bastion SUPERANNUATION SOLUTIONS

SuperNews Spring 2012

SMSF Trustees will need to review their Fund's Investment Strategy following recent legislation changes

In August 2012 amendments were made to the investment strategy requirements in the Superannuation Industry (Supervision) Regulations. These changes are a result of the Government's Stronger Super reforms and are in line with recommendations from the Cooper review.

There are two key changes commencing from the 2012-13 year with trustees of SMSFs required:

- to consider, as part of their investment strategy "whether the trustees of the fund should hold a contract of insurance that provides insurance cover for one or more members of the fund"; and
- to "review regularly" their investment strategy. Previously it was only a requirement to formulate and give effect to an investment strategy.

To consider insurance cover for members

The new requirement does not specify the type of insurance cover a member should have. It is also not an obligation to have cover but merely a need to consider the requirement.

Trustees would need to assess the applicability of different types of insurance cover available including:

- Death only cover;
- Death and total and permanent disablement cover
- Salary continuance (also known as income protection cover)

A fund strategy would at least need to confirm that trustees are aware and have considered the insurance obligation and whether they have determined whether it is required or not.

There are a number of reasons why insurance cover may not be required including:

- the member has sufficient insurance cover in other super funds or outside of superannuation
- premium costs are too high for the level of cover or the member is unwilling to pay the premium
- the member has little need for insurance (high superannuation assets or already in pension phase);
- the member may be outside of acceptable underwriting guidelines;

Bastion Superannuation Solutions operates the Bastion Group Life Pool to assist clients in this area. Advice from your financial adviser may be necessary.

Review Regularly

A further amendment is the need to "regularly review" the investment strategy. However, this term is not defined.

In the past most trustees would have generally reviewed their investment strategy fairly regularly on an ad hoc basis.

We would expect that regularly would mean at least "annually". A more regular review may even be impacted by the type of fund investments and could even mean "six monthly". However, it is highly unlikely that "regularly" would require a more frequent review basis.

At the time of each review in line with the insurance requirement above, trustees would need to review the need for insurance cover to be provided for fund members.

A review does not necessarily mean a change as the current strategy may be still appropriate as there has been no relevant changes in the circumstances of the fund, the members, markets or interest rates.

Where any review has been undertaken it would ideally be documented by way of a trustees' resolution. Documenting the review will demonstrate to the fund auditor and to the Australian Taxation Office (ATO) that the trustees have satisfied the operating standard.

As part of the Bastion fund administration service we prepare an annual investment strategy minute to satisfy your Fund's legislative and compliance obligations. However, it is not a substitute for investment advice and we would recommend any such advice (should the Trustees believe it to be required) should be obtained from a licensed investment adviser.

The revised operating standard

The revised investment strategy operating standard (Reg 4.09(2) is shown over page with the new additions highlighted.

Also in this issue…

The revised investment strategy operating standard

The trustee of the entity must formulate, review regularly and give effect to an investment strategy that has regard to the whole of the circumstances of the entity, including in particular:

a) the risk involved in making holding and realising, and the likely return from, the entity's investments, having regard to its objectives and expected cash flow requirement;

b) the composition of the entity's investments as a whole, including the extent to which they are diverse or involve exposure of the entity to risks from inadequate diversification;

c) the liquidity of the entity's investments, having regard to its expected cash flow requirements;

d) the ability of the entity to discharge its existing and prospective liabilities;

e) for a self managed superannuation fund - whether the trustees of the fund should hold a contract of insurance that provides insurance cover for one or more members of the fund.

New SMSF Administrative Penalties Proposed

In late August 2012, the Government released draft legislation aimed at giving the ATO power to issue administrative penalties, rectification directions and education directions to those trustees who contravene the SMSF rules.

This is in line with a further recommendation of the Cooper review of superannuation.

Current penalties

As it stands, the commissioner is limited in how he can deal with breaches by trustees of superannuation and SMSF regulations. Currently they can either:

- make an SMSF non-complying for taxation purposes
- apply to a court for civil penalties to be imposed
- accept an enforceable undertaking in relation to a contravention, or
- disqualify the trustee of an SMSF.

However applying current penalties can be costly and time-consuming and where a fund is made non-complying the potential consequences can be disproportionately high.

When a fund is made non-complying its income will be taxed at a rate of 46.5% rather than the 15% rate for that of a complying fund. Additionally for the first year of being a non-complying fund assessable income will include the total market value of its assets (less any member contributions where a tax deduction has not been claimed). This is extremely punitive and can result in the loss of a significant proportion of fund assets.

Additionally, any tax free pension exemption is lost. A general interest charge may also be charged from the financial year when the SMSF received a non-complying status up until such time as payment is made

Proposed Changes

The existing penalties will remain available.

However the new law, scheduled to apply from 1 July 2013 will give the commissioner additional powers to:

- Impose administrative penalties without reference to a court.
- Require trustees to take specific action to correct breaches.
- Require trustees to undertake education activities.

Administrative penalties

Under the new penalty regime fines will be imposed on either the individual trustees or the directors of the trustee company rather than the fund itself. In addition, the legislation specifies that penalties imposed on individual trustee or trustee directors cannot be reimbursed by the SMSF.

Administrative penalties will not be imposed for all breaches of the superannuation regulations, but will only apply to 17 breaches specified by the new legislation. Fines are applied on a penalty unit basis that range from five penalty units up to 60. Each penalty unit currently has a value of $110, meaning fines will range from $550 to $6,600.

There are only three breaches where the higher fine will be imposed. They relate to the ban on super funds:

- lending money or providing financial assistance to a member or relative
- breaches of the rules that limit the fund borrowing (other than under the limited recourse borrowing arrangements)
- breaches of the in-house asset rules.

The smaller fines are imposed for more administrative breaches such as for failing to sign required documentation.

Rectification directions

Rectification directions will specify actions that must be taken by the trustees of an SMSF to fix a breach of the regulations. A time limit will be placed on when the rectification must be completed and trustees will be required to provide evidence of the actions having been taken.

Education directions

Education directions will require a person to undertake a specified course of education within a specified time frame. These may be appropriate where the person's lack of knowledge and/or understanding contributed to them breaching the SIS Act or Regulations.

The legislation was issued as an exposure draft seeking industry submissions by mid September.

Two new operating standards

In addition to the investment strategy changes outlined earlier two further additions to Superannuation Law were made in August 2012 requiring that fund assets must:

- be valued at market value; and
- be kept separate from other assets.

These changes are also as a result of the Stronger Super Reforms.

Fund assets must be valued at market value

A new regulation (Reg 8.02B) has been inserted into the Superannuation legislation that now requires trustees to value each fund asset at its market value when preparing the annual financial statements of the fund starting with from the statements for the 2012-13 financial year.

The term "market value" is defined for SIS Act purposes as "the amount that a willing buyer of the asset could reasonably be expected to pay to acquire the asset from a willing seller if the following assumptions were made:

- that the buyer and the seller dealt with each other at arm's length in relation to the sale;
- that the sale occurred after proper marketing of the asset;
- that the buyer and the seller acted knowledgeably and prudentially in relation to the sale."

The market valuation used for tax purposes needs to be assessed on the highest and best use of the asset as recognized in the market.

The SMSF assets need to be valued as they are a key component in preparing meaningful financial reports.

There is a statutory requirement to value assets for certain events such as the preparation of financial statements, the acquisition or sale of assets between related parties, the valuation of collectibles and personal use assets, the determination of the value of assets that support a pension and the determination of the in house asset level in the fund.

Apart from these statutory requirements, appropriate valuation of assets has an impact on member returns and the SMSF sector performance as a whole.

Failure to use market value for the annual financial statements would result in an offence with a significant penalty.

The ATO has provided a new guide for the valuation of assets in SMSFs.

Fund assets to be kept separate

Superannuation legislation already requires SMSF trustees to keep money and other assets of a fund separate. This requirement has been operating as a covenant between the trustees and the members which is deemed to be included in the governing rules of the fund.

However, the ATO was unable to directly enforce the covenant as the ATO is not a member of the fund. To provide the ATO with better enforcement powers a new operating standard for SMSFs has been introduced in the Superannuation Industry (Supervision) regulations (SISR).

The new regulation (Reg 4.09A) requires that trustees must not mix personal assets with the assets of the fund. The operating standard also requires that the trustees must not mix fund assets with assets of a standard employer of the fund (or an associate of a standard employer sponsor of the fund).

As an operating standard, the ATO will be able to directly enforce the requirement.

For example, the new standard will stop situations such as where a bank account (or any other financial account) is used for both fund purposes and for private purposes. Such arrangements are usually justified on the basis of economy or convenience. The new operating standard means that such arrangements (even if expressly permitted by the trust deed) will have to be discontinued.

The new requirement is also intended to catch the situation where fund assets are not recorded in the name of all the trustees or not recorded in a manner which indicates that the assets are trust assets.

Trustees should ensure that the correct naming conventions are followed when dealing with fund assets. As your self managed super fund is a trust and not a separate legal entity, all assets must be registered in the trustee's name on behalf of your fund.

Accordingly, if your fund has individual trustees all assets should be named as follows:

John Smith & Joan Smith as Trustees for the J & J Smith Superannuation Fund.

Should your fund have a corporate trustee, all assets are required to be held by the company in trust for the SMSF. In this case your fund's assets should be named as follows:

XYZ Pty Ltd as Trustee for the J & J Smith Superannuation Fund.

Update: Tax deductibility of total and permanent disability premiums

In earlier SuperNews we outlined developments regarding the tax treatment of total and permanent disability (TPD) insurance premiums paid by super funds.

From 1 July 2011, a superannuation fund trustee will only be able to claim a full tax deduction for TPD premiums where the TPD definition matches the Tax Act definition. If the definition is broader the premium is only partly deductible.

The Government has put in place tax regulations that allow standardised deductible proportions for more common TPD definitions. The final deductible percentages from 1 July 2011 are shown below.

TPD Definition	*Deductible portion of premium*
Any occupation insurance	100%
Any occupation insurance plus (a) activities of daily living; (b) Cognitive loss; (c) Loss of limb; (d) Domestic (home) duties	100%
Own occupation insurance	67%
Own occupation insurance plus (a) activities of daily living; (b) Cognitive loss; (c) Loss of limb; (d) Domestic (home) duties	67%
Own occupation , bundled with equal or greater death cover	80%
Own occupation , bundled with equal or greater death cover plus (a) activities of daily living; (b) Cognitive loss; (c) Loss of limb; (d) Domestic (home) duties	80%

Increased SMSF levy

The SMSF Supervisory Levy has increased to $200 for the 2011-12 financial year. Previously the SMSF levy was $180. At this stage it is proposed the levy will reduce to $191 for 2012 – 13 financial year.

SuperNews Alert – Reduction in Concessional Cap

For the 2012/13 financial year the concessional contributions cap has been reduced to $25,000 for all members regardless of age. The previous limit of $50,000 for people aged over 50 no longer applies. To avoid a cap breach people making employer contributions via salary sacrifice should review these arrangements to ensure they comply with the lower limit.

Contributions tax for higher income earners

In the 2012-13 Federal Budget the government announced that from 1 July 2012, individuals earning income of more than $300,000 will have their contributions tax rate increase from 15% to 30% (excluding Medicare levy).

Under this measure, the term income will include taxable income, concessional superannuation contributions, adjusted fringe benefits, total net investment loss, target foreign income, tax-free government pensions and benefits, less child support.

Where an individual exceeds the income level of $300,000 due to the inclusion of their concessional contributions, the higher tax of 30% will only apply to the excess over the income of $300,000.

The Government has confirmed that the higher tax rate will not apply to excess contributions that have been subject to excess contributions tax.

Please note that, at the time of writing legislation on this proposal is still pending.

About Bastion Superannuation Solutions

Bastion Superannuation Solutions specialises in the provision of administration and compliance services to self managed superannuation fund trustees and advisers.

For further information on our range of services please see our web site.

Our range of services include**:**

- Self managed superannuation fund establishment
- Fund Administration including preparing financial accounts and maintaining member records
- Superannuation compliance and technical guidance
- Group Life Insurance Pool for superannuation fund members
- Assistance with updating self managed superannuation fund trust deeds

Bastion Superannuation Solutions Pty Ltd
AFSL 278 280 ABN 70 105 016 984
Level 3, 400 Queen Street, Brisbane
GPO Box 1859 Brisbane Qld 4001

Phone: (07) 3004 1100
Facsimile: (07) 3221 9811
Email: info @bastionsuper.com.au
Website: www.bastionsuper.com.au