

SMSFs – looking to the future

With a disruptive year mostly behind us, in this article we reflect on the current regulatory environment that SMSFs operate in and what consequences this regulation may have for SMSF members in the future.

Stronger regulatory oversight of SMSF auditors

An SMSF auditor plays an important role in the SMSF sector because they are essentially the ATO's 'eyes and ears' on the compliance health of SMSFs.

Due to the important role that SMSF auditors play, it became mandatory from 1 July 2013 for SMSF auditors to register with the Australian Superannuation and Insurance Commission (ASIC). Since this time, the ATO and ASIC have jointly overseen the SMSF sector.

Since 2013, ASIC has usually moved very quickly to cancel the registration of SMSF auditors or impose conditions on auditors who do not comply with their obligations. The ATO's role has been to refer any non-compliant SMSF auditors they discover to ASIC.

Mandatory changes have now also been made to the Code of Ethics that governs accountants. Due to these changes, an SMSF auditor will generally be unable to audit an SMSF where the same firm has also prepared the financial statements for the fund.

The effect of these changes is expected to be that, from 1 July 2021, an SMSF auditor will have to be completely independent of the firm which prepares financial statements for the fund (with only very limited exceptions).

INFO—Increasing regulatory oversight and strengthened auditor independence are making SMSF audits more rigorous. In many instances, it is leading to auditors request more supporting documentation from trustees.

New penalty regime for SMSF trustees

From 1 July 2014, the ATO received new powers to penalise SMSF trustees who breached their obligations. Prior to this date, the ATO had fewer options available to deal with SMSF trustees who broke the rules.

Under this regime, penalties of up to \$13,320 can be personally levied on each individual trustee and jointly and severally on the directors of a corporate trustee. Further, the penalty must be paid personally (not from the fund).

For serious contraventions, the ATO may permanently disqualify (i.e., for life) one or more SMSF trustees (or directors of the corporate trustee). Being disqualified means that the individual can never again be a member of an SMSF. Since 1 July 2012, the ATO has locked out 3,178 SMSF trustees.

HIGHLIGHTS

SMSFs – LOOKING TO THE FUTURE

A review of how recent changes affect you as an SMSF trustee

ATO UPDATE

New ATO guidance on when it will remit SMSF trustee penalties

TRUSTEE Q & A

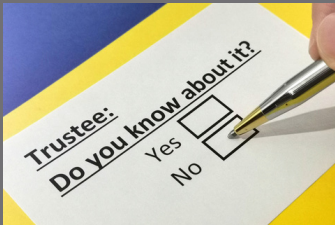
I am aged 68. I was stood down from my employment due to COVID-19 and I am currently receiving JobKeeper. Can my super fund accept a personal contribution from me?

Rules targeting non-commercial transactions

Recent legislative changes target income from 'non-arm's length' arrangements involving SMSFs that incur expenses or buy assets below market rates. Such income is taxed at 45% instead of the normal tax rate of 15%, or taxed at nil if the fund is in 'retirement phase'.

Although tax laws targeting non-arm's length arrangements have been in place for years, a new law aims to address concerns that SMSFs may be circumventing the penalty tax rate of 45% on non-arm's length income by incurring expenses or buying assets at discounted rates (including for free).

WARNING—Concerningly, the ATO states that in some cases, from 1 July 2021, the new law could lead to all income derived by an SMSF being taxed at 45%. These rules increase the pressure on trustees to ensure that all transactions are on commercial terms.



“Regulators see that accountability and responsibility for managing the fund ultimately rests with the trustees...”

ATO UPDATE

The ATO has published guidance for trustees regarding which evidence must be provided to SMSF auditors in order to support valuations of real property. Search for QC 64053.

Additionally, the ATO has released PS LA 2020/3, which outlines the circumstances in which it will consider remitting penalties imposed on SMSF trustees. Search for QC 64054.

The ATO has released its SMSF quarterly statistical report for June 2020, showing that there are currently 593,375 SMSFs. Search for QC 63976.

Recently, the ATO reminded trustees to ensure that they comply with their record-keeping duties. One such duty is the requirement for trustees to create minutes for all investment decisions, including records of why a certain investment was chosen and whether all trustees agreed with the investment decision. Search for QC 63490.

Arm’s length transactions – continued

Focus on investment strategies

A key requirement for SMSF members is to ensure that their fund conducts investments in line with a properly considered plan – called an ‘investment strategy’. It is a legal requirement for SMSF trustees to prepare, implement and regularly review their investment strategy. Although trustees may seek professional investment advice, the ATO considers that trustees are ultimately responsible for complying with the investment strategy requirements.

As the regulator of SMSFs, the ATO recently wrote to around 17,700 SMSF trustees. The ATO was concerned that the investment strategies of these funds had not adequately considered the risks of ‘putting all their eggs in one basket’ (i.e., by having a lack of diversification within the fund’s investments).

Subsequently, the ATO has published a fact sheet (QC 23320) outlining its views on a range of issues regarding the investment strategy – such as what needs to be included in the strategy.

INFO–The ATO view is that the investment strategy is not a ‘set-and-forget’ compliance document. It expects trustees to review the strategy and ensure it is current and caters for the needs of all members.

2017 superannuation reforms

Major superannuation reforms were introduced with effect from 1 July 2017, including:

- The ‘transfer balance cap’ (initially set at \$1.6 million), which limits the amount of superannuation that can support a ‘retirement phase’ pension (e.g., an account-based pension); and
- The ‘total superannuation balance’ concept, which limits the availability of certain superannuation concessions.

In our view, these changes have substantially increased the complexity of the superannuation laws. This complexity makes it more difficult for members to understand when they can access certain superannuation

concessions. Further, the 2017 reforms led to the ATO implementing a new reporting framework for superannuation funds (e.g., the ‘transfer balance account report’). This framework allows the ATO to record and track superannuation transactions for the purposes of the transfer balance cap and to determine a member’s ‘total superannuation balance’.

INFO–We consider that the 2017 reforms have increased the reporting obligations of funds and have made the superannuation system more complex.

Summary – looking to the future

Taking into account the discussion above, SMSFs have entered into an age of increased transparency and accountability, and this has come with greater complexity and stronger regulatory oversight.

Given the size of the SMSF sector, it is understandable that regulators are taking a keen interest in ensuring that SMSFs operate within the rules. So what does this mean for SMSF members? In our view, the changes occurring within the SMSF industry mean that it is important to understand that:

- Regulators see that accountability and responsibility for managing the fund ultimately rests with the trustees;
- SMSFs that break the rules are potentially liable for higher penalties than they were previously;
- Demands from SMSF auditors for supporting documentation are likely to increase (e.g., in relation to the fund’s investment strategy);
- Generally, SMSFs that transact with related parties should ensure that all dealings are documented and are at commercial rates.

No doubt, SMSFs provide members with a great opportunity to take control of their own investment choices. However, now more than ever, that freedom of choice comes with a responsibility to play by the rules.

SMSF trustee Q & A

Question

My SMSF owns real property. Can I provide a 'kerbside valuation' of the property to my auditor?

Answer

On its own, the kerbside valuation is unlikely to be sufficient evidence for the auditor.

Superannuation laws require your SMSF assets to be reported at market value. Accordingly, you must provide your auditor with documentation supporting the property's market value each financial year. In this regard, the ATO considers the following to be acceptable evidence for supporting a property's market value:

- Independent appraisals from a real estate agent (kerbside);
- A contract of sale (only if the purchase is recent);
- Recent comparable sales results;

- A rates notice (if this is consistent with the other valuation evidence provided); or
- The net income yield (this only applies to commercial properties with an unrelated tenant).

The ATO considers that a single piece of evidence is generally insufficient on its own, unless the property has recently been sold (i.e., the sale contract on its own is sufficient). Also, the evidence should support the asset's market value as close to 30 June as possible. Concerning the question above, additional supporting evidence (such as a rates notice) would also need to be obtained, as a kerbside valuation alone is inadequate.

INFO—SMSF trustees can use a valuation from a qualified independent valuer as one form of evidence of market value – especially where the property is a significant proportion of the fund's value.

Question

I am aged 68. I was stood down from my employment due to COVID-19 and I am currently receiving JobKeeper payments. Can my super fund accept a personal contribution from me?

Answer

Yes, your fund can accept the contribution. As you are aged between 67 and 74, a personal contribution can generally only be accepted by the fund if you were gainfully employed for at least 40 hours in 30 consecutive days during the income year in which you are making the contribution (the 'work test').

The Australian Prudential Regulation Authority (APRA) has stated that stood down individuals are still considered to be gainfully employed for the purposes of the work test. Further, they have also confirmed that super funds can assume that members in receipt of JobKeeper meet the 'work test'.

Key dates and reminders

28 Feb 2021

Tax return and payment due date for new SMSFs lodged via a tax agent, unless the ATO advised the fund upon its initial registration of a due date of 31 October 2020.

31 March 2021

Due date for SMSF income tax returns lodged via a tax agent where the fund's total income exceeded \$2 million in the latest year lodged (e.g., the 2019 income tax return).

15 May 2021

Due date for SMSF income tax returns where a return is not required at an earlier date and the SMSF is not eligible for the 5 June concessional lodgement date.

Superannuation proposals not yet law

The following superannuation-related changes are currently before Parliament (they are not yet law):

- Allowing an increase in the number of SMSF fund members from four to six. The commencement date of this change will be confirmed once the law is made.
- Allowing individuals aged 65 and 66 to make up to three years of non-concessional contributions (i.e., after-tax personal contributions) under the 'bring-forward rule'. If passed, the law will apply from 1 July 2020.

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