

**AUSTRALIAN PRUDENTIAL
REGULATION AUTHORITY**

**SUPERANNUATION CIRCULAR
NO. III.A.1**

**ELECTION TO BECOME A REGULATED
SUPERANNUATION FUND
FOR FUNDS REGULATED BY APRA**

September 2000

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Objective

1. The aim of this Circular is to provide general guidance on the requirements for, and consequences of, an election to become a regulated superannuation fund **for funds regulated by APRA** under the *Superannuation Industry (Supervision) Act 1993* (“SIS”).
2. This Circular replaces Superannuation Circular III.A.1 entitled "Election to become a Regulated Superannuation Fund" which was released by the Australian Prudential Regulation Authority (APRA) in December 1998. It incorporates amendments of the *Superannuation Industry (Supervision) Act 1993* (SIS) made by the *Superannuation Legislation Amendment Act (No 3) 1999* (SLAA3) which came into effect on 8 October 1999.

Introduction

3. Electing to be regulated under SIS and notifying the Regulator of the election are essential in order for a fund to gain access to superannuation tax concessions and to be eligible to receive Superannuation Guarantee contributions paid by employers. Electing also makes the fund subject to the requirements of SIS and the trustees liable to penalties if the requirements are contravened. The SLAA3 amendments effected the transfer to the Australian Taxation Office (ATO) of the process to accept and register elections which was formerly handled by APRA. From November 1999 the ATO has been carrying out this function. The ATO forwards to APRA information regarding newly electing APRA regulated entities.
4. This Circular applies only to superannuation funds that are regulated by APRA, although trustees of ATO regulated self managed superannuation funds may find it useful for background information. Approved deposit funds (ADFs) and pooled superannuation trusts (PSTs) are automatically regulated under SIS and hence it is not necessary for their trustees to lodge an election with the ATO, although the SIS Regulations have been amended to require the trustee of a PST to give APRA an election to have the trust treated as a PST. It is necessary however, for ADFs and PSTs to promptly notify the ATO of their existence and provide certain information in accordance with section 254 of SIS. A form on which this can be done is available on both the ATO website at www.ato.gov.au/super and the APRA website at www.apra.gov.au. The trustees of most of these entities must also be approved under Part 2 of SIS.

Background

5. Generally, in order to be eligible for taxation concessions, SIS requires that a superannuation fund:

- give notice to the ATO that the fund elects to be regulated under SIS by way of either the “pensions route” or the “corporations route”; and
- is a resident superannuation fund within the meaning of section 6E(1) of the *Income Tax Assessment Act 1936* (“ITAA”). A fund is a resident superannuation fund if it is established in Australia (or has an asset in Australia at the relevant time), has its central control and management in Australia, has at least one “active” member and at least 50% of the benefits of the “active” members of the fund are held for members who are Australian residents. An approved deposit fund is a resident approved deposit fund within the meaning of section 20A of SIS at a particular time if either the fund was established in Australia **or** at that time, any asset of the fund is situated in Australia; **and** the management and control of the fund is in Australia; **and** the percentage worked out using the following formula is not less than 50%:

$$\frac{\text{Accumulated entitlements of resident members}}{\text{Total assets of fund}} \times 100$$

6. “Resident regulated superannuation funds” (called “funds” in this Circular) will generally be eligible to receive tax concessions. However, under section 42 of SIS, such funds can have their tax concessions withdrawn for a particular year of income if the trustee of the fund has contravened SIS and failed the “culpability test”. Failure of this test generally occurs in circumstances where:

- all the members of the fund were in any way directly or indirectly knowingly concerned in, or party to, the contravention; **or**
- if there are one or more “innocent members” who were not involved in the contravention, they would not suffer substantial financial detriment if the fund were to be treated as a non-complying superannuation fund for the purposes of Part IX of the ITAA in relation to the year of income concerned; **and**
- APRA (after considering the taxation consequences that would arise if the fund were to be treated as non-complying, the seriousness of the contravention and all other relevant circumstances) gives a notice stating that the fund is not a complying superannuation fund in relation to the year of income concerned.

7. The question of whether a person was in any way directly or indirectly

knowingly concerned in, or party to, a contravention is assessed on the balance of probabilities.

8. Tax concessions can also be withdrawn in relation to particular years of income during which a fund ceases to be (or continues not to be) a resident superannuation fund.

9. Funds that lodge a notice of election to be regulated under SIS receive acknowledgment of their regulated status. For most funds, this means that they are deemed to be complying, for taxation purposes, from the date they came into existence. If the fund's first annual return is satisfactory, it will be issued with a notice of compliance.

10. A fund is entitled to continuing tax concessions provided the latest notice that it has received is a notice of compliance. If at some stage it has received a notice of non-compliance, that notice will apply to the specified year of income and to all subsequent years of income until a new notice of compliance is issued by APRA. The Australian Tax Office is informed by APRA when an APRA regulated fund is issued with a non-compliance notice and is also informed of a subsequent compliance notice.

11. A fund that was initially complying and then receives a notice of non-compliance may be taxed at up to 47% of fund assets (less undeducted contributions) and income. Details of the tax implications for a fund found to be non-complying can be obtained from the Australian Taxation Office's general enquiry line 13 10 20 or its home page at www.ato.gov.au/super.

Election to be regulated

Section 19

12. Under section 19, for an election to be valid, the fund must have a trustee. In addition, either:

- the trustee must be a constitutional corporation under a requirement in the governing rules (the "corporations route"); or
- the governing rules of the fund must provide that the sole or primary purpose of the fund is the provision of old age pensions (the "pensions route").

The fund may at a later date opt to vary the elected route if permitted by the governing rules of the fund. For further information on the requirement for continuing validity of a change in election, refer to paragraphs 16 and 17.

13. Funds may choose the option which best suits their affairs. Further discussion regarding these two routes is contained in paragraphs 21 to 29. However, it should be noted that in order to satisfy the election requirements in SIS, the election notice must be lodged within 60 days of the fund coming into existence.

14. The election for a fund to be regulated under SIS is irrevocable (see subsection 19(5)).

The governing rules

Part 6

15. As a consequence of subsection 19(6), trustees have the power to elect to be regulated despite anything in the governing rules of the fund.

16. A trustee must ensure that any changes to the governing rules provide for the continuing effect of a valid election to be regulated. For example, when a fund elects based on the “pensions route”, its rules cannot be amended to change from the pension purpose unless the rules provide, and continue to provide after the amendment, that the trustee must be a constitutional corporation (the “corporations route”). This ensures that if the pensions route ceases to apply to a regulated fund it will nevertheless remain subject to SIS, and hence be eligible for tax concessions, by virtue of the corporations power in the Constitution.

17. Careful drafting of a fund’s governing rules is necessary to ensure the legislative requirements of either the “corporations route” or “pensions route” are met.

18. Trustees may also determine that their fund's governing rules should include the prescribed covenants and restrictions on the contents of governing rules that are set out in Part 6 of SIS. However, if the prescribed covenants and restrictions are not included, they will be deemed to be included by virtue of the various provisions in Part 6 of SIS.

19. One significant advantage of including them is that their presence in any trust deed acts as a reminder of the requirements that they impose. Disadvantages of including them are that they may not be accurately reproduced in the deed or may be rendered inappropriate by subsequent statutory change.

20. More generally, trustees should ensure that the benefits that are available to members under the governing rules are permitted by the sole purpose test under

section 62. That test provides that funds must be maintained solely for the purpose of providing particular types of benefits. Some additional forms of ancillary benefits have also been permitted under section 62(1)(b)(v). These are more fully explained in Superannuation Circular III.A.4 entitled “The Sole Purpose Test and Ancillary Purposes”.

The “Pensions Route”

Section 19(3)(b)

21. A fund choosing the “pensions route” needs to ensure that its governing rules provide that:

“ the sole or primary purpose of the fund is the provision of old-age pensions”.

22. Accordingly, the governing rules of a fund that chooses the “pensions route” cannot provide for lump sum benefits alone. They may, however, provide members with an option to take a lump sum benefit rather than a pension. Trustees choosing the “pensions route” avoid the cost of incorporation. It should be noted that small APRA-supervised funds (SAFs) must choose the corporations route because they are required to have an approved trustee. An approved trustee means a constitutional corporation in relation to which an approval under section 26 of SIS is in force. For further information on approved trustees, refer to Superannuation Circular III.A.3 on Trustee Arrangements – Public Offer superannuation Funds.

23. All funds regulated by APRA including SAFs are required to submit annual returns and pay a supervisory levy to APRA.

Consequences of the “pensions route”

24. The consequences of choosing the “pensions route” include:

- The main benefit, which must be available to all the members, is an old-age pension, within the meaning of paragraph 51(xxiii) of the Australian Constitution. This is a pension or annuity commencing at normal retiring age. The pension need not be a life pension, but may be an allocated pension. The pension may be paid by the fund itself, or alternatively the pension provision may involve the fund using the member’s accumulated benefits to purchase a pension or annuity for the member from a third party (eg. an insurance company or another superannuation fund);

- The fund may permit members, when they become entitled to an old-age pension, to elect to take a lump sum benefit instead, with the lump sum being derived or commuted from the pension entitlement. The pension may be commuted wholly or partly in this way. (However, if the member makes no such election, then the fund would have to pay or arrange for payment of the member's benefit in the form of a pension.); and
- Subject to the sole purpose test discussed at paragraph 20, the fund may also offer incidental benefits to its members, such as benefits payable on death, disability, retirement or redundancy, or other like events that affect life or livelihood. Such benefits would be normal benefits of a pension fund.

The “Corporations Route”

Paragraph 19(3)(a)

25. The “corporations route” to regulation under SIS requires that:

“the trustee of the fund must be a constitutional corporation pursuant to a requirement contained in the governing rules”.

26. A “constitutional corporation” is a trading or financial corporation (within the meaning of paragraph 51(xx) of the Constitution) formed within the limits of the Commonwealth. (Foreign corporations do not fall within this definition and are not intended to be trustees of Australian superannuation funds.) A corporation (company) which is the trustee of a superannuation fund is a financial corporation by virtue of its activity as trustee of the fund.

27. Nearly all corporations which intend to act as the trustee of a superannuation fund for SIS purposes will be established under the Corporations Law. Other types of corporations may also act as trustee, for example, those created directly under a law of the Commonwealth, State or Territory.

28. Funds choosing the “corporations route” may be subject to a reduced Australian Securities and Investments Commission (ASIC) annual return fee. This applies where the corporation was formed for the purpose of acting solely as the trustee of a regulated superannuation fund, and the company’s constitution prohibits the distribution of the company’s income or property among its members.

Consequences of the “corporations route”

29. The consequences of being regulated under the corporations power are:

- the trustee corporation must be a separate legal entity;
- the corporation's officers become subject to the various statutory duties, obligations and penalties contained in the Corporations Law (many of which are expressly reflected in SIS). Such duties include the requirements to keep records and registers, preparation of accounts and reports, and lodgment of documents;
- directors have a fiduciary responsibility to act honestly, carefully, and with diligence while carrying out their duties; and
- a member may receive his/her benefit as either a lump sum or as a pension. Subject to the sole purpose test, the fund may also offer incidental benefits to its members, such as benefits payable on death, disability, retirement or redundancy, or other like events that affect life or livelihood.

Notice to the ATO

Subsection 19(4), regulation 1.04A

30. To be eligible for taxation concessions, the trustee must satisfy the election requirements by giving the ATO a written notice in the approved form of its decision for the superannuation fund to become regulated. This notification constitutes an irrevocable election for regulation under SIS, with the consequences that the requirements and duties under SIS apply to the fund, and the trustees are rendered liable to penalties if these requirements are contravened. The ATO will process the notice, issue a newly electing APRA regulated fund with a Tax File Number (TFN) and an Australian Business Number (ABN) and forward the details of entities regulated by APRA to APRA. On receipt of this information, APRA will then issue a Superannuation Fund Number (SFN) to the trustee for the entity. (SMSFs regulated by the ATO will not be issued with an SFN).

Timing of notice

Subsection 42(1AA)

31. Under subsection 42(1AA), the trustee of a newly established superannuation fund is generally required to complete the steps required for election for regulation within 60 days of the fund's coming into existence. This applies to both the creation of a new superannuation fund and the conversion of a former resident approved deposit fund to a superannuation fund.

32. SIS does not specifically mention the requirements applying to a fund which was formerly an exempt public sector superannuation scheme, and which elects to

become regulated. APRA and the ATO accept that the 60 day election period (commencing on the date of the decision to become regulated) applies in these circumstances.

33. A superannuation fund will come into existence after the trust deed has been signed and property is set apart for the benefit of identified members, eg. when the fund receives its first contribution. In accordance with prudent legal practice, this will most commonly occur on the same day the trust deed was executed. Unless there are documentary indications to the contrary, APRA will administer the provisions on this basis.

34. In order to qualify for tax concessions, however, the new fund is required to have acted in accordance with SIS in the period between its coming into existence and notification to the ATO of the trustee's election for regulation. As well, the fund must be a resident superannuation fund at all times after its establishment.

35. Funds in existence prior to the 1994-95 year of income were expected to elect for regulation at the time of commencement of SIS. A completed election is essential if such funds are to secure future tax concessions. "Late elections" for these funds are discussed further in paragraphs 54 to 58.

The notice form

Sections 19 and 254, regulations 1.04A, 11.03, 11.04 and 11.06A

36. Both the election and the provision of prescribed information are made by completing the "Election for a new superannuation fund to become regulated" form (the notice form) available from the ATO website at www.ato.gov.au/super and from the APRA home page at www.apra.gov.au.

37. The notice form provides the means for a fund to meet the election requirements under section 19, and to provide the ATO with information in the approved form. This information includes fund details and trustee information necessary for supervisory purposes. Subsection 19(7) provides that certain funds must become regulated superannuation funds. Contravention of the requirement to become a regulated superannuation fund is not an offence, but is a ground for the grant of an injunction against the trustee of the fund under section 315 (see subsection 19(8)).

38. Funds wishing to be regulated as a basis for taxation concessions and to allow the receipt of superannuation guarantee contributions should complete and lodge the notice form. Provision of the completed notice form to the ATO also

simultaneously covers registration for an Australian Business Number (ABN) and (if required) the Goods and Services Tax (GST).

39. To ensure that the notice form constitutes a valid election, it must be signed by all the individual trustee(s) or by each director of the relevant corporate trustee. If the corporate trustee is a single director corporation then only one signature is required.

40. The Corporations Law allows a corporation, from 1 July 1998, to execute a document without a common seal. The Government has amended subsection 19(4) of SIS to allow corporate trustees to make an election in the approved form with the use of a common seal being optional.

41. Completed notice forms should be forwarded to the ATO at the address included in the instructions for completing the form.

Elections for regulation in other circumstances

42. SIS provides APRA with discretion to deal with common election problems, for example, 'late' or invalid elections for superannuation funds currently supervised by APRA. A late or invalid election may affect a fund's eligibility for tax concessions from the beginning of its 1994-95 year of income or from the date the fund came into existence where the date is later than this.

43. Broadly, the provisions are:

- Section 42 (1AA) – where a newly created superannuation fund lodged its election with APRA more than 60 days after the fund came into existence;
- Section 42 (1AC) – where an election has been lodged but is invalid because of some deficiency, for example, the fund's trust deed has not been amended to reflect the SIS requirements or the common seal of the corporate trustee was not properly affixed to the notice of election; and
- Section 50(1) – where a fund that existed prior to the commencement of its 1994-95 income year has lodged a late election.

44. Some of the above provisions contain more than one discretionary power. Refer to paragraphs 47 to 58 on late, invalid or purported elections for more information.

45. APRA may write to funds in these categories with details of how to request that the appropriate discretions be exercised. It is also open to affected funds to write to APRA to initiate the processes.

46. In order to exercise a discretion, APRA needs to be satisfied that the conditions set out in the legislation have been met. It should be noted that a discretion would not be exercised unless a trustee can satisfy APRA that past conduct in relation to the operation of the fund does not evidence unacceptable or significant breaches. Requirements for the respective categories are summarised in the following paragraphs.

Late election by a newly created superannuation fund

Section 42 (IAA)

47. The trustee will need to make an election to be regulated to the ATO. Once the ATO has recorded the election and, in respect of an APRA-regulated fund, forwarded the information to APRA, APRA will assess the ‘late election’ request. APRA will determine if the election is ‘late’ by comparing the date of establishment of the fund with the date of receipt of the election form. The election is late where the elapsed days are greater than 60. APRA cannot recognise the election as ‘late’ until it has received the fund information from the ATO. APRA will follow up the circumstances for the late election, using agreed guidelines, and will require a declaration from the trustee regarding the fund’s compliance with the SIS prior to the election.

48. APRA will ask, in all cases, for a written request. It should be addressed to:

“Late Elections”
Locked Bag 3070
BELCONNEN MDC ACT 2617

49. The request should contain a statement signed by at least one of the trustees or trustee directors covering:

- the reason for the late lodgment;
- a declaration that the fund since commencement has complied with the SIS Act and Regulations; and
- details of the fund’s investments since commencement.

50. If the fund contravened SIS on one or more occasions, the declaration about compliance should be replaced by an explanation of the contravention(s). The

explanation should include the steps taken, if any, to rectify the contraventions and any special circumstances in relation to the fund which APRA should take into account in assessing whether it would be reasonable to treat the fund as having satisfied the Act or Regulations.

Invalid or purported elections

Section 42 (IAC)

51. In most cases, an invalid or purported election may be discovered by the ATO, for example, at the time of lodgment or by APRA on receipt of information from the ATO about an APRA regulated entity, or through the fund review process. APRA will require, in all cases, a written request for APRA to exercise its discretionary powers. These should be addressed to:

“Invalid Elections”
Locked Bag 3070
BELCONNEN MDC ACT 2617

A revised notice of election may also be required.

52. The request should contain a statement signed by at least one of the trustees or trustee directors covering:

- proof that the defect in the election has been rectified or is in the process of being rectified. Depending on the circumstances, supporting documentation may be required, for example a copy of relevant amendments to a trust deed or additional signatures or a common seal on an election form;
- a declaration, signed by at least one of the trustees that the fund complied with SIS during the period leading up to the valid election; and
- details of the fund’s investments during that period.

53. If the fund contravened SIS on one or more occasions, the declaration about compliance should be replaced by an explanation of the contravention(s). The explanation should include the steps taken, if any, to rectify the contraventions and any special circumstances in relation to the fund which APRA should take into account in assessing whether it would be reasonable to treat the fund as having satisfied SIS.

Late election by a fund which existed before SIS

Section 50(1)

54. First, an election must be lodged with the ATO to satisfy the requirements of section 19. Once the ATO has recorded the election, where the fund is regulated by APRA, APRA will assess the 'late election' request. APRA cannot recognise the election as 'late' until it has received the fund information from the ATO even though these funds are already deemed 'late'. APRA will follow up the circumstances for the late election, using agreed guidelines, and will require a declaration from the trustee regarding the fund's compliance with the transitional superannuation fund conditions prior to electing.

55. APRA will ask, in all cases, for a written request. It should be addressed to:

"OSS Late Elections"
LOCKED BAG 3070
BELCONNEN MDC ACT 2617

56. The request should contain a statement signed by at least one of the trustees or trustee directors covering:

- the reason for the late lodgement;
- confirmation that fund members were properly notified about the delay in lodging the election (see regulation 3A of the *Superannuation Industry (Supervision) (Transitional Provisions) Regulations*) (the "SIS (TP) Regulations");
- a declaration that the fund complied with the transitional superannuation fund conditions since the commencement of its 1994/95 year of income (the transitional superannuation fund conditions are prescribed by the SIS (TP) Regulations); and
- details of the fund's investments during that period.

57. The SIS (TP) Regulations have the effect that the superannuation fund conditions which applied under the *Occupational Superannuation Standards Act 1987* just prior to the commencement of the SIS legislation continue to apply (subject to certain modifications) to funds in the period after the commencement of SIS and before they elect to be regulated under SIS. These conditions are called the transitional superannuation fund conditions.

58. If the fund contravened the transitional superannuation fund conditions on one or more occasions, the declaration about compliance should be replaced by an explanation of the contravention(s). The explanation should include the steps taken, if any, to rectify the contraventions and any special circumstances in relation to the fund which APRA should take into account in assessing whether it would be reasonable to treat the fund as having satisfied the transitional fund conditions.

Review of Decisions

59. Decisions by APRA concerning the complying status of funds which make late elections and funds which are winding up without making an election have a bearing on the concessional taxation of such funds, and are reviewable decisions. This means that they can be internally reviewed by APRA and ultimately by the Administrative Appeals Tribunal and the Courts. Details of how to appeal are included with the notifications by APRA of its decisions.