5,000 from an art dealer. At the time of the purchase, the total assets of the fund, which include cash and shares, was \$135,000.*

*The trustees determine that they will lease the sculpture to Jones and Associates, a legal firm associated with one of the members of the super fund. The annual rent charged for the sculpture will be \$500.*

*As the market value of the sculpture (\$5,000) is less than 5% of the total value of the fund assets (\$135,000), there is no breach of the 'in-house' asset rules.*

*Note that the purchase of the sculpture must still satisfy the sole purpose test. That is, it must have been purchased for the sole purpose of the provision of retirement benefits to members of the fund.*

*From a taxation point of view, Jones and Associates will obtain a tax deduction for the cost of the lease of the artwork (in this example, the tax deduction will be worth 48.5% of \$500, which is a tax saving to Jones of \$242 per annum).*

*The fund, however, has a tax rate of only 15%, so will pay tax of \$75 in year one on its income of \$500.*

*This low rate of tax on fund income illustrates the attractiveness of holding income producing assets in super funds rather than personally.*

## Other Tax Benefits

Assets held within SMSFs are subject to a lower rate of capital gains tax (CGT) than assets held by individuals.

The CGT rate of assets in super funds is 10% if the asset is held for more than 12 months.

### Example

*Jim Jones has reached 62 years of age and has decided to retire. To help fund his retirement, he decides to sell the sculpture he bought several years ago at a cost of \$5,000.*

*The sale price he obtains for this sculpture is \$15,000, meaning that he has made a capital gain of \$10,000. The fund is liable to capital gains tax of 10% of the gain, which is \$1,000.*

### Note that:

- had Jim Jones purchased the work as an individual, then on achieving a capital gain of \$10,000, the tax payable could be as high as \$2,450, depending on his personal tax rate at the time of sale.*
- it is not necessary for the SMSF to sell the sculpture. It is possible that the sculpture can be 'distributed' to Jim in its physical form rather than being converted to cash. In such a case, a valuation would be obtained of the sculpture, and it would be transferred to Jim at that value. The SMSF would still be liable to CGT, and if the gain was \$10,000, the CGT would be \$1,000.*

## Can I Hang It On The Wall?

What happens if the superannuation fund investment ends up on the living room wall of one of the members? The ATO is on record as saying that putting the art work on the living room wall means that the art has been purchased for the use and enjoyment of the people involved and this clearly fails the sole purpose test. A recent ATO interpretive decision makes the ATO position quite clear (ID 2004/249).

However, this has not been tested at law, and there are certainly a variety of opinions which suggest that the sole purpose test may in fact not be breached.

Does the fund member actually receive any benefit if the art is hung on the wall as opposed to being stored?

The easy answer to this question is yes. Even if the member is not particularly fond of the artwork, there is a benefit in that the art work is being used at no cost. To hire a piece of art from an organisation such as Art Bank would incur a cost, and at its most simple, the benefit to the member is the value of this notional rent.

It has been suggested that any such benefit is offset by the value of storage provided by the member.

The real issue, in our opinion, is whether the fact that a secondary benefit is gained by the member means that the sole purpose test is breached.

The bottom line advice for most trustees will be that the consequences of losing complying fund status are dire and, if the ATO doesn't like it, don't do it!



## Other Issues to Consider

If you can't hang it on the wall, what do you do with it?

One solution is to have the artwork stored, for example, in the secure premises of a reputable art dealer. In this case, you would be responsible to ensure that the art is properly insured and its condition checked regularly.

Also, the ATO have indicated in their rulings that they expect Trustees to receive expert advice and/or have conducted proper research as to the investment potential of any art acquisition, and that this be properly documented.

Finally, regular valuations of the artwork should be obtained and reflected in the accounts of the superannuation fund.

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If there are any aspects of this newsletter you wish to discuss further, please contact **Phil Jaquillard** or **Ed Bernard** on **1300 787 576**.



**Adelaide**  
Level 8, Optus Centre  
(cnr South Terrace)  
435 King William Street  
Adelaide SA 5000

**Melbourne**  
Level 8  
350 Collins Street  
Melbourne VIC 3000

**Postal**  
GPO Box 1215  
Adelaide SA 5001

**Tel** 1300 787 576 (National)  
08 8221 6540 (Adelaide)  
**Fax** 08 8221 6552  
**Email** [info@superguardian.com.au](mailto:info@superguardian.com.au)

**Internet** [www.superguardian.com.au](http://www.superguardian.com.au)