



Self managed superannuation funds—investment strategy and investment restrictions

A key area of responsibility for trustees of self managed superannuation funds (SMSFs) is investment management. The *Superannuation Industry (Supervision) Act 1993* (SISA) places certain duties and responsibilities on trustees when making investment decisions. They aim to protect and increase member benefits over time for retirement purposes.

Investment Strategy

The trustees of every SMSF are required to prepare and implement an investment strategy for the superannuation fund. The strategy must reflect the purpose and circumstances of the fund and have particular regard to:

- Investing in such a way as to maximise member returns having regard to the risk associated with holding the investment;
- Appropriate diversification and the benefits of investing across a number of asset classes (e.g. shares, property, fixed deposit) in a long term investment strategy; and
- The ability of the fund to pay benefits as members reach retirement and other costs incurred by the superannuation fund.

An appropriate investment strategy will set out the investment objectives of the fund and detail the investment methods the fund will adopt to achieve these objectives. Trustees must ensure all investment decisions are made in accordance with the investment strategy and should seek investment advice or appoint an investment manager in writing if in any doubt. Breaches of this requirement can result in the trustees being fined or sued for loss or damages. In addition, the fund can lose its complying status. For these reasons, it is strongly recommended that the investment strategy be in writing.

Investment Restrictions

SISA restricts some investment practices of superannuation funds. The investment restrictions aim to protect fund members from being overly exposed to undue risk, (e.g. an associated business failing). Secondly, they aim to ensure that funds make investment decisions with the sole purpose of generating retirement benefits for members rather than providing current day support.

Investment rules are one of the most important requirements of SISA and failure to comply with the rules could result in trustees being fined and/or the fund losing its compliance status.



Loans/Financial assistance to members or a member's relative

Trustees are prohibited from lending money or providing financial assistance from the fund to a member or a member's relative. The use of a fund asset by a member or a member's relative for no cost or as a guarantee to secure a personal loan for example, would be in breach of this investment restriction.

Borrowings

SMSFs are prohibited from borrowing money except in some limited circumstances. Trustees are able to borrow for a maximum of 90 days to meet benefit payments due to members if the borrowing does not exceed 10% of the fund's total assets. Trustees can also borrow for a maximum of 7 days to cover the settlement of security transactions if the borrowing does not exceed 10% of the fund's total assets.

Acquisition of assets from 'related parties'

Trustees are prohibited from acquiring assets for the superannuation fund from a 'related party' of the fund. Limited exceptions to this rule exist, if:

- the acquisition of the asset would not result in the level of 'in-house assets' of the fund exceeding more than 5% of the fund's assets;

- the asset is a listed security (e.g. shares, units or bonds listed on an approved Stock Exchange);
- the asset is 'business real property'.

'Business real property' of an entity generally relates to land and buildings used wholly and exclusively in a business. Trustees are permitted to acquire up to 100% of the fund's total assets in 'business real property' applying from 12 May 1998 (previously 40%).

Related party of a fund

A 'related party' of a fund covers all members of the fund and their associates and all employer sponsors of the fund and their associates.

Associates of members would include their relatives, business partners and any companies or trusts that they control (either alone or with their other associates).

Associates of employers would include business partners and any companies or trusts that the employer controls (either alone or with their other associates) or companies and trusts which control the employer.

In-house assets

An 'in-house asset' is a loan to, an investment in, and leases with, a related party of the fund. In general, SMSFs are restricted from lending, investing or leasing more than 5% of the fund's total assets in a related party of the fund.





Some exceptions do exist, including allowing an exemption for 'business real property' which is subject to a lease between the fund and a related party of the fund.

In addition, regulations were passed on 29 June 2000 to allow an SMSF to invest in a unit trust or a company without that investment being considered an in-house asset if certain conditions are met. The main conditions are:

The trust or company:

- does not borrow;
- has no assets that have a charge over them;
- does not invest in or loan money to individuals or other entities (other than deposits with authorised deposit-taking institutions);
- has not acquired an asset from a related party of the superannuation fund (after 11 August 1999) other than business real property;
- does not acquire an asset (apart from business real property acquired at market value) that had been owned by a related party of the superannuation fund in the previous three years (not including any period of ownership prior to 11 August 1999);

- does not directly or indirectly lease assets to related parties, other than business real property;
- does not conduct a business; and
- conducts all transactions on an arm's length basis.

Investments to be made & maintained on an 'arms length' basis

Investments by SMSFs must be made and maintained on a strict commercial basis. The purchase and sale price of fund assets should always reflect a true market value for the asset. Income from assets held by the fund should always reflect a true market rate of return.

Changes in the investment rules

The investment rules outlined above incorporate amendments which received Royal Assent on 23 December 1999. The main changes from the previous rules are:

- previously only acquisitions of assets from members and relatives were restricted, now acquisitions from the broader category of 'related parties' are restricted;
- previously only investments in certain employers and their associates were considered in-house assets and subject to the 5% restrictions, now investments in the broader category of 'related





parties' (which includes related trusts) are restricted to 5%;

- previously assets being leased to related parties were not considered in-house assets, now they are and are thus generally restricted to the 5% limit;
- previously the exemption allowing the acquisition of 'business real property' only applied if property so acquired was less than 40% of fund assets, now the percentage is effectively 100%

These changes apply from 11 August 1999, not 12 May 1998 as previously proposed. An exception is the change to the acquisition of 'business real property' which will apply from 12 May 1998.

Transitional Rules

A number of transitional measures apply to the introduction of the new rules. These are as follows.

Existing Investments at 11 August 1999

Fund investments and leases in place at 11 August 1999, are not subject to the new rules. That is, they are not counted as in house assets (unless they were already in house assets under the old rules).

A fund cannot, however, make additional investments in such an arrangement (eg: purchase additional units in an existing related trust investment) unless specifically

allowed under the transitional rules discussed below.

Investments made between 11 August 1999 and 23 December 1999

Investments and leases with related parties made between 11 August 1999 and 23 December 1999 will have until 1 July 2001 to comply with the new rules. That is, they are not counted as in house assets until 1 July 2001.

Certain specified investments after 11 August 1999

Certain specified investments made after 11 August 1999 will also not be subject to the changes. Funds can choose to take advantage of one (but not both) of the following exemptions:

- If a fund had an investment in a related entity (e.g. a trust) at 11 August 1999 it can make additional investments in that trust after that date (provided the investments do not exceed the level of the debt in the trust at that date and are made no later than 30 June 2009); OR
- If a fund had an investment in a related entity (e.g. a trust) at 11 August 1999, it can, after that date but not later than 30 June 2009, reinvest earnings from that trust back into the trust. Also, if a fund had partly paid shares or units at 11 August 1999 it may make additional payments on those





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shares or units after that date (provided they are made no later than 30 June 2009).

If in any doubt about the validity of an investment decision trustees should seek professional advice or contact the Australian Taxation Office for assistance.

Need more information?

For further information on this topic:

- visit the ATO superannuation website at www.ato.gov.au/super
- phone the Superannuation Infoline on **13 10 20** for the cost of a local call
- obtain *A Fax from Tax* on **13 28 60**
- if you do not speak English and need help from the ATO, phone the Translating and Interpreter Service on **13 14 50**
- people with a hearing or speech impairment with access to appropriate TTY or modem equipment can communicate with the ATO by first contacting the Australian Communication Exchange Relay Service on **13 25 44**.

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