SuperNews Spring 2010

New Standards for SMSFs for Storing Collectables and Personal Use Assets?

With the advent of the newly installed minority Gillard Labor Government we are now likely to see legislative changes introduced that will ensure from 1 July 2011 collectables and personal use assets owned by self managed superannuation funds (SMSFs) must be stored according to new rules to prevent them from giving rise to a personal benefit.

This was Labor policy announced during the election campaign to remove some concern and uncertainly that arose in the self managed fund and art and collectables community following the publication of the final Super System (Cooper) Review report as the Cooper Review recommended that:

- the acquisition of collectables and personal use assets by SMSF trustees be prohibited;
- For SMSFs that own collectables or personal use assets they be provided a five year transition period, in which to convert to a small APRA Fund or, alternatively, dispose of those assets.

(See separate article in this newsletter on the Cooper Review final recommendations)

A new Labor Government is likely to allow SMSFs to continue to invest in personal use and collectable assets provided they are held according to new legislative standards that will ensure the assets do not give rise to a personal benefit and are held for the purposes of providing retirement benefits.

Existing assets that cannot meet these rules must be sold within five years. Federal Labor has advised they recognise that collectables like artworks can be a legitimate asset class, providing investment opportunities for self managed retirees as well as important commercial benefits to Australia's artists. However they did acknowledge concerns over such assets attracting superannuation's concessional tax treatment while being available for 'personal benefit' (for example, being displayed in the home of a super fund member).

A new Gillard Government will consult with industry and community groups on the details of legislation to implement these new standards and is likely to be broadly in line with the best practice artwork investing guidelines that were recently released by the Self Managed Super Funds Professionals Association of Australia (SPAA) and the Australian Artists Association (AAA). These Guidelines are detailed below.

Purchase

- The art purchase must be timely, according to SMSF rules. That is, the art must have been planned and prepared for as a purchase for an SMSF in order to be a permitted investment.

Location

- Documented storage or exhibition details.

Existence

- Didactics: The name of the artist, a correct description, its key features, the year it was completed etc. This information should be maintained in the same format art professionals are required to report commercial resales to comply with the Resale Royalty Right for Visual Artists Act 2009.
- Documentation: This should include a photograph of the back and front of the work, and details needed to correctly identify the work.
- Provenance: This should include the origin, source or history of a work with supporting documentation.
- Verification: The auditor should verify that the physical work has been sighted.

Maintenance

- Condition: This would include a condition report on the work, for example, in excellent condition or discolouration evident.
- Valuation: This should be annual to be consistent with the reporting requirements of other asset classes such as property and equities.

Advice

- The valuer should be appropriately qualified and be an art adviser registered with Copyright Agency Limited (the administrator of the Resale Royalty Right for Visual Artists Act 2009).
- The adviser/auditor overseeing advice on the SMSF should be licensed to provide superannuation advice.

Risk/Return

- Revenue: Income from rent/lease arrangements as well as sales of artworks.
- Arrangements: Storage and/or exhibition terms and insurance to cover risk.
- Return: Income and capital returns on artwork portfolio should be calculated.
- Review: Whether a review of the art portfolio is warranted for the SMSF investment strategy.

Also in this issue…

New SMSF Borrowing Rules

In September 2007 Superannuation legislation was changed to allow superannuation funds including SMSFs to acquire permitted assets by borrowing under what was known as an instalment warrant arrangement.

Recently the old legislation in Superannuation Industry (Supervision) Act ("SIS") under which super fund trustees engaged in these arrangements was repealed and replaced with new Section 67A and Section 67B.

The new legislation, effective from 7 July 2010, implemented a number of major changes which are outlined below.

Limited recourse borrowing arrangements

Advisers and Trustees will need to become used to the new terminology as the new legislation has essentially scrapped the term "instalment warrants". The replacement legislation refers instead to "limited recourse borrowing arrangements".

Single acquirable asset

The major change of the new rules is clarification of what asset(s) can be acquired. Only a 'single acquirable asset' can be acquired. The definition of single acquirable asset is an asset that is not money, and is not prohibited by the SIS or any other law from being acquired. A single acquirable asset includes a collection of assets that are identical and have the same market value as each other.

An SMSF would be permitted to borrow to fund the purchase of 1,000 NAB shares under the new legislation as the shares have the same market value and are identical. However, if the SMSF were to purchase 1,000 NAB and 1,000 ANZ shares, this would not be allowed under a single borrowing transaction. However, the SMSF trustee could still borrow for these purchases if it entered into two limited recourse borrowing arrangements. Similarly a fund purchasing two residential units in a complex would need to have two limited recourse borrowing arrangements.

This amendment will not affect compliance of existing structures under the old rules which have acquired two or more properties.

Additionally the borrowed funds can be used to pay expenses associated with the property purchase (for example, stamp duty, conveyancing fees, brokerage and loan establishment costs).

Refinancing

The new rules specifically allow refinancing an existing borrowing. This also applies to existing structures (although after refinancing, the arrangements must comply with the new rules). Under the old rules refinancing did not appear to be allowed.

Repairs allowed but not improvements

The new legislation allows for borrowed moneys to be used to pay for repairs and maintenance, but not improvements.

Replacement assets

The new legislation clarifies the (limited) circumstances in which an asset that is the subject of a borrowing can be replaced with another asset. Generally, it is only shares in a company or units in a unit trust that can be replaced. Further, they can only be replaced with shares or units in the same company or the same unit trust.

Guarantees

The new legislation clarifies that personal guarantees are allowable provided certain criteria are met.

New ATO "Question and Answer" document

In conjunction with the new rules the Australian Taxation Office has also issued a "*Limited recourse borrowing arrangements by self-managed super funds - questions and answers*" document which provides a general discussion on limited recourse arrangements under the old and new rules.

Once the borrowing has been repaid and the loan arrangement comes to an end, the ATO are of the opinion that the property must be transferred from the asset holding trust to the SMSF otherwise it will become an in-house asset of the fund.

No Change in Policy

One pleasing outcome of the new changes is that there has been no major change in policy with purchase of assets via borrowing arrangements continuing to be permitted.

Essentially the focus has been on providing clarity on how the rules work and building in some new restrictions.

Superannuation and Estate Planning Seminars

Over the coming months Bastion will be running "Superannuation and Estate Planning" seminars for our clients. We believe that whilst it is important to build up sufficient amounts of superannuation, it is also important to ensure that what remains reaches beneficiaries in a timely and tax friendly manner.

These will be held on the second Wednesday of each month at 6.00pm in the evening. The seminar will be approximately an hour's duration.

To register your interest in attending one of the sessions please contact our office on 3004 1100.

The Cooper Review

The Cooper review chaired by Jeremy Cooper presented its final submission to the Government in June 2010. This review has been taking an in depth look into the governance, efficiency, structure and operation of Australia's Superannuation System. The review commenced in May 2009 and as part of the review, the Panel also looked at SMSFs with the final report incorporating twenty-nine recommendations for SMSFs.

The report stated that the review process has generally confirmed that the SMSF sector is largely a successful and well functioning part of Australia's superannuation system. The Panel's SMSF recommendations are not dramatic and largely relate to compliance, audit, and adviser competency with the changes aimed at ensuring that this growing sector continues to prosper in an enhanced environment.

Some of the recommendations made by the Review Panel are outlined below.

Fund size and membership

The review does believe that there is a need to mandate a minimum SMSF asset size and the current membership limit of four members for a SMSF should remain unchanged.

Leverage

The Panel has recommended that the 2007 relaxation of the borrowing provisions and the consumer protection measures should be reviewed by government in two years' time to ensure that borrowing has not become and does not look like becoming a significant focus of superannuation funds.

In-house assets

Retirement policy is that superannuation savings should be invested for the sole purpose of providing retirement savings (together with certain approved ancillary benefits) and not for providing current day benefits. Given the closely held nature of SMSFs, the Panel believes that legislation should be amended so that:

- the 5 per cent in-house asset (IHA) investment limit be removed so that no IHA investments would be allowed;
- SMSFs with existing IHA investments be provided a five year transition period, in which to convert to a Small APRA Fund (SAF) or, alternatively, dispose of their IHA investments. No acquisitions of IHA investments would be permissible during the transition period; and
- APRA regulated funds be exempt from these changes.

Related party transactions

The Panel believes that the off market acquisition and disposal of assets between related parties, does not provide transparency, is inherently risky and is open to greater abuse than non related party transactions. As a result the Panel believes that:

- any acquisition or disposal of an asset (including in specie acquisitions and disposals) to a related party where there is an underlying formal market or exchange (for example, securities quoted for trading on the ASX) must be conducted through that market.
- Where a market does not exist, then that acquisition or disposal must be supported by a current independent valuation from a registered valuer (for example, a business real property transaction will need to be supported by a valuation).

Collectables and personal use assets

The Panel believes that there are certain types of assets that should generally not be regarded as investments that build retirement savings and which consequently should not be available to SMSFs. (E.G. paintings, jewellery, antiques and stamp collections, wine, exotic cars, golf club memberships, race horses and boats.)

The Panel has recommended superannuation legislation be amended for SMSFs so that:

- the acquisition of collectables and personal use assets by SMSF trustees be prohibited,
- SMSFs that own collectables or personal use assets be provided a five year transition period, in which to convert to a SAF or, alternatively, dispose of those assets. No acquisitions of collectables and personal use assets would be permissible during the transition period, and
- APRA regulated funds be exempted from these changes.

The Panel does not accept as logical that the art and numismatic industries would be severely or even materially affected by the proposed changes. However, the Government is unlikely to proceed with this recommendation (see page 1).

Asset valuations

Asset valuation is a key component in preparing meaningful SMSF financial reports. It has an impact on the returns for members, a significant impact on a member's ability to ascertain current superannuation benefits and, ultimately, SMSF sector performance as a whole.

The Review Panel's recommendations are that the Government should legislate to require SMSFs to value their assets at net market value and the ATO, in consultation with industry, should publish valuation guidelines to ensure consistent and standardised valuation practices.

The ATO's preferred valuation method, as outlined in its Superannuation Circular 2003/01, is for all SMSFs to use market values for all valuation purposes. Currently, SMSFs are generally able to choose either the historical cost or market valuation accounting method to value their assets; although SMSFs in the pension phase or those with IHA investments, must value assets at market value each year.

At Bastion, generally we prepare Financial Statements on a market basis to ensure trustees have an accurate picture of their fund's investment performance.

Some difficulties can occur with valuing certain assets, such as units in unlisted unit trusts. In these cases, guidelines on different asset classes could be provided by the ATO to ensure consistency of valuation and enable clear auditing of the requirements.

Regulation

The Panel has recommended that legislation should be passed to provide the Tax Office with the power to issue administrative penalties against SMSF trustees on a sliding scale reflecting the seriousness of the breach.

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Regulation (cont'd)

The penalties should not be payable from the corpus of the fund, and may be applied jointly or severally against the trustees or trustee directors.

Superannuation legislation should also be amended to provide the Tax Office with the power to issue relevant persons with a direction to rectify specified contraventions within a specified reasonable time.

Other matters

Standard Trust Deeds

The Government should amend Superannuation legislation so as to automatically deem anything permitted by superannuation legislation or a tax act to be permitted by SMSF trust deeds.

Insurance default

The Government should amend the investment strategy operating standard so that SMSF trustees are required to consider life and total and permanent disability (TPD) insurance for SMSF members as part of their investment strategy.

Minimum pension payment special relief extended to the 2010/2011 financial year.

Shortly before the Federal election was called the Government announced that it would continue to support self-funded retirees by extending the drawdown relief currently provided for account-based, allocated and market-linked pensions to the 2010-11 year.

Each year the level of pension payments must meet at least the minimum thresholds which are determined by age and account balance on the commencement of the pension and thereafter on 1 July each year.

Drawdown relief over the past two years has helped retirees with pensions by reducing the need to sell assets at a loss in order to meet the minimum payment requirement. Extending the drawdown relief for a further year will help retirees to recoup capital losses on their pension portfolios as equity markets recover over time.

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The 50% reduction in minimum pension levels is outlined in the table below. Also shown is the required minimum pension for each $100,000 of an account balance.

	Special Minimum Limits for Financial years 2008-09, 2009-10 & 2010-11		*All Financial years except 2008-09, 2009-10 & 2010-11*	
Age	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**	**Minimum payment as % of account balance**	**Annual Pension Level for each $100,000**
55 - 64	2 %	$2,000	4 %	$4,000
65 - 74	2.5 %	$2,500	5 %	$5,000
75 - 79	3 %	$3,000	6 %	$6,000
80 - 84	3.5 %	$3,500	7 %	$7,000
85 - 89	4.5 %	$4,500	9 %	$9,000
90 -94	5.5 %	$5,500	11%	$11,000
95+	7 %	$7,000	14 %	$14,000

Please note that where a pension has been paid in excess of the reduced minimum limits, the minimum will be the amount paid with no refund allowed.

If the pension commences on or after 1 June then no minimum payment amount is required to be paid in that financial year. When a pension starts on a day other than 1 July, the pension limit and the annual pension amount will be calculated on the number of days the pension has to run during the remainder of the first financial year.

Amendments to the *Superannuation Industry (Supervision) Regulations 1994* and the *Retirement Savings Accounts Regulations 1997* for this change were made in July 2010.

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

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