

Funds really can borrow now  
New Government initiatives  
SGC now ranks equally

In-house assets re-investments  
Breach of sole purpose test  
Income Stream Benefits service

## Funds really can borrow now

But, subject to certain stringent limitations. After a farcical about face by the former coalition government in May 2007 indicating that it would permit self-managed funds to invest in instalment warrants, the coalition introduced section 67(4A) into the *Superannuation Industry (Supervision) Act 1993* ("SIS").

Section 67(4A) permits a self-managed fund to indirectly acquire assets using non-recourse borrowings so long as the following features are present:

1. A security trustee acquires an asset (including an instalment warrant) provided the asset is one which a fund could otherwise, legitimately acquire directly;
2. A security trustee (as an interposed entity) must hold legal interest in the asset on trust for the trustees of a fund until the fund has discharged the loan;
3. Whilst the borrowings undertaken by a fund are being repaid, the fund trustees must at all times maintain a beneficial interest in the acquired asset;
4. If fund trustees default on a loan, the lender's recourse is limited to the asset acquired by the security trustee and no other form of security or recourse to a fund's other assets; and
5. At the end of the loan arrangement, a fund trustee must have the right to acquire legal ownership of the asset from the security trustee.

There are a number of interesting consequences which flow from section 67(4A) and its application in the real commercial world:

- (a) Whilst section 67(4A) was intended to remove uncertainty surrounding self-managed funds purchasing non-recourse instalment warrants, and is in fact headed "*Instalment Warrants*", it has far wider application. For instance, section 67(4A) can be used by a self-managed fund to acquire real estate but, not from a member or associate of a fund;
- (b) There seems no reason why a fund must take legal title to the asset at the end of loan arrangements. It seems that a fund need not take legal title if during or at the end of loan arrangements, it directs a security trustee to sell an asset provided of course that the security trustee accounts to a fund for its equitable share of the proceeds of sale;
- (c) Section 67(4A) arrangements must be sanctioned by a fund's Investment Strategy;
- (d) If a fund is unable to acquire an asset in its own right (for instance in-house assets, acquisitions from members, relatives and associates etc), then section 67(4A) assists it no further;
- (e) There is no reason why a party related to a fund cannot be a security trustee;
- (f) Loan documentation needs to be very carefully considered to ensure that a lender's rights are restricted to the acquired asset and, no further. Even the personal guarantee of a director of a fund trustee to repay the borrowings is sufficient to disqualify the arrangement as complying with section 67(4A). Similarly, the provision of additional security by a party related to a fund will also disqualify an arrangement as complying;
- (g) Given the non-recourse nature of loan arrangements, it remains to be seen whether banks and commercial lending houses will look favourably on section 67(4A) arrangements or, frown upon them as lacking sufficient security and in some cases, failing to meet adequate loan to valuation ratios;
- (h) Obviously, if the asset acquired by a security trustee is real estate, there will be Duty payable on the purchase. Provided the documentation between a security trustee and fund trustees is correctly drawn, there should be no Duty consequences at the end of loan arrangements when a fund must acquire a legal interest in the asset. In other words, when loan arrangements have been completed, the asset must be transferred from the security trustee to fund trustees. In Victoria, at least presently, the transfer from a security trustee to fund trustees will be Duty free provided there is no change in fund membership composition over the life of the arrangement;
- (i) The very nature of the trust arrangement between the security trustees and the fund trustees is sufficient in Victoria to attract Land Tax at penal trust rates unless certain elections are lodged at the State Revenue Office; and
- (j) Yes - section 67(4A) can also be used to enable a self-managed fund to borrow to acquire instalment warrants.

However, a note of caution. The documentation necessary to establish arrangements which comply with section 67(4A) is necessarily complex and assuredly, not for the feint-hearted or, amateur lawyers! Speak to Andrew Gray for further details.

## New Government initiatives

The fall of the Howard Government was not a great surprise. Too long, too old, too out of touch or, too complacent? The reason matters not but, the Howard Government was instrumental in achieving significant superannuation reforms during the last years of its office. What then of the Rudd Government?

The *Parliamentary Library Briefing Book: Key issues for the 42nd Parliament* outlines the Rudd Government's proposed policy changes during its first term. In the context of superannuation, the Rudd Government will visit the following issues:

- Adequacy of existing superannuation arrangements with particular reference to retirement income streams;
- The ability of Australians to accumulate adequate superannuation;
- The role of the Future Fund which currently, has barely enough to cover the Government's unfunded superannuation liability; and
- The Second Intergenerational Report published by the Howard Government in April 2007 "*concerning the financial consequences of the structural ageing of the population*".

Probably some important long term policy issues there but, nothing very exciting!

## SGC entitlements now rank equally

Traditionally, when companies go into liquidation, administration or receivership, amounts of unpaid wages and annual leave are paid to employees before payment is made to ordinary unsecured creditors and once priority creditors and liquidators' fees are paid. Given changes now finalised in the *Corporations Act 2001*, from 31 December 2007, employees' SGC entitlements now rank equally with other employee entitlements such as unpaid wages or annual leave.

## Reinvestment of in-house assets

As a consequence of *Superannuation Legislation Amendment Act (No 4) 1999*, self-managed funds were permitted to retain certain trust and company investments and make re-investments until 30 June 2009 without the reinvested components being considered as in-house assets. For some reason it is now necessary for the Tax Office to tell us when a dividend or distribution reinvested is "received" by a self-managed fund. According to *Self Managed Superannuation Funds Determination SMSFD 2007/1*, a reinvestment is received not when a fund becomes entitled to it but, when a fund applies or deals with the dividend or distribution.

## Breach of sole purpose test

In *Vivian (DCT) v Fitzgeralds & Anor* [2007] FCA 1602, the Federal Court imposed civil penalties totalling \$30,000 on a husband and wife who in breach of the sole purpose test, applied their self-managed fund's assets to pay personal debts. In addition, the couple were ordered to pay the Tax Office' costs of some \$32,000. An expensive exercise but a timely warning to those tempted!

## New Superannuation Income Stream Benefit (Pensions) Service

A "pension" is no longer a pension. It is now (officially) a Superannuation Income Stream Benefit. As a result of the Simplified Super Regime, we have created new Income Stream packages catering for:

- ❖ Account Based Pensions;
- ❖ Transition to Retirement Income Streams; and
- ❖ Market Linked Income Streams (also known as Term Allocated Pensions).

Strictly speaking these are now the only types of new income streams that may be commenced by members of self-managed superannuation funds. Allocated pensions and TRIP allocated pensions which were established prior to 20 September 2007 can continue to be paid by self-managed funds from 20 September 2007. We have streamlined the paperwork and instruction process making it much easier for accounting and other financial advisers to order complete Superannuation Income Stream benefit packages from us. Quotations for the packages are available from Andrew Gray.

The contents of this Newsletter are not intended to constitute the provision or rendering of legal or other advice. Accordingly, we can accept no responsibility for loss or damage (howsoever arising) to persons who act solely on the basis of this Newsletter without first seeking our professional advice.