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The SIS Act matters – purported SMSF loans held unenforceable

By **Keeli Cambourne, Deputy Editor SMSF Adviser and *Matthew Burgess, Director, View Legal***

A recent court case has emphasised the importance of caution that SMSFs must take when lending money and adhering to all the regulations of the SIS Act, says a legal expert.

Matthew Burgess, director of View Legal, said the case of Colaciello v Christensen & Anor; Colaciello Super Pty Ltd v Christensen & Anor [2023] VSC 568 (Colaciello) shows the importance of specialist advisers in the operation of an SMSF.

"Specifically, Colaciello explores the consequences of trustee and member conduct blatantly in breach of key sections of the Superannuation (Industry) Supervision (SIS) Act," he said.

The case revolves around disputes stemming from a betting syndicate and a claim for the recovery of loans originating from an SMSF to an associate of one of its members. These loans were subsequently passed on to another fund member through a series of back-to-back loan agreements.

The associate who borrowed the funds and then resisted paying them back, said the loan agreements were not enforceable as they breached section 65 of the SIS Act, which prohibits an SMSF from lending funds to its members.

"The court referenced another SIS-related case of Frigger v Trenfield (No 10) (2021) 397 ALR 24 to confirm that the purpose of section 65 is to prohibit a trustee of a regulated superannuation fund from lending money to a member or relative of a member or providing any other financial assistance to a member or a relative of a member using the resources of the fund," Mr Burgess said.

"It also confirmed that section 166(1) of the SIS Act provides for an administrative penalty of 60 penalty units to be imposed on a trustee of an SMSF for a breach of section 65(1)."

The court stated that "the fundamental question is whether the statute means to prohibit the contract".

"The statute is to be construed in the ordinary way: one must have regard to all relevant considerations and no single consideration, however important, is conclusive".

Mr Burgess explained that this means that firstly a contract entered into with the object of committing an illegal act is unenforceable.

"The application of this principle depends upon proof of intent at the time the contract was made to break the law," he said.

Secondly, the court will not enforce a contract that is expressly or implied prohibited by statute.

"If the contract is of this class it does not matter what the intent of the parties is; if the statute prohibits the contract, it is unenforceable whether the parties meant to break the law or not," Mr Burgess said.

He further explained that, in this context, the court confirmed that a contract, as outlined in Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd (1978) 139 CLR 410, can generally be voided by statute in four main ways:

(1) by involving actions forbidden by the statute,

(2) by being expressly or implicitly prohibited by the statute,

(3) by being made to achieve a purpose rendered unlawful by the statute, or

(4) by being performed in a manner prohibited by the statute, even if lawful on its own terms.

"Ultimately, however, the court also concluded that it should be 'slow to nullify a bargain' on the basis of what may be properly characterised as regulatory non-compliance."

The court concluded the key parties were aware the loan agreements were improper, and that the purpose of the loan agreements was to circumvent restrictions on member access to superannuation until the member was eligible to do so.

It also noted the SIS Act is designed to protect both individual fund members and the public as a whole by ensuring that retirement benefits are preserved.

"That is, the SIS Act is designed to benefit members in retirement – and relieve the wider community from the cost of pensions," Mr Burgess said.

"Further, there is a public interest in ensuring that SMSFs are properly used.

"Here the use of back-to-back loan agreements was held to be to defeat the operation of section 65 of the SIS Act by lending to a member of the SMSF, and providing financial assistance using the resources of the fund."

Additionally, Mr Burgess said the arrangements in Colaciello were in clear breach of the sole purpose test under section 62 of the SIS Act, meaning the loan agreements were unenforceable as an "affront to the public conscience and the law".

"The practical effect of the illegality was that the status quo remained (subject, it is assumed, to any further compliance activity of the Regulator)," Mr Burgess said.

"That is, the member essentially took the benefit of the funds, and expended them and no other party associated with the arrangements could be held liable to repay them."

Bryce Figot, special counsel for DBA Lawyers told SMSF Adviser, that no party came out of this case well.

"The take away from this case is that the loan agreements were not enforceable," he said.

"These conclusions come as no surprise and the court described the second loan agreement as a sham.

"SMSFs have to be really careful when it comes to lending money. If you try to do [an agreement] in two steps, if you can't do it in one, be very cautious, because it could end badly.

"You've got to look at it from a higher level, look at who is ultimately getting the money.

"If it is a member then it is no go, if it is a relative of a member, it's a no go, if it's a related party there's probably a bit of wriggle room.

"If it's a legitimate investment strategy it could be allowable, as long as all Ts have been crossed, but you could also expect ATO scrutiny.

“Loans can be allowable but it has to be approached with extreme caution.”