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15 September 2011

Stuart Forsyth
Assistant Commissioner
Funds Segment Superannuation

Email: stuart.forsyth@ato.gov.au

Dear Stuart,

RE: SMSF REFORM WORKING GROUP

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission in relation to the issues papers circulated for discussion at the Australian Taxation Office's (ATO) SMSF Reform Working Group meeting on 14 September 2011.

ASFA is a non-profit, non-political national organisation whose mission is to advance effective retirement outcomes for members of superannuation funds through research and advocacy. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self managed superannuation funds (SMSFs) and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

Valuations Guidelines

Valuation Guidelines – preference for a “stand-alone” product

The general feedback from ASFA's SMSF community is that they favour the option of having an SMSF specific location for the valuation guidelines. For relatively inexperienced trustees (and there are around 40,000 new trustees each year) the information should be much easier to find. This will also better cater for more SMSF specific information that is likely to develop over time.

The guidelines need to consider the work that the SMSF auditor needs to perform. In other words the guidelines need to be precise and clear wherever possible so as not to make it impossible for auditors to do their job and enforce a valuation method where the trustee in return mounts an argument about an inappropriate valuation method.

A case in point here is the “Valuation Methods” where a market doesn't exist. How far do trustees have to look, how hard do they have to try to find one? Explaining exactly what is a hypothetical market needs to keep in mind the important work the SMSF auditor needs to do insofar as playing their part in ensuring the health of the system and determining whether the fund is compliant or not.

The ATO will clearly need to make sure that these guidelines are consistent with generally accepted valuation principles that are currently used by valuers. To this end the accounting standards relating to the valuation of assets should be a starting point.

Market Value

There was some confusion as to whether the ATO seeks “market value” or “net market value”. At the moment there are very limited times under the SIS Act when the assets of a superannuation fund are required to be valued at market value.

The ASFA membership returned some disagreement with any move to make the AAS 25 definition of market value applicable to SMSFs because, as you know, SMSFs are not required to satisfy the accounting standard. There was some feedback that indicated the difficulty with including the AAS 25 standard in the legislation instead suggesting a separate definition in the legislation on what is meant by “market value”.

It is appreciated though that it is difficult to contemplate these issues without first seeing at least some draft legislation so as to get an indication of when, how and why the valuation is required.

Asset classes included at point 4 of the discussion paper

Related unit trusts should extend to related companies whether controlled by related parties or not. Preference was also voiced for inclusion of some commentary on the different types of trusts such as discretionary trusts and whether the depreciation value be accepted as a market value in some cases.

Collectables and Personal Use Assets

Further suggested subject matter for inclusion in a collectables Q&A:

- Questions regarding the storage and garaging of collectables and personal use assets, particularly those relating to private residences
- Would a garage attached to a private residence be treated differently to a free standing garage where one was used as storage for say a motor vehicle?
- Can the garage be on the same title as a private residence or does it need to be on a separate title?
- Questions that make clear the requirements for inspection of the assets by auditors and the regulator, including will auditors need to inspect the assets each year?
- Whether pre and post assets should be stored in the same way e.g. stamps purchased before 1 July 2011 and those purchased after
- Will collectables ever be treated as trading stock?
- If the collectable or personal use asset is owned via a company or trust in which the SMSF and related parties have a minority interest will this fall outside the legislation or will it be caught by the legislation?
- What type of valuation is necessary i.e. “drive by”, market assessment or sworn valuation?
- Where the SMSF has a collection of collectable assets i.e. a collection of multiple artworks, manuscripts, cars, bottles of wine etc, will the trustee be required to insure each asset separately or can the collection as a whole be insured?
- A related question to the previous is where there is a breach in relation to a collection

will the penalties apply to each separate asset or to the collection as a whole i.e. if the trustee was storing 30 bottles of Grange in their private residence would that be 30 separate breaches or 1 breach?

- What should a trustee do if it can not get reasonable insurance any more to cover the collectable as result of the new storage requirements?
- A common problem for collectables is identifying which assets are owned by a super fund, especially where the person owns similar assets outside the fund. Can they be stored together or in the vicinity of each other? How should assets be tagged so that an auditor can verify their identity and ownership by the fund.

General comments in regards collectables

The guide will need a definition of "bullion coin" and also clarify that precious metal bullion is a commodity rather than a collectable. Comments from ASFA members suggests that a number of people who buy gold and silver coins do it as a means of storing wealth more so than as a means of exchange, but any coins which are legal tender are just money, which is not a collectable.

Also, even if precious metals are held in a form other than bullion, if the value is wholly determined by the metal content, then should that not be treated as a commodity? If it has additional value due to form (such as jewelry) but is not legal tender, then the asset becomes a collectable.

Differentiated compliance treatments

Generally speaking, ASFA believes that the ATO should grade each breach, the levels of seriousness of the breach and whether the contravention occurred intentionally or accidentally based on a reasonably arguable position, in determining the appropriate compliance treatment.

Regard also needs to be given to the fact that many SMSFs have a combination of active and passive trustees. This is no more apparent than when the active trustee dies generally leaving behind the passive trustee(s) who are then left to a great extent to flounder with the trusteeship of the fund. Notwithstanding the fact that trustees have a shared responsibility, the reality is that in many cases one trustees tends to make the decisions.

For this reason any differentiated compliance treatment needs to recognise that a feature of SMSF trusteeship today, be it proper or not, is that not all trustees are equal.

Directions to undertake education

AFSA generally agrees that the ATO will need to set and develop the course requirements. However ASFA also has a few concerns with this:

- Is the ATO geared to actually create and deliver the course or courses? Would it not be better that under guidance from the ATO, registered training organisations are used to create and deliver the product?
- It is also unclear how many courses will be needed and exactly what they will seek to achieve i.e. presumably to teach trustees about in-house-assets or related party transactions or some such thing.

- However, the subject matter and time needed to complete the course would depend on the severity of the breach, the breach itself and whether it relates to a breach of one standard or a number of standards.
- Clearly with some trustees an education program which starts from scratch would not be necessary, but is it the aim of the ATO to have an all encompassing course available when needed, but from which segments can be presented where specific topics are needed to be covered?

Directions to rectify contraventions

Any direction to rectify a contravention needs to have a realistic expectation that it can be achieved. It follows therefore that there may be circumstances where it is inappropriate to issue a direction to rectify such as where a trustee has died and the rectification will cause hardship and financial stress to the surviving, and potentially passive, trustee personally. Also circumstances where there is little likelihood of money being returned would render any rectification direction useless.

Administrative penalties

It would appear to be harsh to disqualify a trustee on the basis the trustee is not a fit and proper person if they fail to pay a penalty. Unless of course the non payment of the penalty included a previous history of poor compliance and failing to pay other penalties.

In regards the remission guidelines presented in the discussion paper, although extremely brief, they appear to be reasonable. However, more detail is needed here, but ASFA appreciates that the paper is a reflection of some very early thinking. In time ASFA would expect further guidelines and a practice statement to support the ATO's remission process.

Illegal early release promoters

ASFA endorses the efforts of the ATO and other regulators to bring to account promoters of illegal early release schemes.

However, penalties should not be imposed on fund members who receive no financial benefit from the illegal access due to fraud perpetrated by the promoter. The member should only be penalised where they have received a financial gain and the penalty should be relative to the gain obtained and previous history, where one exists, of obtaining benefits via illegal access.

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We thank you for this opportunity to provide our thoughts on the SMSF Reform Working Group papers. ASFA looks forward to continuing its involvement in this important work.

Should you have any questions on any of the matters raised above please feel free to contact

Tony Keir Senior Policy Adviser on 02 8079 0815 or at tkeir@superannuation.asn.au

Yours sincerely

A handwritten signature in black ink that reads "D. Graus". The signature is written in a cursive style with a large, looped initial "D".

David Graus
General Manager, Policy & Industry Practice