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SOLUTION BRIEF

Self-Managed Superannuation Fund Investment Rules

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01

Background

Superannuation is an enforced saving scheme to move toward an overall scenario where Australian workers put aside a portion of their income so that they can self-fund their retirement, rather than relying on government support.

Some people choose to set up self-managed superannuation funds (SMSFs) to maintain greater control over their retirement savings and investments.

SMSFs are essentially a special type of trust, governed by the terms of a Trust Deed and subject to additional rules and restrictions that are mainly set out in the Superannuation Industry (Supervision) Act 1993 (Cth) (SISA).

To ensure assets held in SMSFs are used only for their intended purpose of providing retirement benefits to members, the SISA provides strict investment rules that apply to all SMSFs.

This Solution Brief gives an overview of the investment rules and restrictions that apply to SMSFs.

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What is an SMSF?

To be considered a 'self-managed superannuation fund', a Fund must meet the following basic conditions:

- Have a maximum of 4 members;¹
- If trustees of the SMSF are individuals:
 - Each trustee of the Fund must also be a member of the Fund;² and
 - Each member of the Fund must also be a trustee of the Fund;³

¹ SISA s 17A(1)(a).

² SISA s 17A(1)(b).

³ SISA s 17A(1)(d)(i).

- If SMSF has a corporate trustee:
 - Each director of the body corporate must also be a member of the Fund;⁴ and
 - Each member of the Fund must also be a director of the corporate trustee;⁵
- Members of the Fund cannot be employees of other members of the Fund, unless they are relatives;⁶ and
- The trustees of the SMSF (or directors of trustee if body corporate) cannot receive any income from the Fund for services performed as trustees.⁷

There are slightly different basic conditions for single member SMSFs.⁸

SMSFs can be contrasted to public offer funds, that must meet other conditions and rules.⁹

SMSFs are regulated by the ATO. Public offer funds are regulated by APRA (the same body that regulates banks).

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What does it mean to be a ‘complying’ SMSF?

We are most often asked to give advice or assist SMSF trustees to ensure that they maintain status as a ‘complying superannuation fund’.

Complying superannuation funds are entitled to a concessional income tax rate (15%).

In summary, to be complying an SMSF must:

- Remain an Australian ‘resident’ Fund;¹⁰ and
- Comply with the rules set out in the SISA.¹¹

⁴ SISA s 17A(1)(c).

⁵ SISA s 17A(1)(d)(ii).

⁶ SISA s 17A(1)(e).

⁷ SISA s 17A(1)(f),(g).

⁸ SISA s 17A(2).

⁹ SISA s 18.

¹⁰ SISA s 42A(1)(a).

This is important because if the SMSF is deemed ‘non-complying’ it will be subject to the highest marginal tax rate.

In addition, a number of the SISA provisions carry penalties, so individual trustees / directors of corporate trustees could be personally liable if the provisions are breached.

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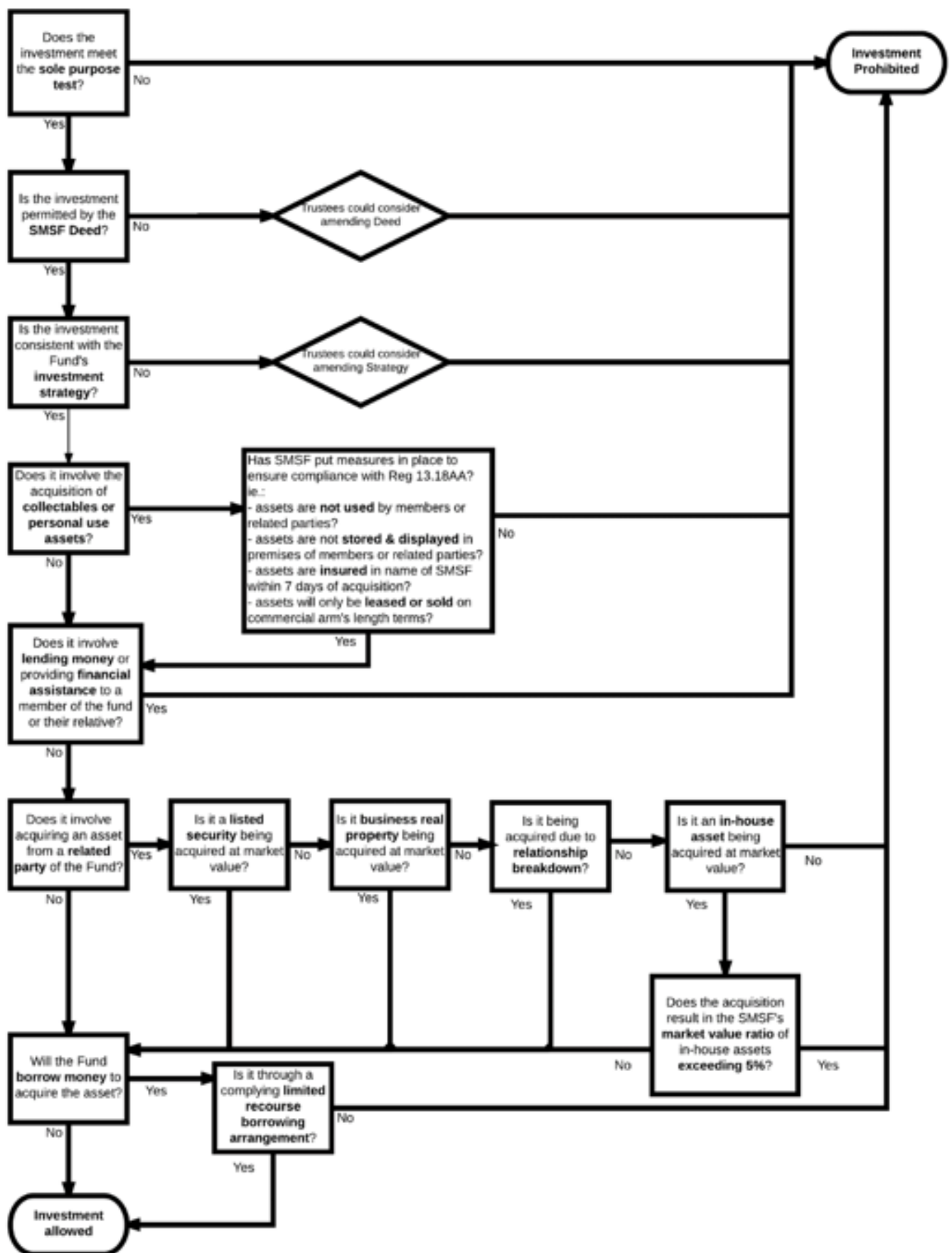
SMSF Investment Roadmap

So, what are the relevant rules?

The diagram on the next page is a quick reference guide that we prepared showing the different factors that need to be considered by SMSF trustees before deciding to use or invest SMSF resources.

If the SMSF trustees have any doubt as to whether a particular restriction applies to their proposed investment or use of funds, it is always best to get specific professional advice, rather than running the risk of the SMSF becoming a non-complying fund.

¹¹ SISA s 42A(1)(b);(5).



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Sole Purpose Test

As a starting point, SMSF trustees must ensure that the Fund is maintained solely for the purpose of providing retirement benefits to members. This is known as the 'sole purpose test'.¹²

The practical application of the sole purpose test is set out in detail in the ATO Ruling SMSFR 2008/2.¹³

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SMSF Deed and Investment Strategy

Like any other trust, an SMSF is governed by the terms of its Deed. The SISA imposes a range of terms that must be included in the Deed.¹⁴

The SMSF trustees must formulate, review regularly and give effect to an investment strategy that addresses issues such as risk; diversification of investments; liquidity and maintaining the SMSF's ability to discharge its liabilities.¹⁵

The SMSF trustees must check that the proposed investment is permitted under the Deed and is consistent with the SMSFs investment strategy.

If there are issues at this level, the trustees could consider making amendments to either the Deed or the Strategy but should first ensure that the proposed investment does not breach any of the investment restrictions set out in the SISA.

¹² SISA s 62.

¹³ SMSF 2008/2: *Self Managed Superannuation Funds: the application of the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993 to the provision of benefits other than retirement, employment termination or death benefits.*

¹⁴ SISA s 52B.

¹⁵ SISA s 52B(2)(f).

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SISA Investment Restrictions

The main investment restrictions relate to:

- Investing in collectables and personal use assets;
- Providing loans and financial assistance to members;
- Acquiring assets from members and other related parties; and
- Limiting the proportion of in-house assets held by the SMSF.

Collectables and Personal Use Assets

The restriction: An SMSF must comply with specific rules set out in the Regulations if acquiring collectables or other personal use assets.¹⁶

Collectables and personal use assets are defined in section 62A and includes artwork, jewellery, antiques, coins, postage stamps, wine, cars, boats and memberships of social and sporting clubs.

The rules about investing in these assets is set out in regulation 13.18AA of the Superannuation Industry (Supervision) Regulations 1994 (Cth).

In summary, if an SMSF invests in this type of asset:

- The asset cannot be:
 - loaned or leased to a member / related party of the fund;
 - stored in the private residence of a member / related party of the fund; or
 - transferred to a member / related party of the fund unless it is for full market value as determined by an independent valuer;
- Any decision of the trustees as to where to store the asset must be fully documented; and
- The asset must be insured in the name of the SMSF.

Loans and Financial Assistance

¹⁶ SISA s 62A

The restriction: An SMSF must not loan funds or provide financial assistance to a member or a member's relative.¹⁷

There are no exceptions that are applicable to SMSFs.

Acquisitions from Members

The restriction: An SMSF must not acquire assets from a related party of the fund.¹⁸

There are a number of exceptions to the general rule, including the acquisition of:

Listed securities or business real property at market value;¹⁹

In-house assets at market value (so long as the in-house asset restriction is not breached – see below for further detail);²⁰ and

Assets as a result of a relationship breakdown (i.e., from a family law property settlement).²¹

The definition of business real property is set out in sub-section 66(5), with further detail in SMSFR 2009/1. This ruling also provides detailed examples in relation to both this restriction and also the in-house asset restriction (see below).

In-house Asset Restriction

The restriction: An SMSF cannot hold more than 5% of its market value in in-house assets.²²

The term in-house asset is defined in section 71(1). It is basically an asset involving a related party of the SMSF, whether that be a loan to, investment in or lease with a related party. SMSFR 2009/4 is helpful in providing further detail on the definition of in-house assets.

Again, there are a number of exceptions to the general rule, mainly around what falls within the definition of 'in-house asset'.²³

Importantly, a lease of land that falls within the definition of business real property is not considered an in-house asset.²⁴ The definition of business real property in this context is the same as set out in sub-section 66(5) (the restriction on acquiring assets from members). Again, SMSFR 2009/1 is helpful in working out whether the asset is business real property or not.

¹⁷ SISA s 65.

¹⁸ SISA s 66.

¹⁹ SISA s 66(2).

²⁰ SISA s 66(2A).

²¹ SISA s 66(2B).

²² SISA s 82.

²³ SISA s 71(1).

²⁴ SISA s 71(1)(g).

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Borrowing Restrictions

In addition to the above investment restrictions, the SMSF is also subject to particular borrowing restrictions.

The restriction: In general, SMSFs cannot borrow or maintain a borrowing of money.²⁵

There is one key exception to the general rule and that is where the borrowing is undertaken through a limited recourse borrowing arrangement.²⁶

Under this form of arrangement:

- The borrowed funds must be applied toward the acquisition of a single acquirable asset;²⁷
- The asset must be held on trust for the beneficial interest of the SMSF;²⁸
- The SMSF has the right to acquire legal ownership of the asset by making one or more payments after acquiring the beneficial interest;²⁹
- The lender's rights of recourse in connection with the borrowing are limited to the asset;³⁰ and
- The asset is not subject to any other charge other than the one provided under the limited recourse borrowing arrangement.³¹

There are some tricky definitions around the meaning of 'single acquirable asset' and also how borrowed funds may be used which may need to be carefully looked at before entering into a limited recourse borrowing arrangement. For example, borrowed funds can be used to repair or maintain an asset but cannot be used to improve the asset.

²⁵ SISA s 67(1).

²⁶ SISA s 67A.

²⁷ SISA s 67A(1)(b).

²⁸ SISA s 67A(1)(c).

²⁹ SISA s 67A(1)(d),(e).

³⁰ SISA s 67A(1)(d),(e).

³¹ SISA s 67A(1)(f).

SMSF trustees should read and understand SMSFR 2012/1 if they are looking to borrow funds through the SMSF or get specific advice on the issue. The ruling includes some very helpful practical examples of what is and isn't allowed.

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Summary

Superannuation is an increasingly important store of personal wealth, and there are some very good reasons for choosing an SMSF to manage your retirement savings. The SMSF investment rules are key to your SMSF retaining complying status, which in turn is critical to maximising the benefits that you gain from your SMSF.



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TALK TO US

What next?

If you would like to speak to someone about the SMSF investment rules, call us on 1300 654 590 or email us at wehelp@adlvlaw.com.au.

Further information can also be found on our website at www.adlvlaw.com.au.

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