Self - managed Superannuations - A Practicle Guide for Accountant

Introduction

Self-managed superannuation has for many years been a popular saving, investment and tax-effective vehicle in Australia. In recent years, however, its relative value as an important tax strategy has increased.

The penetration of revenue laws into new areas - notably, the area of capital gains - coupled with the closing of other effective vehicles - such as employee share acquisition schemes - has led to greatly increased interest in self-managed superannuation funds.

Due mainly to the previous Federal Government's favouritism towards superannuation as the preferred vehicle for funding the retirements of an ageing population, and the recent poor performances of many fund managers, there has been a visible increase in the interest shown in self-managed superannuation funds.

In fact, at the end of June 1998, of 180,000 superannuation funds in Australia, 174,000 had 4 or less members.

Inevitably, the first serious questions raised by those clients interested in self-managed superannuation are directed to their accountants. Each accountant should be in a position to at least give clients a brief summary of the self-managed superannuation fund - from establishment to benefit payment - and to determine, in conjunction with the client, whether it is an appropriate strategy for the client concerned.

In relation to the establishment of a superannuation fund, an accountant should know where to obtain a superannuation fund and what he or she should expect to receive from the supplier of the fund.

As regards administration, accounting, tax, trusteeship and audit (those areas directly relevant to the accountant's areas of advice, and in which the majority of the accountant's time will be spent throughout a fund's life), the accountant should have sufficient knowledge to either perform these functions in-house with confidence, or alternatively, to discuss the issues with clients and to critically assess the credentials of potential external service providers.

Though many accountants do not involve themselves directly in investment advice to their clients, they should be aware of the basic requirements concerning investment strategies for superannuation funds, and those types of investments which are either restricted or prohibited by legislation.

And finally, in relation to benefit payments, the accountant should know the restrictions on benefit payments - in particular as to when, in what manner and how much may be paid.

By necessity, this discussion must be brief in what is an increasingly complex area, however, it must be remembered that many accountants have become comfortable and capable in dealing with the affairs of those of their clients who operate businesses through companies, without a detailed knowledge of the *Corporations Law*.

Establishment

A superannuation fund is a trust, in the say way as a family discretionary trust, or a unit trust. It simply has a limited and special purpose, and restrictions on methods of accounting for the interests in and payments from that trust.

When a self-managed superannuation fund product is received, therefore, it should contain a number of things:-

1. At least one (and preferably more) superannuation fund trust deeds. Though a deed from a given supplier is likely to change relatively infrequently once drafted, the importance of ensuring the quality of the deed prior to recommending that supplier to your clients is essential.

The first requirement is that the deeds be drawn by a solicitor. This does not mean that a superannuation fund may not be established via a shelf company supplier or superannuation industry source. Rather, it means that a solicitor has drawn the deeds that form part of the overall fund establishment service. In this way, the supplier acts as a conduit, engaging solicitors to draw the deeds used.

After this matter has been determined, the most obvious determining factor as to whether the supplier should be used is whether or not the deed is drawn with the provisions of the *Superannuation Industry (Supervision) Act 1993* and *Regulations* in mind. If not, the fund would not be eligible to make a valid election to become a "regulated" superannuation fund, and could not, therefore, obtain the 15% concessional tax rate.

Other relevant matters include: whether the deed spells out important aspects of the legislation, or simply refers the reader to the legislation; whether it can accept both self-employed people and employees in the one fund; whether it adequately provides for the different requirements applicable, should the fund grow to 5 or more members; and whether or not it has an index or table of contents.

2. In addition to the deeds themselves, most suppliers will provide drafts of applications for membership to the fund, applications for admission as employer sponsors of the fund; and the first minutes of trustees of the fund.

3. These documents will usually be provided in a Fund Register, with other items necessary or desirable at the point of establishment, such as an APRA Election to Become a Regulated Fund form, a tax file number application form, a register of the first members of the fund, and notices to the first members (outlining the fund's basic operation and benefit payment structure, and other matters prescribed in the *Regulations*).

The deed used by ACIS is presently in use by over 8,000 self-managed superannuation funds around Australia. It is a document of the highest quality and flexibility, which has withstood the test of time and which continues to meet the needs of fund trustees and members.

Administration, Accounting, Tax, Trusteeship and Audit

The areas of administration, accounting, tax, trusteeship and audit are best dealt with as a group, because they are all annual considerations for the accountant throughout the life of a self-managed superannuation fund. For the main, they are inter-related and, often, are interdependent.

Administration

Fund administration has developed an almost generic usage, which extends beyond the limits of its traditional definition. Historically, administration has encompassed the keeping of membership, contribution, benefit accrual and benefit payment records on behalf of the fund. It included the production of necessary documentation to fund members on commencement, annually, and on termination of fund membership or retirement.

At this time, funds with less than 5 members (called "excluded funds" under the *SIS Act* and *Regulations*) are exempted from certain administrative requirements. Nevertheless, the accountant should still be aware that, upon admission to the fund, a new member should receive information concerning the fund's main features, management and financial condition of the fund and the investment performance of the fund.

Annually, a member of a fund should receive a member's benefit statement, which contains certain prescribed information, including the contact details of the fund, progress of the member's account balances during the year and the amount of the member's withdrawal benefit at the end of the financial year.

Upon termination or retirement, a number of calculations must be made to determine the member's exit benefit, taking account of taxation and other costs, an exit statement must be prepared, and eligible termination payment statements and (possibly) roll-over notifications prepared.

Accounting

The internal accounting for the fund's balances should, as a minimum, enable proper tracking of the sources, nature (eg. preserved, non-preserved, undeducted contributions, etc.), income, taxes, expenses and withdrawals of member's benefits and entitlements. However, it should be noted that most trust deeds will contain at least basic (and in some cases restrictive) directions as to internal fund accounting.

The external accounting for the majority of self-managed superannuation funds has been simplified by the introduction of the "reporting entity" concept. Having said this, however, it has been considered that financial reporting for superannuation funds is sufficiently specialised to deserve its own accounting standard - viz. AAS25.

Under AAS25, each fund's financial statements should consist of a Statement by Trustees, Operating Statement, Statement of Financial Position and Statement of Cash Flows (with appropriate notes to each). It should further be noted that full compliance with AAS25 requires that all assets of the fund be reported at their year end net market values.

Where the fund is not considered to be a reporting entity, compliance with AAS25 is not mandatory. However, an excluded fund must still prepare, at least annually, a Statement of Financial Position and an Operating Statement. Additionally, the accounts must include a Statement by Trustees in the prescribed form (which, in summary, contains undertakings and confirmations of the accuracy of the accounts).

Taxation

One of the major reasons why self-managed superannuation funds have developed and maintained their popularity is the continuing concessional income taxation treatment that they attract.

<u>Within the Superannuation Fund</u>

Currently, a superannuation fund pays tax at 15% on its taxable income. It is a common misinterpretation that a superannuation fund has a 15% "contributions tax". In actual fact, contributions to a fund will be included in the assessable income of the fund, along with investment earnings of the fund, then reduced by all allowable deductions prior to arriving at the fund's taxable income. The result is that, in a properly managed fund where assessable investment returns exceed total allowable losses and outgoings in most years, the tax on contributions will amount to 15%. Strictly speaking, however, it is not correct to refer to a 15% "contributions tax".

Additionally, it should be noted that where contributions are made to superannuation funds in circumstances whereby the contributor does not claim a deduction, the contributions will not normally be assessable income in the hands of the fund's trustee. From 1994, however, only non-deducted member contributions are exempt, with non-deducted employer contributions still being subject to tax.

Other special points to note in relation to the fund's assessable income include: that, with minor modifications, the capital gains tax regime applies to superannuation funds at the fund's concessional tax rate of 15%; the dividend imputation system operates so as to allow the fund full credit for imputation credits (normally approximately 36%), while including dividends received in calculating taxable income at the 15% concessional rate; within limits, proceeds from life assurance and insurance policies will not be subject to tax if paid to the spouse or dependant of the deceased.

A superannuation fund is entitled to most deductions allowable to other entities under the *Income Tax Assessment Act 1936*.

<u>Superannuation Surcharge</u>

In one of the most disappointing political decisions of recent years affecting superannuation, the superannuation surcharge (now renamed the superannuation contributions tax) on high-income earners was introduced with application from the 1996/97 year of income.

This highly complex, administratively expensive paper-chase may be summarised as follows. Where a person's Aadjusted taxable income (basically, their individual taxable income, plus employer superannuation contributions made on their behalf) reaches $70,000 or above, an additional tax is levied on the employer superannuation contributions made in respect of that person in that year. This additional tax, which is 1% at an adjusted taxable income of $70,000, increases at the rate of 1% per additional $1,000 of adjusted taxable income, until reaching a maximum rate of 15% for adjusted taxable incomes of $85,000 or above. Note that these thresholds are indexed each year according to movements in AWOTE. As such the original levels of $70,000 and $85,000 have become $75,856 and $92,111 for the 1998/99 year of income.

Each year, a self-managed fund must submit a surcharge return form, listing (for each member) the contributions received by the fund on the member's behalf, as well as certain other information, such as amounts transferred in and amounts transferred out. This return is due by 31 October after each year of income. The Australian Taxation Office then match this data against data from the individual's tax return (viz. their taxable income) and forward a surcharge assessment to the fund by 15 March in the following year. The fund has one month to pay any surcharge liability. An advance instalment system is then initiated, whereby the fund is required to remit 50% of the previously assessed surcharge liability by 15 June. When surcharge liability is eventually determined (by 15 March in the following year), this advance instalment is applied against any liability to reduce the amount owing, or create a refund (as the case may be). The advance instalment system has been discontinued from 1 July 1999.

The legislation does not prescribe the way in which surcharge liability is to be dealt with by the fund internally. Therefore, it is up to the trustee of each fund to deal with it (and the associated administrative costs) in a fair and equitable manner.

Deductions for the Contributor

In these days of the superannuation guarantee system, virtually all remunerated employees will have superannuation contributions made on their behalf. Where this superannuation support exists, it will be rare that the employee will be entitled to claim a deduction for contributions that they make personally to a fund.

Where a sole trader or other person without employer support (eg. a person not currently employed, but employed at some time during the past 2 years) is entitled to be a member of a fund and to make contributions to a fund, they will be entitled to claim as a deduction the amount of:-

First $3,000-00	100%
Additional amounts (up to max. deduction limit)	75%

Where a person is an "employee" for the purposes of Division 3 in Part III of the *Income Tax Assessment Act 1936*, the employer may make contributions in respect of that employee up to the employee's maximum deductible contribution limit.

This limit used to be determined by the application of long and complex algorithms. It is now determined by a simple age-based formula which allows the employer to claim deductions as follows for the 1998/99 year of income (indexed each year): -

Age Limit	Deduction Limit
under 35	$10,60
35 to 49	$29,443
50 and over	$73,019

Here it should be noted that it is the responsibility of the employee to ensure that he or she stays within their reasonable benefits limits, and an employer may still be allowed a deduction up to these limits, even if they will result in the employee's final benefits exceeding the reasonable benefits limits.

It should be noted that an employer who borrows funds at interest in order to pay superannuation contributions could also claim a deduction for the interest costs (and other borrowing costs allowable) associated with the debt. Though the Commissioner of Income Tax has stated that such arrangements may be scrutinised under the anti-avoidance provisions of the *Income Tax Assessment Act*, the author is unaware of any assessments having been issued on this basis to date.

Trusteeship

Prior to the introduction of the *SIS Act* and *Regulations*, the main regulation of superannuation funds was by way of taxation concessions (a "carrot and stick" approach) - if trustees of superannuation funds did not comply with the legislative requirements, the concessional tax status of the fund was removed and the fund taxed at the rate for undistributed trust income (effectively the top marginal rate for personal taxation). This approach was recognised as potentially unfair upon members of funds who should not suffer because of a trustee's failures.

However, the Federal Government is limited by the heads of power given to it in the Australian Constitution. Traditionally, the capacity to pass laws with respect to trust funds was a matter for each State.

However, by requiring that the trust deed of each superannuation fund wishing to pay the concessional rate of tax contain a requirement that either the trustee be a Constitutional corporation, or that the sole or primary purpose of the fund be the provision of old-age pensions, the Federal Government have arguably brought such funds under their powers to pass laws with respect to trading and financial corporations, and with respect to old-age pensions.

Though still able to remove taxation concessions for certain breaches of the *SIS Act*, trustees are now faced with an array of fines, exclusion order, and criminal sanctions if they do not adequately fulfil their responsibilities.

It is this area of the new regime to which the majority of provisions in the *SIS Act* and *Regulations* is directed. When studied in detail, however, it becomes apparent that (with certain exceptions such as member, accounting, and tax information, and investment restrictions) most restrictions simply lay down the existing principles of trust law and common sense as they relate to superannuation funds.

As with the penalties and sanctions prescribed in relation to the activities of companies by the *Corporations Law*, a self-managed superannuation fund operated by a trustee under the guidance of a properly informed professional should not have any contact with the more onerous provisions of the *SIS Act* and *Regulations*.

At this point, it is appropriate to reiterate the comments made in the introduction that the majority of company officers and their advisers successfully negotiate the corporate landscape without a detailed knowledge of the *Corporations Law*.

As with the *Corporations Law*, it is important that trustees and their advisers obtain a working knowledge of the "dos" and "don'ts" of trusteeship under the new regime. If this is done, operating a self-managed superannuation fund should not be substantially more onerous than operating a company.

Though the context of this paper does not enable detailed examination of all new responsibilities, some issues for consideration not specifically dealt with in this paper include: equal representation on trustee boards for funds with 5 or more members; internal dispute resolution procedures; the requirement for agreements with external investment managers to contain certain provisions; restrictions on forfeiture of benefits.

New Trustee Rules Proposed

In conjunction with the Government's change in the terminology used to refer to small funds (previously called "excluded", those funds with fewer than 5 members will now be defined as "self-managed" funds), the rules regarding who can be trustees and who can be members of these funds has also changed.

Following the principle that "all trustees should be members and all members should be trustees", the new legislation (presently before Parliament) carries through these changes, with some small modifications for special circumstances. In summary, the changes are as follows: -

1. All members of the fund must be either trustees (where individuals are the trustees) or directors of the corporate trustee of the fund.
2. For children under age 18, one of their parents can represent them on the Board, until such time as they turn 18 years.
3. For single member funds, there must be at least 2 individual trustees (and these trustees must either have a family or business relationship), OR the fund may have a corporate trustee. Where there is a corporate trustee, the company must either be a sole director company, OR any co-directors of the member must have the requisite family or business relationship.
4. A "disqualified person" (ie. a person disqualified from being a trustee of a fund under existing rules) does not appear to be eligible to be a member of a SMF.

Where existing funds are required to restructure their positions to meet these new provisions, they will have until 31 March 2000 to comply.

Audit

Audit of superannuation funds is an area of great concern to all accountants who undertake this function on behalf of their clients' self-managed superannuation funds.

It is an area in which ever-increasing responsibility is being transferred from the regulatory bodies (viz. the APRA and ATO) to the fund's auditor. Failure to correctly audit a superannuation fund can result in action by the fund trustees and/or members. Additionally, in extreme cases fines and penalties, and/or disqualifications from conducting superannuation fund audits may be issued.

It should be noted that, while experience in the conduct of audits is a pre-requisite to conducting a superannuation fund audit, a superannuation fund audit is a specialised audit function and general audit experience is by no means sufficient.

Accountants intending to conduct superannuation fund audits should thoroughly familiarise themselves with the *SIS* requirements.

In particular, no accountant should conduct a superannuation fund audit without first having obtained and reviewed the Australian Accounting Research Foundation AUP 20.1 - Audit Evidence Implications of Externally Managed Assets and Income of Superannuation Funds.

Additionally, an extremely good (though now somewhat dated) publication issued jointly by the AARF & APRA is "The Audit of Superannuation Funds - Audit Guide No.4."

Above, reference is made to an audit of a superannuation fund, rather than an audit of the financial statements of the superannuation fund. Though the stated function of the audit is still to ensure that the financial statements present and true and fair view of the financial position of the fund, in reality the audit extends beyond the financial statements to include other areas relevant to a superannuation fund's compliance.

In effect, the special provisions of the *SIS* regime relating to superannuation fund audits require the auditor to keep a watchful eye on the management of the fund. Should the auditor become aware that the fund is in breach of the *SIS Act* or *Regulations*, the auditor is obliged to report such a breach to the fund's trustee.

The auditor is required to give the trustee a written notice requesting that the trustee provide to the auditor a written report outlining the steps which will be taken to rectify the breach, and a time within which the breach will be rectified. If this is done and the breach rectified within the time specified, no further action need be taken by the auditor.

However, if the trustee fails to either give the report, or rectify the breach as promised, the auditor must report the matter to the APRA.

The net effect of the auditor's responsibilities under the *SIS* regime is that the auditor must have a level of knowledge sufficient to know a breach of the *Act* and *Regulations* when he or she sees one. A failure to identify a breach when confronted with one may well result in some or all of the consequences stated above.

In summary, therefore, any accountant intending to conduct an audit of a superannuation fund must be prepared to do two things. First, he or she must update their knowledge of the legislation governing superannuation funds and obtain all relevant materials available on the proper conduct of superannuation fund audits.

Second, the accountant must be prepared to take a hard line with clients who fail to adequately discharge the responsibilities imposed upon them by the *SIS* regime. The consequences of taking a "softly-softly" approach to clients not adequately fulfilling their duties under the legislation will be financial (whether by way of fines, disqualifications, or civil action).

Even in view of these facts, it is expected that the APRA and the courts will take a practical approach to the auditors' responsibilities - remember, there are over 170,000 superannuation funds in Australia which require auditing each and every year. If insufficient accountants are prepared to conduct these audits for fear of liability, the system will collapse.

Investment Strategies & Restricted/prohibited Investments

Investment Strategies

Significant in the new *SIS* regime is the covenant imposed on superannuation fund trustees to develop and implement an investment strategy.

For funds with 5 or more members, this requirement has always been an operating standard under *SIS*. As a consequence, failure of a 5-or-more-member-fund's trustees to develop and implement such a strategy is a breach of an operating standard, resulting in a fine against the trustee(s) or officers of the trustee(s).

For funds with fewer than 5 members, the requirement was not an operating standard. However, it became one from 1 July 1996 onwards. Should the trustees fail to implement such a strategy, the consequences are the same from this date as with 5 or more member funds.

It has often been mooted that some "standard" model investment strategy could be developed to deal with this requirement (especially in relation to excluded funds). This view, whilst practical for excluded funds (where all parties are close to the management), should be cautioned against for funds with more than 5 members and certainly should not be undertaken on a fee for reward basis by any person not holding or properly authorised to advise on investments.

A proper investment strategy should start with an analysis of a fund's membership for attitudes to risk, potential liquidity requirements considering the time to retirement (and potential for transfers out of the fund) of members. The desired level of return, considering this risk and liquidity profile should then be considered, and potential investments (and investment markets) considered so as to optimise the prospects of the desired level of return being reached over the medium to long term. In the end, it may be that the trustees, having considered these matters and consulted with members, determines that the fund's investment strategy will produce satisfactory results. However, the process and the result should be documented for all funds.

Though it is not considered essential that an excluded fund take external advice in developing an investment strategy, it would be a very knowledgeable or cavalier trustee of a 5 or more member fund which did not bring in an expert.

Investment Prohibitions/restrictions

The rules prohibiting or restricting otherwise commercially acceptable investments by superannuation funds are essential knowledge for both professional advisers and trustees of superannuation funds alike.

The main prohibitions and restrictions on the investment of superannuation fund assets may be summarised as follows: -

In-house assets	Restricted
Borrowings	Restricted or prohibited
Security/guarantees over assets	Restricted or prohibited
Loans/financial assistance to members	Prohibited
Purchases of assets from members	Prohibited
Purchases of assets from entities associated with members	Prohibited if entity acquired assets after 30 June 1993

In-house Assets

An "in-house" asset is an investment in or a loan to an employer sponsor of the fund, or an associate of the employer sponsor.

The definition of "associate" is the broad definition used by section 26AAB(14) of the *Income Tax Assessment Act 1936*.

It is interesting to note, however, that the Federal Court of Australia in *Trevisan v. FC of T* 91 ATC 4416, determined that, where a superannuation fund was the sole unit-holder in a unit trust, even in the though the trustee of the unit trust is associated with the employer sponsor, the trust itself is not an associate of the employer sponsor.

Presumably, therefore, a property-holding unit trust "owned" by a superannuation fund may lease that property to an employer sponsor of the fund, on commercial, arm's length terms (see APRA Circular No. II.D.6, at para. 41).

The APRA have indicated, however, that they will scrutinise such arrangements for compliance with the "sole-purpose" test and the requirement that members' benefits be fully secured.

Even having considered these issues, it remains the case that a superannuation fund may invest a certain proportion of its funds in "in-house" assets. However, the rules regarding such investments are not straightforward, and are subject to ever-decreasing levels as time goes on.

Two concepts of value are relevant here (historical cost and market value), and there are a number of critical dates.

The position is summarised below and a superannuation fund must ensure that these criteria are met by the relevant dates, or divest assets to the extent that the criteria are met: -

(a) where the Fund was established on or after 12 March 1985, the historical cost of In-house Assets of the Fund do not exceed, at any time during the Years of Income prior to the 1998-1999 Year of Income of the Fund, 10% of the historical cost of the total assets of the Fund;

(b) where the Fund was established before 12 March 1985, the historical cost of In-house Assets of the Fund do not exceed:

(i) at any time during the Years of Income prior to the 1995-1996 Year of Income the greater of:

(A) either:

(I) 70% of the percentage of the historical cost of the total assets of the Fund at 11 March 1985; or

(II) the actual percentage of the historical cost of the total assets of the Fund at 11 March 1985,

whichever is the lesser; or

(B) 10% of the historical cost of the total assets of the Fund; and

(ii) at any time during the Years of Income after the 1994-1995 Year of Income, but prior to the 1998-1999 Year of Income, 10% of the historical cost of the total assets of the Fund;

(c) the Market Value of In-house Assets of the Fund do not exceed, at the end of a Year of Income of the Fund after the 1997-1998 Year of Income, but before the 2000-2001 Year of Income, 10% of the Market Value of the total assets of the Fund;

(d) the Market Value of In-house Assets of the Fund do not exceed, at the end of any Year of Income after the 1999-2000 Year of Income of the Fund, 5% of the Market Value of the total assets of the Fund.

But, where, at any time after 28 January 1993, the Market Value of In-house Assets of the Fund exceed 5% of the Market Value of the total assets of the Fund, the Trustee shall not make any further investment in In-house Assets, which would result in the Market Value of In- house Assets exceeding 5% of the Market Value of the total assets of the Fund.

Proposed Changes to Investment Rules

The long-awaited exposure draft of the Federal Government's proposed changes to investment rules for superannuation funds was finally released on 22 April. It has taken just under 12 months for these rules (first announced in last year's Budget) to surface.

The new rules which, in conjunction with changes to the definition of "self-managed funds" and the transfer of regulation of SMF's to the Australian Taxation Office, represent the most significant amendments to SMF's in years will not please many people.

The new rules further restrict dealings between a superannuation fund and related parties. A new term: a "Part 8 Associate" includes all non-arms' length individuals, companies, trusts, trustees of trusts, and partnerships. A superannuation fund must not acquire any assets from a Part 8 Associate (except cash, listed securities and Business Real Property). Additionally, a superannuation fund may not make a loan to, invest in, or enter into a lease arrangement with a Part 8 Associate if such a transaction represents more than 5% of the market value of the assets of the fund.

The two exceptions are that the fund may use an unlimited amount of its assets to acquire listed securities, or an interest in real estate which is used solely in an employer sponsor's or a member's business.

Transitional arrangements apply in relation to two situations: for investments made prior to Budget night last year 12 May 1998), and for investments made between 12 May 1998 and the date when this draft legislation is introduced into Parliament (estimated to be some time in early June 1999).

Transitional arrangements for pre-Budget assets will allow funds to continue to hold these assets and to meet the terms of pre-Budget contracts (eg. in the case of partly paid units issued before Budget night). Where shares in a company or units in a trust are the pre-Budget assets, the only new investments able to be made will be reinvestments of dividends and distributions of profits until 30 June 2005, after which no further reinvestments may be made. When the pre-Budget assets underlying the investment have been sold, the transitional arrangements end with respect to the fund's investment (eg. where a unit trust's main pre-Budget asset is sold, the fund's holding in the trust must be wound back to 5%).

Transitional arrangements for investments made between 12 May 1998 and the date when the draft legislation goes before Parliament are the same a previously announced: they must not exceed 5% of the fund's assets and, where this is the case, they must be wound back to 5% before 30 June 2001. In effect, this will mean that any unit trusts in a "negative cashflow" position, originally relying upon further subscriptions for units by the fund as contributions were made will not be able to continue this course. The only options would be to sell the underlying asset and wind-up the trust, or have other parties subscribe for units in the trust, from time to time.

Borrowings

A superannuation fund is, as a general rule, not permitted to borrow. In certain restricted circumstances, it may make short-term borrowings to fund liabilities, however the stress is on *short-term*.

The prohibition extends not only to borrowings, but also to pledging, guaranteeing, or otherwise using a superannuation fund's assets as security for a transaction.

In this regard, when a superannuation fund trustee is engaged in these types of transactions independently of the fund (eg. because it is the employer sponsor) it is essential to ensure that any security documentation which it signs (and which contains a clause indicating that the security extends to any assets of which the fund is a trustee) does not extend to the assets of the fund.

Borrowings/Financial Assistance to Members

The general rule is that a superannuation fund may not make loans to, or provide financial assistance for members or relatives of members.

An exception exists in the provision of loans to members, however it is restricted. Where a fund was established prior to 16 December 1985, and at that time it had both the power to lend money to members and had, in fact, lent money to members, those loans (if still in existence) may continue.

The concept of financial assistance is not defined and must therefore be considered to take its natural, ordinary meaning. Presumably, it would include allowing members or relatives to use assets of the superannuation fund on more favourable terms that arm's length parties, using fund assets as a pledge or guarantee of members' or relatives' debts, and so on.

Purchases of Assets from Members and Associated Entities

A superannuation fund is prohibited from purchasing assets from members of the fund. Similarly, it is prohibited from purchasing assets from relatives of members, and from entering into arrangements, via partnerships, trusts, or companies with the intention of avoiding this primary restriction.

There are 2 main exceptions to this general exclusion. First, the fund may purchase such assets if the fund is an excluded fund and the assets are "business real property" to the extent of 40% of the market value of the fund's assets. Second, any fund may purchase an unlimited amount of listed securities from members, relative, or associated entities.

Business real property is a leasehold or freehold interest in real property that is used wholly and exclusively in the transferor's business.

These exclusions were first introduced into the *Regulations* to the *Occupation Superannuation Standards Act 1987*, with effect from 30 June 1993. As such, if the assets to be purchased were owned by an entity associated with a member or relative (as opposed to being owned directly by the member or relative themselves) as at 30 June 1993, the purchase is not restricted.

Unit Trusts as Investment Vehicles

The most commonly used investment vehicle for self-managed superannuation funds in the market-place were previously unit trusts. However, the changes to the investment rules (see above) from the 1998 Federal Budget have almost negated their use.

Benefits Payments

The final objective of any superannuation planning is benefit payment. It is the reason for existence of the self-managed superannuation fund. It is also an involved field that could encompass an entire discussion in itself. As such, in the present context, it is intended only to deal with a few of the more salient points relating to this topic.

A superannuation fund may pay benefits in one of two forms:- either as one or more pensions, or as one lump sums. Combinations of the two are also permitted.

The *SIS* regime is structured so as to set out in detail those types of benefits that constitute a "pension", as defined. These are matters relating to timing, amount, residual capital values, payments to dependants, and so on. The definition is framed so as to enable a number of different types of pensions to qualify - eg. life pensions, pensions with remainders, allocated pensions, and so on. However, not every type of pension called, for example, an "allocated pension" by the promoter will qualify as a "pension" for the purposes of the legislation, and each product should be examined individually.

Where a benefit payment does not fall within one of the categories of "pension" for *SIS* purposes, it is, by default, a lump-sum benefit.

The importance of these concepts relates to the funding limits, or reasonable benefits limits placed on pensions vs. lump sums.

Previously, the reasonable benefits limits calculations involved long, complex actuarial algorithms, and this may still be the case for people aged 45 years or over as at 1 July 1994.

For all others, however, the reasonable benefits limits have been fixed as follows for the 1998/99 year of income (indexed annually):-

Pension-based RBL $942,175

Lump sum-based RBL $471,088

These amounts are to be indexed annually in accordance with movements in the Adult Ordinary Time Earnings index.

Whether the lump sum or pension-based RBL applies is determined by whether 50% or more of benefits is taken in a lump sum or pension form.

Where reasonable benefits limits are exceeded, no concessional taxation treatment is afforded to the excess, which is taxed at the member's marginal rate, in the year benefits commence to be paid.

Note that there are numerous treatments for different portions of benefit payments from superannuation funds. Amounts considered part of the tax-free threshold, undeducted contributions, pre-July '83 components, post-June '83 taxed and untaxed components, and preserved and unpreserved components arise.

All these terms are used as the basis for determining whether or not (and, if so, how much) tax should be applied. They also impact upon when benefits may or may not be paid to members.

Where the payments arise from a self-managed superannuation fund, the person administering the fund will be responsible for determining the various components and tax treatments applicable to the benefits.

As regards the timing of benefit payments, unrestricted unpreserved amounts (which nowadays are somewhat rare) may be paid at any time. Where a member is aged 55 years or more and retires, superannuation benefits may be paid.

Where a member is aged 60 years or more, benefits may normally be paid, regardless of whether or not the member has retired.

Finally, superannuation benefits must *commence* to be paid out of the fund once a member actually does retire on or after age 65 years, or upon the member's death.