SMSF Working Group

Issues paper on Amendments to SIS Provisions

March 2011

PROPOSED REFORM

The Super System Review recommended that amendments be made to a range of provisions in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations).

The proposed reforms are intended to address the potential risks, inconsistencies and administrative burdens that have been found to exist under the current law.

The issues for discussion are detailed below.

ISSUES

Issue 1

Recommendation 8.13 – Acquisition and Disposal of Assets

The Government announced that it supports *in principle* the recommendation to amend SIS legislation relating to acquisitions and disposals between related parties of SMSFs.

The proposed amendments will require:

a) where an underlying market exists, all acquisitions and disposal of assets between SMSFs and related parties must be conducted through that market; or
b) where an underlying market does not exist, acquisitions or disposals of assets between related parties must be supported by a valuation from a suitably qualified independent valuer.

Currently, the SIS Act prohibits SMSF trustees and investment managers from acquiring assets from related parties subject to exceptions, namely listed securities, business real property and certain in-house assets. For the exceptions to apply, these assets must be acquired at market value. The proposed amendments will apply where an acquisition from a related party is permitted.

The most common asset transfer that will be affected by paragraph (a) will be listed securities. Currently shares can be transferred to and from a related party off-market without having to engage

a broker to buy and sell the shares. Under the proposed amendment, listed securities will have to be sold on and purchased through the market or exchange.

These amendments are intended to mitigate the potential risk of transaction date and asset value manipulation to illegally benefit the SMSF or the related party.

It is acknowledged that these changes will result in an increase in transaction costs for SMSFs; however these additional costs will only be borne by those who chose to enter into related party transactions.

The proposed amendments are consistent with the requirements to be met when an SMSF disposes of collectables and personal use assets to a related party discussed at the working group meeting on 9 March 2011.

Questions

1. What assets are able to be acquired and disposed of in an underlying market? How would the transfer of these assets be undertaken?
2. How current does a valuation have to be?
    i. Should this be the same for both acquisitions and disposals?
3. Who would be considered a suitably qualified independent valuer?
4. What should happen if a valuation cannot be obtained?

Issue 2

Recommendation 8.16 – Valuation of Assets

The Government supports the recommendation to legislate the requirement for SMSFs to value their assets at net market value (NMV).

Current SIS legislation requires assets to be valued at *market value* for purposes such as determining the market value ratio of the fund's in-house assets at the end of each income year and when acquiring an asset from a related party.

The SIS Act defines *market value* in relation to an asset 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:*
>
> *a) that the buyer and the seller dealt with each other at arm's length in relation to the sale;*
> *b) that the sale occurred after proper marketing of the asset;*
> *c) that the buyer and the seller acted knowledgeably and prudentially in relation to the sale.*

Superannuation funds which are 'reporting entities' are required to value their assets at their NMV in accordance with Australian Accounting Standard 25 – *Financial Reporting by Superannuation Plans* (AAS 25). NMV is defined in this standard as:

> *'the amount which could be expected to be received from the disposal of an asset in an orderly market after deducting costs expected to be incurred in realising the proceeds of such a disposal'*

SMSFs are not reporting entities and are therefore not required to comply with this standard. However, the ATO has previously stated its view in Superannuation Circular 2003/1 that SMSFs should use market values for all valuation purposes.

In addition to the Superannuation Circular, the ATO has published *Market Valuation for Tax Purposes* which aims to provide assistance to taxpayers and their advisers on the processes to establish a market value for taxation purposes. It advises that market value should be assessed on the basis of the highest and best use of the asset as recognised in the market. Where a market exists for an asset, that market is widely considered to be the best evidence of market value of the asset.

In addition to determining the market value of an asset, ascertaining the net market value of an asset will require determining any expected disposal costs.

It is intended that this measure will ensure assets held within the superannuation system are valued in the same manner, enhancing the comparability of financial information across all sectors of the system. It will also assist in providing greater understanding of the SMSF sector and its performance. Requiring SMSFs to value assets at net market value will also provide members with current and accurate information about the financial position of the fund and their entitlements.

It is not intended that obtaining a valuation should be onerous or expensive for trustees. Frequency of valuations may depend on the type of investments held by the SMSF and whether member's accounts are in accumulation or pension phase.

Annual valuations should be required where an SMSF has in-house assets or is in pension drawdown. Otherwise, valuations may be appropriate every 2-3 years.

Questions

1. How often should a valuation be obtained? Should this be the same for all assets?
2. Who can determine the NMV of an asset? Should all valuations be undertaken by a qualified valuer?
3. Will there be difficulties in determining the NMV for particular assets?
4. Will SMSFs incur additional costs in determining the NMV of an asset? Are such costs reasonable?

Issue 3

Recommendation 8.17 – Valuation Guidelines

The Government supports the recommendation for the ATO, in consultation with industry, to publish valuation guidelines to ensure consistent and standardised valuation practices.

The ATO has published guidelines outlining the basis for conducting market valuations in Superannuation Circular 2003/1. It outlines the view that SMSFs should use market values for all valuation purposes and includes general information on when and how a valuation is to be conducted.

The ATO has also published *Market Valuation for Tax Purposes* which is a guide to provide assistance to taxpayers and their advisers (including valuers) on the processes to establish a market value for taxation purposes.

The publication advises that market value should be assessed on the basis of the highest and best use of the asset as recognised in the market. It also advises that to determine the market value, the most appropriate valuation method is to be used. Where a market exists for an asset, that market is widely considered to be the best evidence of market value of the asset.

In relation to who undertakes the valuation, it outlines that except for the most straight forward valuation processes, valuations undertaken by persons experienced in the field of valuation would be expected to provide more reliable values than those provided by non-experts.

In implementing this recommendation the ATO will look to use this publication as the basis for the valuation guidelines developed for SMSFs. This will maximise consistency of valuation practices for tax and superannuation purposes, whilst still allowing for tailored or specific guidance for SMSFs where required.

Questions

1. Does the ATO guide on Market Valuation for Tax Purposes provide an appropriate valuation framework on which to base SMSF valuation guidelines?
2. What is current industry practice in relation to valuations? Are there difficulties in obtaining a valuation for certain assets?
3. To what extent does it differ from the principles and guidance outlined in the ATO guide?

Issue 4

Recommendation 8.19 – Removal of Unnecessary Requirements

The Government supports the recommendation to amend legislation to remove SMSF trustee administrative burdens that are identified as unnecessary.

All superannuation entities, including SMSFs with two or more individual trustees and all directors of a corporate trustee, are required to prepare minutes of all meetings of trustees or directors at which matters affecting the fund are considered. Where an SMSF has a single individual trustee the requirement is to retain records of all decisions made.

The requirement for the outcomes of these meetings to be documented provides an evidentiary framework for trustees or directors. For example, there may be occasions where the ATO is examining the actions of the trustees and the existence of minutes or other records may assist the trustees in demonstrating the courses of action taken and the intent of the trustees. Equally, the evidentiary benefit of such documentation may become important if at a future time there is any dispute between trustees or directors.

In making the recommendation, the Panel noted that it would like to see the administration of an SMSF align more with the rules applying to small and single member proprietary companies under the Corporations Act, where meetings, minutes and other formalities have been reduced to an absolute minimum.

The application of such an approach may mean that that trustees or directors could sign a statement saying they are in favour of a resolution set out in the statement, as opposed to holding a meeting to discuss the issue. By signing the statement, this then negates the need for minutes to be taken, as it provides some sort of record that all members agreed to a decision made about the fund.

Other requirements of trustees in the SIS Act that may be regarded as being of an administrative nature generally relate to record keeping or informing the Regulator of specified events. These requirements can be seen as supporting the effective operation and regulation of the fund.

Questions

1. What are the administrative requirements placed on SMSF trustees that are considered unnecessary or could be streamlined?

Issue 5

Recommendation 8.27 – Standard Deeming Provisions

The Government supports the recommendation to amend the SIS Act so as to automatically deem anything permitted by the SIS Act or a tax act to be permitted by SMSF trust deeds.

This amendment would remove the need for trustees to ensure trust deeds are updated regularly due to changes in the law. SMSFs will no longer have to bear the costs associated with having to regularly update the fund's deed.

Possible legislative amendments would deem certain rules to be included the SMSFs trust deed and may include:

1. anything permitted by the SIS Act or a tax Act is permitted by the trust deed.

2. anything prohibited by the SIS Act or a tax Act is also prohibited by the trust deed.

3. anything permitted to be done under the SIS Act or a tax Act is permitted by the trust deed unless expressly prohibited by the trust deed.

4. if any part of the trust deed is or becomes inconsistent with the SIS Act or a Tax Act, the trust deed is deemed not to contain that part to the extent of the inconsistency.

Options 2 and 3 are favoured as they will still allow SMSF trustees to tailor the operation of their fund to meet their own objectives and particular circumstances.

Questions

1. Should the standard deeming provision override any prohibitions in the trust deed?

2. Are the possible legislative amendments too broad?

3. Should trustees be required to review and update their trust deed periodically?

Issue 6

Recommendation 8.28 – Separation of Assets

The Government supports the recommendation to replicate the covenant requiring the separation of fund assets from personal or employer assets in a SIS operating standard.

The covenant in paragraph 52(2)(d) of the SIS Act requires trustees to keep money and other assets of the fund separate from any money or assets that are held by the trustee personally or by a standard employer sponsor or an associate of a standard employer sponsor.

Contraventions of this covenant are one of the most commonly reported contraventions by auditors. While many of the reported contraventions relate to inadvertent administrative errors or failing to update records following a change in trustee, other situations can include where separate bank accounts are not held or where assets are held in the name of the member rather than the SMSF. The ATO is unable to enforce compliance with this covenant other than encouraging rectification by the trustee/s.

Replicating the covenant in a SIS operating standard will provide the ATO with the power to enforce the requirement.

Questions

1. Will the introduction of the operating standard increase compliance with the requirement?

2. Should this requirement be extended to ensure money and assets of the SMSF are kept separate from all related parties of the SMSF as defined by the SIS legislation?

Issue 7

Recommendation 8.29 – Consideration of Life and TPD Insurance

The Government supports the recommendation to 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.

Submissions to the review suggested that SMSF members were more likely to hold appropriate levels of insurance, or hold insurance outside their superannuation, than members of other superannuation sectors. This amendment is intended to ensure SMSF trustees give adequate consideration to the holding of life and TPD insurance within superannuation, not to force them to hold insurance.

Questions

1. Will the amendment of the investment strategy operating standard ensure trustees give adequate consideration to the holding of life and TPD insurance? Are any other amendments necessary to achieve this outcome?