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## CHAPTER 4:

# CLAUSE 64<sup>3</sup> - PROHIBITION ON SUPERANNUATION FUNDS ACQUIRING ASSETS FROM MEMBERS OR RELATIVES

**Clause 64 has arisen from the questionable practices of a small section of the superannuation profession, who are more concerned with the 'gimmicks' of superannuation, rather than the long term true benefits that superannuation provides.<sup>4</sup>**

### **Introduction**

4.1 This chapter examines one of the most controversial aspects of the Superannuation Industry (Supervision) Bill 1993, clause 64. The chapter outlines the policy underlying clause 64, the submissions received on the issue and evidence provided at the public hearings plus a recommendation for an amendment to the Bill.

4.2 Of the total submissions received by the Committee on the SIS legislation approximately one half were concerned with the impact of clause 64 which prohibits regulated superannuation funds from acquiring assets from fund members or their relatives. Clause 64 is designed to take effect from 27 May 1993 as an anti-avoidance measure to prevent superannuation fund members selling assets to their superannuation fund in order to obtain cash benefits. Such transactions, according to a number of witnesses, have the potential to abuse the concessional tax treatment afforded to

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<sup>3</sup> Clause 64 was Clause 62 when the Bill was introduced in the House of Representatives

<sup>4</sup> John Fraser, SIS Sub No 40

superannuation funds.<sup>5</sup> Further examples of the current abuse involve members selling private assets to their fund, such as houses and boats in order to obtain cash benefits. The ISC Commissioner, Mr George Pooley, advised the Committee that there are a number of schemes in existence that are designed to manipulate assets in this way.<sup>6</sup>

4.3 The early date of effect was achieved by way of amendment to OSS Regulations. The Regulations and Ordinances Committee has given notice that it will move a motion of disallowance of this regulation.

### Issues raised

4.4 The majority of written submissions received focused on the following areas of concern with clause 64, namely:

- its complete prohibition is too harsh as it discriminates against legitimate business transactions and small business activities;
- it prevents people from funding their own superannuation funds and in particular discriminates against the self employed;
- it fails to take into account the same types of investments held in different names;
- it appears easy to avoid simply by interposing another entity between the superannuation fund and the member; and
- its imposition of a jail sentence for breaches is too severe.

4.5 The Committee heard further evidence in relation to the impact of clause 64 at the public hearings. The evidence provided reinforced the impression that many in the superannuation industry view clause 64 as a draconian measure that is designed to 'crack a nut with a sledgehammer'.

4.6 Two witnesses, John Fraser and Tony Kincaid indicated that a degree of confusion and 'woolly thinking' surrounded the development of

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<sup>5</sup> Tony Kincaid, John Fraser, evidence p 87

<sup>6</sup> Evidence p 182

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clause 64.<sup>7</sup> Mr Fraser provided an example of the types of abuse that clause 64 is designed to prevent, such as the selling of assets to a superannuation fund to overcome cash flow problems. He also gave some examples of how clause 64, in its present form, can be rendered inoperative.

4.7 It was suggested by Mr Kincaid that one way in which clause 64 could be avoided would be to transfer assets of the same value into another person's superannuation fund and have them transfer assets into your superannuation fund. Written submissions also described in detail how clause 64 could be avoided by similar means or by interposing a third party between the member and superannuation fund, so that the asset is sold to the third party and then on-sold to the superannuation fund. Once again, although higher transaction costs are incurred, clause 64 could be easily avoided.

4.8 The Committee also noted that there is an absence of empirical evidence supporting the need for clause 64. This point was highlighted in evidence provided to the Committee by the ISC who advised that their position was based on information that a number of organisations were providing advice on how to manipulate assets in a way that clause 64 is designed to prevent.<sup>8</sup>

4.9 *The Committee believes that to a large extent the problems which have given rise to measures to prohibit funds acquiring assets from members or relatives (clause 64) are the result of promoters who offer superannuation arrangements which are at odds with the rationale of concessional tax treatment afforded to superannuation. The Committee is of a view that the Government should monitor closely the activities of these promoters with a view to making their activities subject to the requirements and penalties of clause 64 and other relevant provisions of the SIS legislation.*

#### Alternatives to clause 64

4.10 A common feature of both the written submissions and the evidence provided at the public hearings concerned suggested ways in which clause

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<sup>7</sup> Evidence p 89

<sup>8</sup> Evidence p 182

64 could be amended to enable it to provide an effective anti-avoidance mechanism whilst enabling certain transactions between a members and their superannuation funds to take place.

4.11 Alternatives to clause 64 focused upon the need of the ISC to analyse the type of transaction rather than its source. Accordingly, exemptions to clause 64 were suggested as a means of enabling the type of transaction to be scrutinised to ensure that dubious transactions such as the selling of paintings or holiday homes to the superannuation fund are prohibited. Precedent for this treatment of these transactions, it was suggested, could be found in Capital Gains Tax provisions of the *Income Tax Assessment Act 1936 (ITAA)*<sup>9</sup>.

4.12 The Committee noted that a major advantage associated with differing between types of assets is that, prima facie, it would allow a distinction between different types of transactions to occur. That is, the sale of legitimate assets on a commercial basis to a superannuation fund would be permissible, whilst the sale of assets that clause 64 is designed to prevent would still be disallowed.

4.13 A major question that arose in connection with the exclusion of certain types of assets is whether it would be preferable to specify what transactions should be entered into or what transactions should not be entered into. Evidence provided by John Fraser suggested that it would be more appropriate to describe the types of investments that are acceptable to a superannuation fund and specify that these transactions be carried out on an arms length basis.<sup>10</sup> In addition, a report could be attached to each ISC return detailing where a member-orientated transaction was involved.

4.14 Another approach to changing clause 64 was suggested by Jim Richardson, who recommended that the legislation specify what types of assets cannot be acquired by a superannuation fund from a member or relative of a member, for example such assets would include:

- jewellery;
- motor vehicles;

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<sup>9</sup> Greenwood Challoner, SIS Sub No 42

<sup>10</sup> Evidence p 89

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- boats; and
  - a print, etching, drawing, painting, sculpture or similar work of art.<sup>11</sup>

4.15 In outlining these exemptions Mr Richardson drew attention to the current definition of personal use assets, in section 160B of the ITAA 1936, as a precedent for such exclusion.<sup>12</sup>

4.16 Strengthening of the sole purpose provisions of the Bill rather than employing a blanket prohibition under clause 64 was yet another approach which the Committee considered. The sole purpose provisions, as contained in clause 60 of the SIS legislation, require the trustee of the fund to maintain the fund solely for certain purposes. These purposes are divided into core and ancillary purposes. Core purposes are those for which the fund must be maintained, for example, the provisions of benefits to each member of the fund upon reaching a prescribed age, although the member has not retired.

4.17 Ancillary purposes are those for which the fund may be maintained, in addition to the core purposes, for example, the payment of death benefits wholly or partly to a member's estate.

4.18 As it is apparent that the SIS legislation is framed to allow clause 64 to complement the operation of the sole purpose test, it would appear from a number of submissions that a more appropriate alternative would be to provide certain exemptions from clause 64, whilst increasing the powers of the ISC under the sole purpose test.

4.19 When providing exemptions from the operation of clause 64, regard must be given to achieving a balance between its original objective and a more equitable approach as outlined in the various submissions. Therefore, it was argued, exemptions from clause 64 should only relate to the acquisition of freehold or leasehold property which reflects true market value, that is used wholly or exclusively in the business of the member, and

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<sup>11</sup> *ibid*

<sup>12</sup> SIS Sub No 42

certain strictly defined marketable securities.<sup>13</sup> In this regard the ISC prepared a draft amendment which defines marketable securities. This appears in Appendix D and includes a share; or unit; or bond or debenture; or a right on option; or any other security; listed for quotation in the official list of a stock exchange in Australia.

4.20 It could be argued that this would provide a seemingly more equitable alternative which would allow superannuation funds to acquire certain assets from members, whilst at the same time providing the Government with certain checks and balances to ensure that the concessional tax treatment afforded to superannuation funds is not abused. The Committee acknowledges that strengthening the sole purpose test is a move away from its traditional use. However, given the nature and impact of clause 64, the Committee considers that some change is needed to balance the competing interests which became evident during the inquiry.

**Recommendation 4.1:**

The Committee recommends that clause 64 be amended to allow certain types of assets to be acquired by a superannuation fund from a member or relative of the member at an arms length price.

These assets are to include only freehold or leasehold property, which reflects true market value, that is used wholly or exclusively in the business of the member or member's relative, plus certain strictly defined marketable securities.

The Committee further recommends that the sole purpose test be strengthened to ensure that any asset or assets included in the exemption provided under clause 64 acquired by the superannuation fund from a member or member's relative does not contravene the sole purpose test.

**Penalty for breach of clause 64**

4.21 Another major issue surrounding clause 64 concerns the penalty for a breach of the provision which can be up to two years imprisonment. A

<sup>13</sup> COSBOA, SIS Sub No 49 provided the Committee with guidance on what type of marketable securities could be included within the amendments.

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common feature of most submissions on the matter concerned the abhorrence at such a penalty, some describing it as totally inappropriate for the offence involved.<sup>14</sup>

4.22 When designing penalties for the breach of certain provisions, regard must be given to the severity and nature of the mischief that the provision is designed to prevent. The Committee noted that the imposition of a jail sentence for a breach of clause 64 would appear to be excessive given its intention.

**Recommendation 4.2:**

The Committee recommends that the penalty for breach of clause 64 be amended to provide a maximum penalty of 200 penalty points (one penalty point equals \$100) and/or one years imprisonment.

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<sup>14</sup> Greenwood Challoner, SIS Sub No 42