

**AUSTRALIAN PRUDENTIAL
REGULATION AUTHORITY**

**SUPERANNUATION CIRCULAR
NO. II.D.3**

**ACQUISITION OF ASSETS FROM
RELATED PARTIES**

November 2000

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OBJECTIVES

1. The aim of this Circular is to provide general guidance on the restrictions on superannuation fund investment imposed by section 66 of the *Superannuation Industry (Supervision) Act 1993* ("SIS") which prohibits the acquisition of an asset from a related party of a fund.
2. This Circular replaces Superannuation Circular II.D.3 entitled "Acquisition of Assets from Members" which was released by the Australian Prudential Regulation Authority in September 1998. It incorporates amendments of SIS made by the *Superannuation Legislation Amendment Act (No 4) 1999* (SLAA4) which came into effect on 23 December 1999. It covers APRA's interpretation of the legislation as it applies to superannuation funds regulated by APRA.

BACKGROUND

3. Trustees of superannuation funds are generally free to make properly considered investment decisions that are consistent with their responsibilities for the sound and productive management of assets for the benefit of members. However, SIS prohibits or limits certain investment practices, which are inconsistent with Government retirement income policy objectives. Trustees who breach these provisions are exposed to significant penalties.
4. The SIS investment restrictions generally help protect and enhance the retirement benefits of members by limiting the exposure of their benefits to unnecessary risk. 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. The amendments introduced the definition of "related party" of a fund and extended to such parties the previous prohibition on acquisition of assets from members and relatives. The term "related party" applies to all members of the fund and their associates and all standard employer sponsors of the fund and their associates. See Table 1 of the Appendix.
5. The general prohibition on the acquisition of assets from related parties is designed to ensure that the retirement incomes policy objectives and taxation concessions are not compromised by inappropriate transactions, for example, those which provide a source of concessionally taxed finance to members in their pre-retirement years.

THE GENERAL PROHIBITION

Section 66

6. Section 66(1) prohibits trustees or investment managers of regulated superannuation funds from intentionally acquiring assets from related parties of the fund. The rule prohibits such parties from selling most assets to their fund, or from contributing assets “in specie” (assets other than money).
7. The term "related party" is defined in section 10 of the SIS Act and covers all members and all standard employer sponsors of the fund and "Part 8 associates" of these. The former section 70 definition of "associate" of an employer sponsor has been repealed and the new term "Part 8 associate" introduced. 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 Table 2 of the Appendix, together with definitions of certain terms used in the listing.
8. The term "entity" means any of the following: an individual, a body corporate, a partnership or a trust.
9. The term “asset” means any form of property including money, real property (eg. house and land) and personal property (eg. a boat, work of art or copyright ownership).
10. The prohibition is not restricted to acquisitions of assets, which occur only as a result of a purchase. Rather, the term “acquire” has a wider meaning and is generally taken to envisage any means by which the trustee becomes the legal or equitable owner of the asset. The intentional transfer or assignment of assets from a related party to the trustee of a fund, such as a life insurance policy acquired from a member of the fund or a relative of a member, is also subject to the prohibition.
11. The wide scope of the section prohibits a fund from accepting in specie contributions (non-cash assets) from related parties. However, the acceptance of monetary contributions is specifically allowed for by the definition of “acquire an asset” in section 66(5) of SIS. The term “money” is taken to include negotiable instruments such as cheques, bills of exchange or promissory notes.
12. The general prohibition does not prevent in specie contributions being made by a party other than a related party (for example, by an employer-sponsor that is not a related party of the fund) provided that the anti-avoidance provision or other investment provisions of SIS are not breached.

EXCEPTIONS TO THE GENERAL PROHIBITION

13. There are several exceptions to the prohibition against acquiring assets from related parties. These exceptions balance two important policy objectives. These are to stop any abuse of concessional tax treatment by superannuation funds (which may arise from transactions designed to manipulate assets) and the need to avoid discriminating against legitimate business transactions and impeding small business activities.
14. Notwithstanding these exceptions to the prohibition against acquiring assets from related parties, regulated superannuation funds are also required to comply with the other investment related provisions of SIS. These include the provisions requiring all investments to be made and maintained on an arm's length basis (that is, on commercial terms) and undertaken as part of a properly formulated, documented and implemented investment strategy for the fund.

Acquisition of listed securities

Section 66(2) and 66(5)

15. The first major exception allows trustees or investment managers to acquire listed securities from related parties, provided that these securities are acquired at market value. If the acquisition was at no cost, as an inspecie contribution, then the security should be recorded at the market value as at the date of transfer.
16. "Listed securities" are defined in subsection 66(5) of SIS as shares, units, bonds or debentures, rights or options or any other security listed for quotation in the official list of a stock exchange in Australia, or of an international stock exchange approved under the *Income Tax Assessment Act 1936*¹ or an exempt stock market under the Corporations Law².

Acquisition of business real property

Sections 66(2), 66(5), 66(6) and 15A

17. The second major exception to the general rule relates to business real property of a related party of a fund and applies only to superannuation funds with fewer than 5 members. Such funds are either self managed superannuation funds, regulated by the Australian Taxation Office, or small APRA funds with an independent corporate trustee approved under Part 2 of SIS.
18. Under this exception, a trustee of such a fund, from 7.30pm (by legal time in the Australian Capital Territory) on 12 May 1998, is able to utilise the whole of the assets of

¹ Refer Section 470 and Schedule 3 of the Income Tax Assessment Act 1936

² Refer Section 771 of the Corporations Law

the fund to acquire business real property from a related party. Prior to this time, the percentage of total fund assets that could be used to acquire exempt business real property from a member or relative of a member was capped at 40%. There was no cap, other than the particular investment strategy established by a trustee, on the percentage of fund assets that could be used to purchase property assets from third parties.

19. “Business real property” of an entity is defined in subsection 66(5) of SIS to mean:
- any freehold or leasehold interest of the entity in real property; or
 - any interest of the entity in Crown land, other than a leasehold interest, being an interest that is capable of assignment or transfer; or
 - another class of interest in relation to real property that is prescribed in regulations for this purpose;

where the real property is used wholly and exclusively in one or more businesses (whether carried on by the entity or not) but does not include any interest held in the capacity of beneficiary of a trust estate.

20. Property that meets this definition includes land on which business is conducted (eg. shop or factory) and land that is the subject of a business (eg. land held by a property developer for development or redevelopment, or in the process of being developed or redeveloped). The question of whether rental property owned by a related party is business real property that can be acquired by the trustee will depend on the facts of the case. Generally speaking, a single residential rental property will not be treated as business real property unless it forms part of a business of owning and leasing residential property.
21. Shares in a property owning company are not regarded as business real property for SIS purposes. Like units in a unit trust, these shares are personal property, and do not represent freehold or leasehold property rights. Therefore, such shares cannot be acquired from related parties under the exceptions, unless they are listed securities obtained by the fund at market value.
22. “Business” is defined in section 66(5) to include any profession, trade, employment, vocation or calling carried on for the purposes of profit. The carrying on of primary production and the provision of professional services are specifically included.
23. The term “business” does not include occupation as an employee. “Employee” is defined in section 15A of SIS to have its ordinary meaning, subject to specific provisions, which seek to expand the meaning of the term and clarify the status of certain persons. The following are examples of some of the individuals who are regarded, under this definition, as employees (in addition to those traditionally thought of as “employees”):

- a person who is entitled to payment for the performance of duties as a member of the executive body (eg. board of directors) of a body corporate;
 - a person who works under a contract that is wholly or principally for the labour of the person;
 - a person who is paid as a performer or presenter, or who provides services in connection with such performances or presentations;
 - a person who is paid to perform services in, or in connection with, the making of a film, tape, disc, television or radio broadcast;
 - a person who holds office as a member of any of the following bodies:
 - a local government council;
 - the Northern Territory or ACT Legislative Assembly; or
 - a State Parliament or the Commonwealth Parliament.
24. The question whether an entity is carrying on a business for the purpose of this exception is determined on a case-by-case basis. For an enterprise to be considered a “business” there must be some organised activity, which may be demonstrated by:
- the keeping of separate records;
 - the size of the operation and the capital investment involved;
 - whether transactions are conducted continuously or systematically, or merely ad hoc;
 - the time spent on the activity;
 - whether a business plan exists;
 - whether there is a reasonable expectation of profit; and
 - whether employees are involved.
25. It is also necessary that the property is a freehold or leasehold interest in real property **and** that the property is used “wholly and exclusively” in a business. It is no longer necessary that the business be carried on by the entity that is the related party of the fund. For example, the related party may be conducting a business on part of the land to which it has title, but may have subdivided and let out a vacant area to another business.

26. On the other hand, a situation where a property is used only partly for business will not meet the "wholly and exclusively" test. For example, a doctor's residence where part of the home is set aside for medical practice, or where a mechanic works from his home garage. The trustee of the fund could not acquire the residential property in these cases from the member.
27. After 11 August 1999, real property used in one or more primary production businesses will still meet the test of being used wholly and exclusively in that business, or those businesses, if an area of no more than 2 hectares of the property contains a dwelling used primarily for domestic or private purposes, and that area (of no more than 2 hectares) is used primarily for domestic or private purposes. That is, a farm property can still be treated as business real property where the house and garden of the owner or manager (for example) does not exceed 2 hectares, and the domestic or private purposes do not constitute the predominant use of the whole property. The latter provision restricts the exception to genuine primary production businesses rather than extending it to "hobby farms".

Other exceptions applying after 7.30 pm on 12 May 1998

Section 66(2)(c), (d)

28. Two further exceptions to the general prohibition on acquisition of assets from related parties apply from the 1998 Budget announcement.
29. The first relates to assets acquired by the trustee of a regulated superannuation fund under a merger between regulated superannuation funds, where the merger would otherwise result in acquisition of assets from a related party. A merger in this context comprises all the assets and liabilities of two or more separate funds being transferred into either one of the funds or into a new fund.
30. The second is a general provision that provides APRA (or the Commissioner of Taxation in respect of self managed superannuation funds) with the power to provide additional exceptions to section 66. APRA (or the Commissioner of Taxation in respect of self managed superannuation funds) may give a written determination that an asset is of a kind that may be acquired by any fund or by a class of funds in which a particular fund is included.

Other exceptions applying after 11 August 1999

Section 66(2A)

31. While section 66 prevents acquisition of assets from related parties, the in-house asset provisions in Part 8 of SIS allow a certain percentage of fund assets to be invested in, or

lent or leased to, related parties. To address the interaction between section 66 and Part 8, section 66(2A) was inserted into SIS by SLAA4.

32. The new subsection provides an exception to the prohibition of acquisition of assets by a trustee or investment manager of a superannuation fund from a related party of the fund, where the acquisition:
- constitutes an investment that is an in-house asset within the meaning of subsection 71(1), or would be an in-house asset if not for the transitional arrangements set out in Subdivision D of Part 8, or is covered by any of the exceptions set out in any of the paragraphs 71(1)(b) to (f) and (h) and (j); or is a life insurance policy issued by a life insurance company other than a policy acquired from a member of the fund or a relative of a member; and
 - is at market value; and
 - does not result in the level of in-house assets exceeding the level permitted by Part 8 of SIS.
33. For example, under section 66 a trustee would now generally be prohibited from acquiring shares in a private company that is a related party, such as a company associated with a standard employer-sponsor. However, under Part 8, it is permissible to make an investment in a related party (in the example, to buy shares in the private company) provided the new investment does not cause the fund's in-house asset level to exceed prescribed limits (5% of the market value of fund assets). Therefore, to be consistent, section 66 allows acquisition of an in-house asset from a related party provided the percentage of total fund assets involved does not exceed the limit set out in Part 8.
34. Amendment of the SIS Regulations as from 28 June 2000 allows a regulated superannuation fund with fewer than 5 members to jointly own business real property with a related party by investing in a related entity that holds the property. The entity must meet particular conditions, such as not borrowing, in order for the fund's investment in it to be excepted from the in-house asset provisions. The regulations (SIS regulations 13.22A to 13.22D) were made under section 71(1)(j)(ii) and therefore section 66(2A) operates to allow the acquisition of an asset (in this case, shares or units in the related entity) from a related party without breaching section 66. For further information, see APRA Superannuation Circular II.D.6 "In-House Assets" issued in November 2000.
35. Subsection 66(2A) specifically prohibits the acquisition of a life insurance policy from a member of the fund or a relative of a member. Risk only and whole of life or endowment or other policies with an investment component are covered by the prohibition.

THE ANTI-AVOIDANCE PROVISION

Section 66(3)

36. In order that the intention of subsection 66(1) of SIS is not circumvented, subsection 66(3) contains an anti-avoidance provision. This provision prevents a person from intentionally entering into or carrying out a scheme which has the effect of avoiding the general prohibition on the acquisition of assets (“proscribed asset”).
37. The anti-avoidance provision prohibits a trustee or investment manager from acquiring a proscribed asset from a person who has a connection (whether direct or indirect through one or more partnerships, companies or trusts) with a related party of the fund.
38. It applies (amongst other things) where the asset has been acquired by the interposed entity or person, either directly or indirectly from a related party, with the **intent** of avoiding the rule against acquisition of assets by a superannuation fund from related parties.

Transitional provisions

39. A transitional provision allows the acquisition of a proscribed asset from a related party, other than a member or relative, under a contract entered into before the test time of 11 August 1999. This is because at the time of entering into the contract, it was permissible to acquire an asset from those parties. (*Refer Item 47, Schedule 1, SLAA4*)
40. Prior to the amendments made by SLAA4, the anti-avoidance provision was unlikely to apply in practice where the asset was acquired from the member or a relative of the member prior to 30 June 1993. That is because a transfer before that date could not have been made with the intention of avoiding the application of the rule (because the rule was not then in force).
41. The earlier anti-avoidance provision also did not prohibit a fund from acquiring a proscribed asset from an interposed person or entity (such as a partnership, company or trust), where that interposed person or entity acquired the asset on or after 30 June 1993 from a party **other** than a member or a relative of the member, and the acquisition was not part of a scheme to avoid the application of the general prohibition.
42. However, the situation was different where the trustee wished to acquire an asset from a trust where the trustee of that trust was also a member, or relative of a member, of the superannuation fund. In that situation, the acquisition of the asset was prohibited under the general terms of section 66 because the member or relative acting as a trustee of a trust was the legal owner of the assets of the trust in their capacity as trustee. As section 66 includes legal ownership, and does not distinguish between capacities, it would have

made no difference to the operation of the provision whether an asset was owned by a member, or relative, in a personal capacity or whether it was owned by the member, or relative, in their capacity as trustee of a trust. The extension of the application of section 66 to related parties removes any doubt about this position.

PENALTIES

Section 66(4)

43. The trustee of a regulated superannuation fund must ensure that section 66 is complied with at all times. A person who contravenes section 66 is guilty of an offence.
44. Significant penalties may apply to trustees and investment managers contravening the restrictions on the acquisition of assets.
45. Failure to comply with the prohibition on acquisition of assets from members or relatives may also result in the fund becoming a non-complying superannuation fund for taxation and Superannuation Guarantee purposes.

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

Legislative reference	Related Party	Note
10(1) SIS <i>related party</i>	(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 <i>related party</i>	(b) standard employer-sponsor of the fund	defined in s.16 SIS
10(1) SIS <i>related party</i>	(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
<i>Where the primary entity is an individual, for example, a member, or where a standard employer-sponsor is an individual</i>	70B(a)	a relative of the individual
	70B(b)	if the individual is a member of a superannuation fund with fewer than 5 members- (i) each other member of the fund; (ii) if it is a single member self managed superannuation fund whose trustee is a company - each director of that company; (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: (i) the individual; (ii) another Part 8 associate of the individual; or (iii) 2 or more Part 8 associates of the individual
<i>Where the primary entity is a company, for example, the standard employer-sponsor is company, including a company in the capacity of a trustee</i>	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 that on its own can 'sufficiently influence', or holds a majority voting interest in, the company, or another entity that is a Part 8 associate of the 'controlling entity' (because of section 70B or 70D) or a combination of 2 or more such entities
	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 (because of section 70B or 70D) of a 'controlling' entity
<i>Where the primary entity is a partnership, for example, the standard employer-sponsor is a partnership</i>	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 Table 2 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	<p>A company is sufficiently influenced by an entity or entities if:</p> <ul style="list-style-type: none"> - the company, or a majority of its directors, - is accustomed or under a formal or informal obligation, or might reasonably be expected, to act - 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	<p>An entity or entities hold a majority voting interest in a company:</p> <ul style="list-style-type: none"> - if the entity or entities are in a position to cast, - or control the casting of, - 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	<p>An entity controls a trust if:</p> <ul style="list-style-type: none"> (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 (b) - the trustee of the trust, or a majority of the trustees, <ul style="list-style-type: none"> - is accustomed or under a formal or informal obligation, or might reasonably be expected, to act - 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 (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.
Group in relation to entity	70E(3), for the purposes of 70E(2)	<p>Group, in relation to an entity, means</p> <ul style="list-style-type: none"> (a) the entity acting alone; or (b) a Part 8 associate of the entity acting alone; or (c) the entity and one or more Part 8 associates of the entity acting together; or (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		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.
Relative		
Entity	10(1)	means any of the following: an individual, a body corporate, a partnership, a trust.