# AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

# SUPERANNUATION CIRCULAR NO. II.D.6

# IN-HOUSE ASSETS

**November 2000**

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## Contents

## OBJECTIVES

1. The aim of this Circular is to provide general guidance to trustees of APRA regulated funds on the restrictions on superannuation fund investment imposed by Part 8 of *the Superannuation Industry (Supervision) Act 1993* (SIS). Part 8 sets out the "in-house asset" rules that apply to regulated superannuation funds. Trustees of self managed superannuation funds should seek guidance from the Australian Taxation Office in respect of the application of this legislation to their funds.

2. This Circular replaces Superannuation Circular II.D.3 entitled "In-house Assets" which was released by the Insurance & Superannuation Commission in October 1994. It incorporates guidance on the amendments to SIS made by the *Superannuation Legislation Amendment Act (No 4) 1999* (SLAA4) which came into effect on 23 December 1999.

## BACKGROUND

3. The policy underlying the SIS Act is generally to enable trustees to make investment decisions in respect of a particular fund as they see fit, given the circumstances of the fund. However, the SIS Act requires that a trustee develop an overall investment strategy for a fund[1] and contains a number of provisions that prohibit or limit certain investment practices that would be inconsistent with retirement income policy objectives. Trustees who breach these provisions are exposed to significant penalties.

4. The investment restrictions are designed to help protect and enhance the retirement benefits of members by limiting the exposure of members' benefits to unnecessary risk.

5. The in-house asset provisions in Part 8 of SIS are amongst the most important of the investment restrictions. They are designed to ensure that the security of investments set aside for the provision of members' retirement income is not dependent on the success of the business activities of an employer or other related party.

6. Prior to SIS, the basic rules were contained in the *Occupational Superannuation Standards Regulations* (OSS Regulations). Substantial enhancements were made to the rules with the passage in December 1999 of SLAA4. This Circular sets out the investment restrictions as they apply post SLAA4. Table 1 in Appendix B sets out the timeframe under which the initial SIS rules were phased in.

7. Amendments introduced by SLAA4 gave effect to the announcement in the 1998-99 Budget of the intention to amend the investment rules for superannuation funds. In summary, the amendments widened the application of the in-house asset restrictions to "related parties" of a fund, and included, as

[1] refer APRA Circular II.D.1 "Managing Investments and Investment Choice" April 1999

in-house assets, investments in a related trust and any assets subject to a lease or a lease arrangement with a related party.

8. Transitional provisions allow fund investments or leases in place at 11 August 1999, and which were not in-house assets at the time, to continue without being subject to the new rules. While the permitted level of in-house assets generally remains capped at 5% of fund assets, the transitional rules allow additional investments in existing related party assets to be made until 30 June 2009 in certain limited circumstances. Table 2 in Appendix B sets out the timeframe for the SLAA4 amendments.

9. The previous cap of 40% of fund assets that applied to the business real property exemption under section 66 of SIS was removed, enabling a trustee of a fund with fewer than 5 members to utilise 100% of fund assets in the acquisition of business real property from a related party. Circular II.D.3 "Acquisition of Assets from Related Parties" (November 2000) has been revised to include this change.

## THE BASIC RULE

*Section 71*

10. An "in-house asset" of a fund is:
    - a loan to, or an investment in, a related party of the fund; or
    - an investment in a related trust of the fund; or
    - an asset of the fund subject to a lease or lease arrangement between the trustee of the fund and a related party of the fund

    other than an asset which is excepted under section 71 of SIS (see paragraphs 25 to 27 below).

11. The amount of in-house assets that a fund may have is generally limited to 5% of the market value of a fund's assets. See Appendix B for a summary of the phasing in of the limits.

12. There are also rules about agreements that result in the circumvention of the in-house asset requirements, and other anti-avoidance measures. These are discussed at paragraphs 84 to 87 below.

## MEANING OF CERTAIN TERMS

*Section 10, 70E, 71(1A)*

13. ***Related party of a fund*** The term "related party of a fund " covers all members and standard employer-sponsors of the fund and all Part 8 associates of these. Introduction of the term in SLAA4 effectively widens the parties in respect of whom the in-house asset restrictions apply. Previously, the restrictions applied only in respect of investments in, and loans to, standard employer-sponsors and their associates.

14. ***Part 8 associate*** The term "Part 8 associate" has replaced the former section 70 definition of "associate" in relation to an employer-sponsor. New sections

70B to 70E set out which individuals and entities are associates of a standard employer-sponsor or a member of a fund and explain concepts relating to control and influence. A detailed listing of Part 8 associates in relation to various entities is set out in Appendix A, together with the meaning of certain terms used in the listing. The amendments bring both controlled and controlling entities into the ambit of "associate".

15. ***Entity*** The term "entity" means any of the following: an individual, a body corporate, a partnership, a trust.

16. ***Standard employer-sponsor*** A "standard employer-sponsor" is an employer that contributes to a fund (or has ceased only temporarily to contribute) for the benefit of a member of the fund or a member's dependants, the member being either an employee of the employer or of an associate of the employer, wholly or partly pursuant to an arrangement between the employer and the trustee of the fund.

17. Typically "company funds" and "industry funds" are standard employer-sponsored funds. However, where an employer allows employees to select the fund to which the employer will contribute, but the employer has no other association with the fund, the fund is not a standard employer-sponsored fund. A common example of this is a "personal" superannuation fund established and operated by an insurer or bank. In some cases a master trust or a public offer fund will also not be considered to be an employer-sponsored fund.

18. Determining the basis on which contributions are made requires examination of relevant documents on a case-by-case basis to see if they refer to an employer having agreed, formally or informally, with a trustee to make contributions and/or for the trustee to accept contributions and credit them to the fund. Alternatively the agreement for the employer to make contributions may be between the employer and one or more members. If the former applies, the employer-sponsor will be a standard employer-sponsor; if the latter, the employer will not be a standard employer-sponsor.

19. APRA has the power, in respect of the funds which it regulates, to make a written determination that a person can be taken to be a standard employer-sponsor of a fund.

20. ***Related trust of the fund*** A "related trust of the fund" means a trust that a member or a standard employer-sponsor of the fund controls (within the meaning of section 70E of SIS), but does not mean a trust that arises when a fund investment is made, under which a listed security is held in trust until the purchase price of the security is fully paid. An example is the "instalment warrant" issued by Telstra. If an investment in the underlying security will otherwise be an in-house asset of the fund, it will still be treated as an in-house asset.

21. ***Lease arrangement*** A "lease arrangement" means any agreement, arrangement or understanding in the nature of a lease (other than a formal lease) between the trustee of a fund and another person, under which the other

person uses, or controls the use of, property owned by the fund. This is regardless of whether the agreement, arrangement or understanding is enforceable, or intended to be enforceable, by legal proceedings. The concept encompasses informal arrangements that lack formal evidentiary documentation.

22. ***Loan*** The term "loan" includes the provision of credit or any other form of financial accommodation, whether or not enforceable, or intended to be enforceable, by legal proceedings.

23. ***Invest*** A definition of "invest" was inserted in SIS (by *Superannuation Legislation Amendment Act 1999*) and the former definition of "investment" repealed. The term "invest" means apply assets in any way, or make a contract for the purpose of gaining interest, income, profit or gain.

24. ***Widely held trust*** A unit trust in which the unitholders have fixed entitlements to all of the income and capital of the trust**,** and fewer than 20 entities between them do not have fixed entitlements to 75% or more of the income or capital of the trust. For this purpose, an entity and its Part 8 associates are taken to be a single entity. Spreading entitlements to the income and capital of a unit trust within a particular group of associated entities will not gain for the trust the character of a widely held unit trust.

## EXCEPTIONS TO THE IN-HOUSE ASSET DEFINITION

*Section 71*

25. Not all investments by funds in related parties, or arrangements with related parties, are in-house assets. Exceptions are listed in section 71(1). They are, briefly:

| **Exception** | **Applies from** | **Legislative Reference** |
|---|---|---|
| A life policy issued by a life insurance company;<br><br>but not a life policy acquired from a member of the fund or a relative of a member | commencement of SIS<br>_____<br>from 11 August 1999 | 71(1)(a)<br><br>see 66(2A)(a)(iii)) |
| A deposit with an authorised deposit-taking institution (ADI), that is, a body corporate that is an ADI under the *Banking Act 1959*, or a State bank (includes building societies and credit unions formerly regulated under the Financial Institutions Code of the various States and Territories) | commencement of SIS, amended to include from 1 July 1999 former approved non ADIs | 71(1)(b) |
| An investment in a pooled superannuation trust made on an arm's-length basis | commencement of SIS | 71(1)(c) |
| An investment by a public sector fund in securities issued by the Commonwealth, a state or territory government, or a public authority that is not a standard employer-sponsor or associate of a standard employer-sponsor of the fund | commencement of SIS | 71(1)(d) |

| | | |
|---|---|---|
| In the case of a fund with fewer than 5 members, business real property subject to a legally enforceable lease or lease arrangement between the trustee and a related party of the fund, provided that during the whole term of the lease the property is business real property of the fund within the meaning of subsection 66(5). Revised Circular II.D.3[2] explains further. | from 11 August 1999 | 71(1)(g) |
| An investment in a widely held unit trust | from 11 August 1999 | 71(1)(h), also 71(1A) |
| Property owned by the fund and a related party as tenants in common, that is not property subject to a lease or lease arrangement between the trustee and a related party of the fund | from 11 August 1999 | 71(1)(i) |
| In the case of a fund with fewer than 5 members, an investment in a company or unit trust that meets the conditions in Division 13.3A of the SIS Regulations (investment in non-geared related entity that holds business real property or other assets not subject to a lease or lease arrangement or otherwise prohibited by the Regulations). | from 28 June 2000 | SIS Regulations Division 13.3A |

26. In addition to the above exceptions, the Regulator also has the power to determine that an asset of a fund is not an in-house asset of that fund *(section 71(1)(e))*, or any fund *(section 71(1)(f)(i))* or a class of funds in which the fund is included *(section 71(1)(f)(ii)*). This may occur where an asset is technically caught by the provisions, but by its nature is not considered to pose the same investment risk as in-house assets in general. A determination under section 71(1)(e) may be made with retrospective effect, and a decision not to make, or to revoke, a determination is a decision that may be reviewed. A determination under section 71(1)(f) is a disallowable instrument under the *Acts Interpretation Act 1901*. In making a determination, APRA would have regard to the objectives of the full range of the investment rules.

27. Further, there is scope under the Act for regulations to be made to specify that a class of assets not be an in-house asset of any fund *(section 71(1)(j)(i))* or of a class of funds *(section 71(1)(j)(ii))* to which the fund belongs. For this purpose, a class of assets may consist of, but is not limited to, assets that are investments in entities that undertake, or do not undertake, specified activities. In other words, the focus of the regulation would be the underlying investment activity of an entity in which the fund has an interest. Regulations have been made under this provision to exempt from the in-house asset rules investments by funds with fewer than 5 members in certain related non-geared entities. See the Table in paragraph 25 above and further description at paragraphs 63 to 67 below. Regulations made under section 71(1)(j) may also be made with retrospective effect.

[2] Circular II.D.3 "Acquisition of Assets from Related Parties" (November 2000)

## TRANSITIONAL EXCEPTIONS IN SLAA4 - SECTIONS 71A-71E

28. Transitional rules apply in respect of certain related party investments, loans and leases in place before the "test time" (that is, in place before the end of 11 August 1999, the date of introduction into Parliament of the SLAA4 legislation). Where such assets were not previously classed as in-house assets but would be caught by the changes, the transitional rules apply to prevent retrospective disadvantage. They also allow additional investments in existing related party assets to be made until 30 June 2009 in certain limited circumstances.

### Section 71A - 11 August 1999 investments and loans

29. Fund investments and loans in place at 11 August 1999, are not subject to the new rules *(section 71A(1)(a)(i)).* That is, they are not counted as in-house assets unless they were already in-house assets under the pre-SLAA4 definition *(section 71A(1)(b)).*

30. Fund investments or loans that were not in place at 11 August 1999 but were made after that time under a contract entered into before the end of 11 August 1999 are also not subject to the new rules *(section 71A(1)(a)(i) and (c)).*

31. The same applies to shares, or units in unit trusts, notwithstanding any subsequent payments made in respect of those shares or units, after the test time and before 1 July 2009 *(section 71A(1)(a)(ii)).* See paragraphs 39 to 47 below for rules about further investment in such entities before 1 July 2009.

32. Payments made after 30 June 2009 on partly paid shares or units in a unit trust, that would have been in-house assets after 11 August 1999 but for the transitional provisions, will be counted as in-house assets *(section 71A(2))* from the time of making the payment. A formula for working out the value of the post 30 June 2009 in-house asset is provided *(section 71A(3)).*

### Section 71B - 11 August 1999 leases and lease arrangements

33. Assets subject to a lease or lease arrangement between the trustee and a related party and in place at 11 August 1999, are not subject to the new rules after 11 August 1999, provided the lease continues or is renewed with any related party and there are no gaps between lease renewals. That is, they are not counted as in-house assets *(section 71B(1)).*

34. The terms and conditions of a renewed lease need not be the same, but must be in respect of the same asset or assets. Further, there must be an uninterrupted sequence of leases or lease arrangements. The exemption also applies if the lease had been entered into before the end of 11 August 1999 but did not commence until after 11 August 1999, provided the lease or lease arrangement was enforceable by legal proceedings *(section 71B(2)).*

**Section 71C - Transition period: post 11 August 1999 and pre Royal Assent**

35. Investments in and loans to related parties made between the date of introduction and the date of Royal Assent to the SLAA4 amendments will not be counted as in-house assets until 1 July 2001. That is, investments and loans made between 12 August 1999 and 23 December 1999 that would be in-house assets but for this provision, are not counted as such until 1 July 2001.

36. If a contract was entered into before the end of 11 August 1999 that resulted in an investment or loan being made in or to a related party after 11 August 1999, then the resulting asset is not one that is treated as being made during the transitional period ending on 30 June 2001 *(section 71C(1)).*

37. Leases and lease arrangements entered into with a related party after 11 August 1999 (if section 71B does not apply) but before 23 December 1999 are also not counted for in-house asset purposes until 1 July 2001 *(section 71C(2)).*

**Sections 71D and E - reinvestments and geared investments**

38. Certain specified investments made after 11 August 1999 are also not subject to the changes. These exceptions, set out in sections 71D and 71E, may apply in certain situations where, under arrangements commenced prior to the end of 11 August 1999, ongoing investment by the fund is relied upon to reduce or extinguish debt in an underlying asset of the fund. Section 71E is only available in respect of funds with fewer than 5 members. Trustees of such funds can choose to take advantage of either, but not both, of the exemptions, where the particular fund asset was not classed as an in-house asset prior to the end of 11 August 1999.

**Option A: 71D - Reinvesting earnings**

39. If a fund has an investment in a related entity at the end of 11 August 1999, the trustee can, after that time but not later than 30 June 2009, reinvest earnings from that entity, back into that same entity. "Earnings on earnings" may also be reinvested during that period. The total amount reinvested up to 30 June 2009 must not exceed the sum of the amounts received by the fund as dividends or trust distributions during the 12 August 1999 - 30 June 2009 period.

40. Amounts covered by the calculations under section 71D do not include investments that fall within the exceptions in section 71A. Thus, a trustee can meet outstanding capital calls under 71A and reinvest earnings under 71D up to 30 June 2009. (However, note that neither section 71A nor 71D will apply to reinvestment in the case of a fund that has fewer than 5 members and the option under section 71E (see below) is chosen.)

**Option B: 71E - Geared investments**

41. If, at 11 August 1999, a fund with fewer than 5 members had as an asset an investment in a related unit trust or company, and:

- the asset was not an in-house asset of the fund at that time, but
- additions to that investment after 11 August 1999 would be counted for in-house asset purposes except for this section, and
- that related trust or company was geared at 11 August 1999, and the borrowing was owed to any entity other than the fund, then

the trustee of the fund can make certain additional investments in the trust or company after that date without having the additional investment counted for in-house asset purposes *(section 71E(1)(a))*.

42. The additional investments may be made provided:

- the sum of the additional investments does not exceed the amount of the loan in the trust or company at 11 August 1999 *(section 71E(2))*, and
- the additional investments are made no later than 30 June 2009 *(section 71E(1)(a))*, and
- the trustee makes a written election by 23 December 2000 (or later if allowed by regulations) that section 71E is to apply to all the additional investments of the fund in that related entity *(section 71E(1)(e) and (5)).*

43. *Example:* in a situation where a fund with fewer than 5 members held units in a related unit trust at 11 August 1999, and that unit trust had bank borrowings of $100,000, the trustee may make additional investments in that unit trust, for example after receipt of contributions into the fund or of other fund income, until 30 June 2009. However, the sum of the additional investments by the fund must not exceed $100,000, and the trustee must have made the election that section 71E applies to the additional investments.

44. The amount of the debt at 11 August 1999 need not necessarily be the original capital amount of the loan - it may include previously capitalised interest on the original principal. However, for ongoing purposes it is the amount of the principal outstanding at 11 August 1999 that is the relevant amount *(section 71E(6)).*

45. In the event that the sum of the additional investments exceeds the amount of the debt at 11 August 1999, then a formula applies to calculate the value of the increment that will be treated as an in-house asset *(sections 71E(3) and (4)).*

46. The effect of making an election under section 71E is to limit additional fund investment in the underlying geared asset to the amount of debt at 11 August 1999. That is, the options under sections 71D and 71A are no longer available to a trustee that makes an election under section 71E *(sections 71E(5))*.

47. The election under section 71E must be made in writing. The trustee must retain the election, or a copy of it, for 10 years *(section 103(2A)).*

## COST OF IN-HOUSE ASSETS

*Section 73*

48. Under the SIS Act, where an asset is acquired for no consideration, for other than "arm's length" value, or part of the consideration was not monetary, the cost of the asset is taken to be its arm's length value. The arm's length value is the amount that the asset could reasonably have been acquired for if the parties to the transaction were dealing with each other at arm's length. Barring exceptional circumstances, this is expected to equate to market value.

49. Section 73 of the SIS Act ensures that the intention of the in-house asset rules is not avoided by a fund acquiring in-house assets at less than market value or non in-house assets at inflated values (section 85 would also generally operate to prevent such avoidance, refer paragraph 87 below).

50. The cost of an in-house asset (for historical cost purposes) would ordinarily have been the price for which the asset was purchased. Brokerage and stamp duty costs incurred in connection with the purchase of shares or securities need not be regarded as part of the historical cost of such assets.

51. From the beginning of the 1998/99 year of income of a fund, in-house assets are measured at market value. The basis for testing compliance is at the end of the year of income. For the 1998/99 and 1999/2000 years, the limit is a 10% market value ratio, that is, market value of in-house assets expressed as a percentage of the market value of total fund assets. From the 2000/01 year of income, a market value ratio of 5% applies to all funds.

52. A general provision set out in section 83 prohibits the acquisition of an in-house asset (including commencement of a lease with a related party) if the market value ratio of the fund's in-house assets already exceeds 5%, or if the acquisition would cause the market value ratio of the fund's in-house assets to exceed 5%.

### Leases

53. Measurement of fund exposure to related parties via leasing transactions is required following the SLAA4 amendments which brought leases of fund assets to related parties into the ambit of the in-house asset restrictions.

54. Where an asset of a fund is the subject of lease, it will be the market value of the leased asset that is to be counted for the in-house asset ratio. APRA is aware that some trustees may consider this to be inappropriate in some limited circumstances. If the trustee of an APRA regulated fund believes a different treatment is warranted in their particular circumstances, an approach may be made to APRA for a determination under section 71(1)(e).

55. A determination under paragraph 71(1)(e) would be considered only where the nature of the asset does not pose the same investment risk as in-house assets in general.

### Treatment of capitalised earnings

56. Funds with in-house assets consisting of loans to related parties often agree to capitalise earnings on such loans rather than receive regular interest payments. APRA generally regards such capitalised interest payments as an addition to the level of in-house assets of the fund. Where a fund does not receive due interest payments, and these are not capitalised, the fund **may** be in breach of the arm's length requirement in section 109 of the SIS Act. A factor in determining whether a breach has occurred is the degree of any attempts by the trustee to secure repayment of the loan.

## INVESTMENT IN RELATED TRUSTS

***Sections 71(1) and (1A,) and 66(2A)***

57. As a consequence of the SLAA4 amendments, a fund investment in a related trust will be an in-house asset unless the trust is a widely held trust. If the investment meets the definition of widely held trust, the trust is automatically not a related trust and is therefore excluded from the in-house asset definition. This test is not satisfied if there are fewer than 20 unrelated entities that between them are entitled to 75% of the income or 75% of the capital of the trust.

58. There will be some corporate structures where the responsible entity of a Managed Investment Scheme or the trustee of a unit trust can be regarded as controlled by the standard employer-sponsor of a fund that has investments in the Scheme or the unit trust. Where the Scheme or trust is not a widely held trust, the fund investment will, by default, be an in-house asset. However, an exception is an investment in a pooled superannuation trust which is not treated as an in-house asset, provided the investment is entered into on an arm's length basis *(section 71(1)(c))*.

59. A trustee may apply for a determination under section 71(1)(e) that the investment in the related trust not be taken to be an in-house asset. Significant factors that would be taken into consideration by APRA in assessing such an application would include whether the underlying assets of the related trust are investments in the employer-sponsor or a related party and whether the investors behind the related unit holders are unrelated parties. As noted in paragraph 26 above, the objectives of the full range of the investment rules would be taken into account, as would the substantive effect of a transaction.

60. If a determination is made under section 71(1)(e), then section 66(2A) operates to permit the trustee of the fund to acquire from the related party an asset that constitutes an investment in the related party.

## JOINT INVESTMENTS WITH RELATED PARTIES

61. The SLAA4 amendments clarified that a fund could invest in property with a related party on a tenants in common basis without the investment being classed as an in-house asset *(section 71(1)(i))*. While the borrowing restrictions prevent a fund from charging assets, the prohibition does not extend to the

other titleholder. In APRA's view, it would be more prudent for a trustee to refrain from investing as a tenant in common where the related party intends to use its investment in the property as security against borrowings.

62. In considering a joint investment when formulating the investment strategy of the fund, a trustee should weigh any risk that the strategy would be subordinated to the circumstances of the other party, for example, in respect of a forced sale of the property where the other titleholder is required to liquidate its assets. While effectively a forced sale would only be in respect of the other tenant's share, it is commercially more realistic to expect that the whole property would have to be sold in such circumstances. In APRA's view, an appropriate protection would be to obtain in writing the agreement of the lender that the fund's share of the proceeds of any forced sale would receive priority and are therefore not, indirectly, subject to any charge.

## INVESTMENT BY FUNDS WITH FEWER THAN 5 MEMBERS IN RELATED NON-GEARED ENTITIES

*Regulations 13.22A to 13.22D*

63. These regulations commenced on 28 June 2000. They enable a small superannuation fund to jointly invest with members and employer-sponsors in a company or trust that owns real property used for business purposes and also allows the business real property to be leased to members and employer-sponsors. While the assets that may be owned by the company or trust are not restricted to business real property, certain conditions apply to the company or trust so that the objectives of the investment rules that apply to regulated superannuation funds are maintained.

64. Briefly, the main conditions are that:
- the entity does not borrow;
- there is no charge over an asset of the entity;
- the entity does not invest in or lend money to individuals or other entities (normal deposits with authorised deposit taking institutions are excepted, but shares or units in other companies or trusts are not permitted);
- the entity has not acquired an asset from a related party of the fund after 11 August 1999 other than business real property;
- the entity does not acquire an asset, other than business real property, that has been owned by a related party of the fund in the previous 3 years (not including any period of ownership prior to 11 August 1999);
- the entity does not directly or indirectly lease assets to related parties, other than business real property;
- the entity does not conduct a business, and
- the entity conducts all transactions on an arms-length basis.

65. To qualify for exception to the definition of an in-house asset, an investment by a small superannuation fund in a related company or trust must meet the requirements set out above. If one of the requirements is breached, the exception ceases to apply to existing investments by the fund in the entity (the

investment will then be an in-house asset) and is unavailable to future investments in that entity.

66. The regulations provide for investments made before as well as after commencement of the regulations.

67. The regulations are made for the purposes of section 71(1)(j)(ii). Thus, where the company or trust is owned by a related party before the fund invests, section 66(2A) operates to permit the trustee of the fund to acquire shares or units in the company or trust from the related party. Additional shares or units may also be acquired, provided the conditions set out above are met.

## TREATMENT OF SUB-FUNDS AND FUNDS WITH UNRELATED EMPLOYER-SPONSORS

*Sections 69A, 72, 75*

68. For the purpose of calculating in-house asset ratios, a sub-fund within a regulated superannuation fund may be treated as a separate fund when the following conditions apply:

- the sub-fund has separately identifiable assets and separately identifiable beneficiaries; and
- the interest of each beneficiary of the sub-fund is determined by reference only to the conditions governing that sub-fund *(section 69A).*

69. Similarly, where there are 2 or more employer-sponsors of a fund, and at least one of these is not a Part 8 associate of any other employer-sponsor of the fund, the in-house assets requirements apply separately. That is, any loans, investments or leases with:

- a particular unrelated employer-sponsor, or
- a Part 8 associate of that employer-sponsor, or
- a standard employer-sponsored member in respect of whom that employer-sponsor (or its associate) contributes,

together with any investments in a trust controlled by any of the above parties, will be regarded as in-house assets in respect of that particular unrelated employer-sponsor.

70. Accordingly, the in-house asset ratio will be calculated separately in relation to the in-house assets of the fund that are attributable to that unrelated employer-sponsor.

71. Where there are 2 or more related employer-sponsors, the in-house asset ratio in respect of this group will be calculated in relation to the in-house assets of the fund attributable to the related employer-sponsors.

72. The same principle applies where there are 2 or more groups of related employer-sponsors but the groups are unrelated. The in-house asset ratio is calculated for each group according to the in-house assets of the group.

73. In each of the above situations, the in-house asset ratio would include the in-house assets of the class identified (for example, the in-house assets of the fund attributable to a group of related employer-sponsors) plus the in-house assets that do not correspond to one or more employer-sponsors of the fund *(section 75)*.

74. Self managed superannuation funds are not required to differentiate between unrelated employer-sponsors when calculating fund in-house asset ratios.

## TREATMENT OF DEFINED BENEFIT FUNDS

*Sections 83A to 83E*

75. The in-house asset rules are relaxed to a limited extent for defined benefit funds that have substantial surplus assets. Division 3A of Part 8 of SIS applies in respect of a fund's 1998-99 year of income or a later year of income if certain conditions are met. In essence, Division 3A enables certain defined benefit funds to hold their existing in-house assets and not have to sell them in order to comply with the phased reduction of in-house assets to 5% of the market value of total assets. However, there are a number of conditions that must be met in order for a fund to be able to take advantage of this concession.

76. These conditions are as follows:

- the defined benefit fund must have an employer-sponsor which is a listed public company or an associate of a listed public company;

- the market value of the fund's assets must not be less than the base amount defined in section 83A (to provide a buffer against short term decreases in the value of the assets backing the vested benefits and to increase the security of fund assets); and

- the trustee of the fund must decide, and record this decision in writing, that Division 3A is to apply to the fund in respect of a particular year of income.

77. Essentially, a defined benefit fund that meets these conditions is permitted to use a base amount of 120 per cent of the greater of :

- the fund's liabilities in respect of vested benefits, or
- the fund's accrued actuarial liabilities

as the amount against which the prescribed in-house asset ratio is calculated. The prescribed percentage is the same as applies to all other funds, that is, 10% of market value during the 1998/99 and 1999/2000 years of income, and 5% thereafter.

78. Further, any excess above the prescribed in-house asset level may be ignored provided the excess:

- consists of the amount (if any) by which the market value of the fund's assets at the time exceed the base amount at that time; and
- is composed of shares in listed public companies, provided that the shares held comprise no more than 5% of the voting shares in such company that is the employer-sponsor of the fund or an associate of the employer-sponsor.

79. For example, a fund with liabilities of $100m must have assets of at least 120 per cent of $100m in order for Division 3A to apply, that is, the base amount would be $120m. If the market value of the fund's assets is $150m, the maximum permitted amount of in-house assets that the fund may have in the 2000-2001 year of income is calculated as follows:

(5% x $120m) + ($150m - $120m )
= $6m + $30m = $36m

80. Further acquisition of in-house assets is not permitted unless the market value of the fund's in-house assets has ceased to exceed the prescribed percentage (10 per cent or 5 per cent after 1999-2000) of 120 per cent of the fund's liabilities. Thus, financially strong defined benefit funds can continue to hold certain in-house assets but cannot acquire additional in-house assets. In other words, excess in-house assets may only be increased by way of revaluation, not by new acquisitions.

## TREATMENT OF PUBLIC OFFER FUNDS

81. The in-house asset restrictions in Part 8 originally applied only to loans to and investments in a standard employer-sponsor of a fund and in any associate of the standard employer-sponsor. Trustees of public offer funds, which are rarely standard employer-sponsored funds, are generally prohibited from investing in the trustee itself or in a related body corporate.

82. However, there are exceptions where the related body corporate is another institution regulated under the same supervisory system. There is no restriction where the related body corporate is a life insurance company or an authorised deposit-taking institution (ADI) and the relevant fund investments are policies issued by, or deposits with, those institutions.

83. Investments other than policies or deposits in such related bodies corporate, for example loans or equity investments, are restricted to 5% of fund assets. These restrictions, and the course of action to be followed in the event that the 5% ceiling is exceeded at the end of the income year, are set out in SIS Regulations 13.17A and 13.17AA.

## INDIRECT IN-HOUSE ASSETS AND ANTI-AVOIDANCE MEASURES

*Sections 71, 85*

84. Prior to the SLAA4 amendments, SIS contained a provision to cover certain agreements where any person that entered into or carried out the agreement did so for the purpose of achieving the equivalent of an in-house investment

*(section 71(2))*. Where this provision applied, an asset that would not otherwise be an in-house asset is taken to be an in-house asset. For example, an investment may have been made in a non-associated entity which in turn invested into a standard employer-sponsor or an associate, resulting in the equivalent of an in-house asset.

85. Now, for this provision to apply, it is sufficient that the persons who entered into or carried out an agreement were aware that the result would be that a loan would be made to, or an investment made in, or an asset would become subject to a lease with, a related party of the fund. An agreement in this context includes any arrangement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable, or intended to be enforceable, by legal proceedings *(section 71(2A))*. The provision does not apply to investments in life policies, deposits with banks and other approved institutions, investments in PSTs and widely held unit trusts *(section 71(2B))*.

86. In respect of the funds it regulates, APRA may determine, by written notice to the fund and with effect from the date of the notice or an earlier date specified in the notice, that an asset of the fund is an in-house asset *(section 71(4))*.

87. Schemes that result, or would be likely to result, in the artificial reduction in the market value ratio of a fund's in-house assets and thus the avoidance of the in-house asset restrictions, are also prohibited *(section 85)*. In this context, 'scheme' means any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable or intended to be enforceable by legal proceedings, as well as any scheme, plan, proposal, course of action or course of conduct, whether unilateral or otherwise.

**PENALTIES**

*Sections 84, 85,193*

88. Trustees of regulated superannuation funds are obliged to take all reasonable steps to ensure that the relevant in-house asset provisions are complied with.

89. Significant civil and criminal penalties may apply to trustees breaching the in-house asset provisions.

90. In addition, where a trustee contravenes the provisions, the fund may as a result be refused complying status for the relevant year of income, with adverse taxation consequences.

## APPENDIX A

### Table 1. A related party of a superannuation entity means any of the following:

| Legislative reference | Related Party | Note |
|---|---|---|
| 10(1) SIS ***related party*** | (a) member of the fund | in SMSFs includes (a) a person who has deferred his/her entitlement to receive a benefit from the fund, and (b) a pensioner of the fund. Otherwise as set out in the trust deed and governing rules of a specific fund |
| 10(1) SIS ***related party*** | (b) standard employer-sponsor of the fund | defined at s.16 SIS |
| 10(1) SIS ***related party*** | (c) Part 8 associate of a member or a standard employer-sponsor | see next table |

**Table 2. A Part 8 associate of a member or a standard employer-sponsor includes any of the following:**

| **Primary entity** | **SIS Act Leg.Ref** | **Part 8 associate of primary entity** |
|---|---|---|
| *Where the primary entity is an individual,* for example, a member, or where a standard employer-sponsor is an individual | 70B (a) | a relative of the individual |
| | 70B(b) | if the individual is a member of a fund with fewer than 5 members -<br>(i) each other member of the fund;<br>(ii) if it is a single member self managed superannuation fund whose trustee is a company - each director of that company<br>(iii) if it is a single member self managed superannuation fund whose trustees are individuals - those individuals |
| | 70B(c) | a business partner of the individual or a partnership in which the individual is a partner |
| | 70B(d) | if a partner in (c) is an individual - the spouse or child of that individual |
| | 70B(e) | a trustee of a trust (in the capacity of trustee of that trust) controlled by the individual |
| | 70B(f) | a company sufficiently influenced by, or in which a majority voting interest is held by:<br>(i) the individual;<br>(ii) another Part 8 associate of the individual; or<br>(iii) 2 or more Part 8 associates of the individual |
| *Where the primary entity is a company*, for example, the standard employer-sponsor is company, including a company in the capacity of a trustee | 70C(a) | a partner of the company or a partnership in which the company is partner |
| | 70C(b) | if a partner in (a) is an individual - the spouse or child of that individual |
| | 70C(c) | a trustee of a trust (in the capacity of trustee of that trust) controlled by the company |
| | 70C(d) | a "controlling" entity or another entity that is a Part 8 associate of the "controlling entity" (within the meaning of Subdivision B)or a combination of 2 or more such entities that on its own can "sufficiently influence", or holds a majority voting interest in, the company, |
| | 70C(e) | another "controlled" company which the primary entity sufficiently influences, or in which the primary entity holds a majority voting interest, alone or with another entity that is a Part 8 associate of the primary entity, or a combination of 2 or more such entities |
| | 70C(f) | Part 8 associates of a "controlling" entity because of section 70B or 70 D or because of another paragraph of section 70C |
| *Where the primary entity is a partnership,* for example, the standard employer-sponsor is a partnership | 70D(a) | a partner in the partnership |
| | 70D(b) | if the partner in (a) is an individual, any Part 8 associate of that individual (because of section 70B) |
| | 70D(c) | if the partner in (a) is a company, any Part 8 associate of that company(because of section 70C) |

**Table 3. Meaning of terms used in determining which entities are Part 8 associates**

| Term | Legislative Reference | Meaning |
|---|---|---|
| Sufficient influence | 70E(1)(a), for the purposes of 70B, 70C and 70D | A company is sufficiently influenced by an entity or entities if:<br>- the company, or a majority of its directors,<br>- is accustomed or under a formal or informal obligation, or might reasonably be expected, to act<br>- in accordance with the directions, instructions or wishes of the entity or entities (regardless of whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts. |
| Majority voting interest | 70E(1)(b), for the purposes of 70B, 70C and 70D | An entity or entities hold a majority voting interest in a company:<br>- if the entity or entities are in a position to cast,<br>- or control the casting of,<br>- more than 50% of the maximum number of votes that might be cast at a general meeting of the company. |
| Control of trust | 70E(2), for the purposes of 70B, 70C and 70D | An entity controls a trust if:<br>(a) a group in relation to the entity has a fixed entitlement to more than 50% of the capital or income of the trust; or<br><br>(b) - the trustee of the trust, or a majority of the trustees,<br>- is accustomed or under a formal or informal obligation, or might reasonably be expected, to act<br>- in accordance with the directions, instructions or wishes of a group in relation to the entity (regardless of whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts); or<br><br>(c) a group in relation to the entity is able to remove or appoint the trustee, or a majority of the trustees, of the trust.<br><br>Note that a situation can arise where 2 or more unrelated funds each own equal proportions of a unit trust, with no fund (or any of its related parties) having control over the activities of the trust. Such a trust would not be a related party of either fund. However, anti-avoidance rules apply to agreements that result in investments in in-house assets. |
| | 70E(3), for the purposes of 70E(2) | Group, in relation to an entity, means<br>(a) the entity acting alone; or<br>(b)a Part 8 associate of the entity acting alone; or<br>(c)the entity and one or more Part 8 associates of the entity acting together; or<br>(d) 2 or more Part 8 associates of the entity acting together. |

| Term | Legislative Reference | Meaning |
|---|---|---|
| Company | 70E(4), for the purposes of 70B, 70C and 70D | has the same meaning as in the ITAA Act 1997 |
| Partnership | | |
| Relative | | A “relative” means the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the member or of the member's spouse, the spouse of the member, or the spouse of any of those relations. |
| Entity | 10(1) | means any of the following: an individual, a body corporate, a partnership, a trust. |

**APPENDIX B**

**Table 1. Initial phase-in of in-house asset limits under SIS**

The in-house asset limits were phased in as follows**:

| IHA definition | Year of income | IHA limit and basis of testing compliance | Legislative reference |
|---|---|---|---|
| An investment in, or a loan to, a standard employer-sponsor or an associate of a standard employer sponsor [(section 71(1) prior to SLAA4] | 1994/95 year of income of a ***private sector fund*** established ***on or after 12 March 1985*** | Historical cost ratio must not exceed 10% of total assets **at all times during the year** | section 76 |
| | 1994/95 year of income of a ***private sector fund*** established ***before 12 March 1985*** | Historical cost ratio must be the lesser of 70% or the percentage of IHA (historical cost) at 11 March 1985, **at all times during the year** | section 77 |
| | 1994/95 year of income of a ***public sector fund*** established ***on or after 1 July 1990*** | Historical cost ratio must not exceed 10% of total assets, **at all times during the year** | section 78 |
| | 1994/95 year of income of a ***public sector fund*** established ***before 1 July 1990*** | Historical cost ratio must not exceed the greater of 10% or the percentage of IHA (historical cost) at 1 July 1990, **at all times during the year** | section 79 |
| | ***All funds*** - start of 1995/96 year of income to end 1997-98 year of income | 10% of total assets based on historical cost values, **at all times during the year** | section 80 |
| | ***All funds, unless Div.3A* applies*** - at end of 1998/99 or 1999/2000 year of income of a fund | 10% of total assets based on market values, **at end of year** | sections 80A and 81 |
| | ***All funds, unless Div.3A* applies*** - start of 2000/01 year of income of a fund, and later years of income | 5% of total assets based on market values, **at end of year. If 5% exceeded, plan to be made to comply.** | sections 80A and 82 |
| | ***All funds, unless Div.3A* applies*** - from commencement of SIS | If the market value ratio of a fund's IHA exceeds 5%, further IHA must not be acquired. If it does not exceed 5% but an increase in IHA would result in the market value ratio exceeding 5%, the new investment must not be made | sections 80A and 83 |

*Under Division 3A of Part 8 of SIS, in-house asset rules are relaxed to a limited extent for certain defined benefit funds in surplus. Division 3A commenced from 31 May 1999. See page 15.

** Previously the in-house asset limits were prescribed in *the Occupational Superannuation Standards Regulations,* and before that, in the *Income Tax Assessment Act 1936*.

## Table 2. Timeframe for commencement of SLAA4 amendments

| **Leases** | Leasing of asset commenced before 11/8/99 | Leasing of asset commenced between 12/8/99 and 23/12/99 | Leasing of asset commenced after 23/12/99 |
|---|---|---|---|
| Pre-11/8/99 contract | Exempt | Exempt | Exempt |
| No pre-11/8/99 contract | Exempt | Exempt until 1/7/2001 | In-house asset |

| **Investments** | Investment made before 11/8/99 | Investment made 12/8/99 to 23/12/99 | Investment made after 23/12/99 |
|---|---|---|---|
| Investment covered by pre-11/8/99 contract | Exempt | Exempt | Exempt |
| Investment not covered by a pre-11/8/99 contract (unless transitional rules apply) | Exempt | Exempt until 1/7/2001 | In-house asset |
| Payment on partly paid shares issued before 11/8/99 | Exempt | Exempt | Exempt if payment made before 30/6/2009 |
| Reinvestment that meets the requirements of section 71 D | N/A | Exempt | Exempt if made before 30/6/2009 |
| Investment into geared entity, that meets requirements of section 71E | N/A | Exempt | Exempt if made before 30/6/2009 |