

Changing Face of SMSF



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September 2019



Smarter SMSF

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Today's session

Bills & Treasury

ATO updates

Case law

Bills & Treasury

Bills & Treasury

Re-introduction of lapsed super measures

Bills & Treasury

Re-introduction of lapsed super measures

- Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2019 was re-introduced into Parliament on 24 July 2019
- Bill focuses on three (3) key measures:
 1. Amending the SGAA 1992 to allow individuals to avoid unintentionally breaching their concessional contributions cap when they receive superannuation contributions from multiple employers;
 2. To extend the purpose of the NALI provisions to prevent the inflating of fund earnings through non-arm's length dealings; and
 3. To include within a member's TSB the outstanding loan amount of a limited recourse borrowing arrangement (LRBA) entered into by an SMSF after 1 July 2018.

Bills & Treasury

Employees with multiple employers

- In the 2018-19 Federal Budget, the Government announced that from 1 July 2018, individuals with multiple employers would be able to nominate to opt-out of the SG system to avoid breaching \$25,000 concessional cap.
- Rules allow for individual to apply to the Commissioner for an **employer shortfall exemption certificate** – prevents an employer from having an SG shortfall in relation to employee for a quarter
- Means that an employer's maximum contribution base for an employee for a quarter is nil if covered by certificate
- Does not prevent the employer from making contributions on behalf of the employee – effect is to simply remove consequences of failing to making contributions for the quarter covered by the certificate

Bills & Treasury

Employer Shortfall Exemption Certificate

- A certificate cannot be varied or revoked once issued
- **Conditions** for issuing an employer shortfall exemption certificate:
 - the Commissioner considers that, disregarding the effect of issuing the certificate, the person is likely to exceed their concessional contributions cap for the financial year that includes the relevant quarter; and
 - the Commissioner is satisfied after issuing the certificate, the employee will have at least one employer that would either have an individual SG shortfall in relation to the employee, or have such a shortfall if they did not make any contributions for the benefit of the employee; and
 - the Commissioner considers that it is appropriate to issue the certificate in the circumstances.

Bills & Treasury

Non-arm's length income

- Bill intends to remove ambiguity surrounding a technical deficiency with the NALI provisions (Subdivision 295-H of ITAA 1997) as it relates to:
 - Acquiring assets at less than market value (ordinary & statutory income)
 - Non-arm's length expenditure (revenue or capital account)
 - Net capital gains (incl. impact of market value substitution rules)
- A non-arm's length arrangement exists where SMSF enters into a transaction or scheme with a party (often related), where typically the outcome is not reflective of 'real bargaining'
 - Refer *Commissioner of Taxation v. AXA Asia Pacific Holdings Ltd*

Bills & Treasury

Example

- SMSF acquired a commercial property for \$1.0M on 1 July 2015, using LRBA
- The SMSF derives rental income of \$1,500 p/wk (\$78,000 p.a.)
- LRBA terms included no interest, no repayments until the end of the 25 year term and 100% LVR
- SMSF was in a financial position to enter into an LRBA on commercial terms with an interest rate of approx. 5.8%
- SMSF has not incurred expenses that it might have been expected to incur in an arm's length dealing in deriving the rental income.



Bills & Treasury

Example

- As such, the income derived from the non-arm's length scheme is NALI
 - \$78,000 rental income (less deductions attributable to the income) forms part of the fund's non-arm's length component and taxed at highest MTR
 - **No deduction** for interest, which under the scheme was nil
- Non-arm's length interest on borrowings to acquire an asset will result in any eventual capital gain on disposal also being treated as NALI.



Bills & Treasury

Non-arm's length schemes and internal arrangements

- Requirement that parties are not dealing with each other at arm's length means that NALI rules **do not apply** in respect of purely internal arrangements of a fund
 - Internal functions are not undertaken with another party on any terms, non-arm's length or otherwise
- For example, an SMSF trustee may undertake book-keeping activities for no charge in performing their trustee duties.
- Such internal arrangements are **outside of the scope** of the NALI rules as they do not constitute a scheme between parties dealing with one another on a non-arm's length basis.

Bills & Treasury

Non-arm's length schemes and internal arrangements

Important distinction in applying NAL provisions is looking at capacity in which the trustee undertakes those activities:

- **s.17A(1)(f) of SISA** – trustee cannot charge for services of functions in capacity as trustee; services of this kind do not involve a scheme between parties as they fundamentally relate to the trustee's obligations in respect of the fund
- **s.17B of SISA** – trustee charging for non-trustee services, but is generally restricted to charge up to an arm's length amount for those duties or services performed.

Bills & Treasury

Non-arm's length capital expenditure

- Where a fund acquires an asset for less than MV through non-arm's length dealings, not only will the revenue generated be NALI, but statutory income (e.g. capital gains) upon disposal will be assessed as NALI
- Will also apply with acquisitions in accordance with section 66 of the SISA
 - Related party acquisitions – e.g. listed shares or BRP where not acquired at market value
- **Market value substitution** rules in s. 112-20 of ITAA 1997 may apply, adjusting the first element of the cost base of the CGT asset that is acquired to its market value
- NALI rules would continue to apply even after market substitution rules increase cost base/reduced cost base

Bills & Treasury

NALI & capital expenditure

- For example, where real property is acquired (not as a contribution) by the fund for less than market value as part of a scheme where the parties were not dealing at arm's length, any income generated from that asset (for example, rental income) will be non-arm's length income.
- When the property is ultimately disposed of, the **resulting capital gain will also be NALI**.
- However, in calculating the resulting capital gain, the market value substitution rule may apply such that any capital gain on the disposal of the asset is reduced as a result of the asset's increased cost base to the market value at the time of acquisition.

Bills & Treasury

LRBAs & TSB measures

- Integrity measure being added by Government to change the TSB rules to ensure that, from 1 July 2018, a member's total superannuation balance may increase by the share of the outstanding balance of the LRBA where:
 - The member has **satisfied a condition of release with a nil cashing restriction** (paragraph 307-80(2)(c) of ITAA 1997); or
 - Those whose interests are supported by assets that are subject to a LRBA **between the super fund and one of its associate** (e.g. related party loans)
- These TSB amendments only apply to SMSFs and SAFs

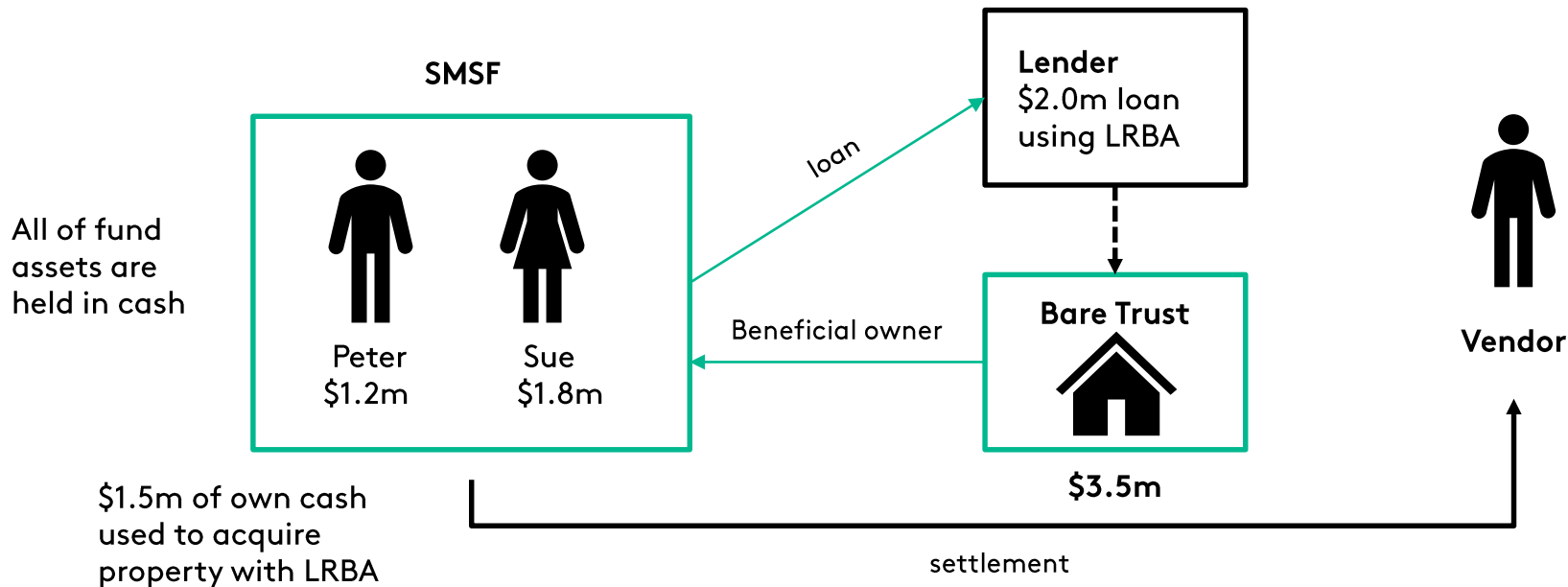
Bills & Treasury

LRBAs & TSB measures

- Policy intent is to increase an individual member's TSB to ensure that it more accurately reflects the overall value of assets in the fund.
- Limits any ability to circumvent TSB rules by:
 - withdrawing benefits and providing back as a loan; or
 - providing a loan to the fund rather than as a contribution
- Need to establish connection between asset and member's super interest to determine if included within TSB calculation
 - If segregated to a specific member, will only impact interest of that member, not all members of the fund
 - If one member has satisfied COR, the increase is only applied in respect of that member

Bills & Treasury

Example – more than one member



Legislative Update

Example – more than one member

- Both members have retired and therefore satisfied a COR with nil cashing restriction
- Of the \$1.5m cash used to acquire the property, 40% (\$600k) was supporting Peter's interest and 60% (\$900k) supporting Sue's interest
- As a result of these measures:
 - **Peter's TSB is \$2.0m** – comprising \$600k cash (in fund), 40% net share of property (\$600k) and 40% share of outstanding LRBA (\$800k)
 - **Sue's TSB is \$3.0m** – comprising \$900k cash (in fund), 60% net share of property (\$900k) and 60% share of outstanding LRBA (\$1.2m)

Bills & Treasury

LRBAs & TSB measures

- Trustees will need to include LRBA amounts that relate to a member for reporting purposes when advising ATO of an individual's TSB at end of each year

2019 SMSF Annual Return

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Accumulation phase value **X1** \$, , .

Retirement phase value **X2** \$, , .

Outstanding limited recourse borrowing arrangement amount **Y** \$, , .

Sensitive (when completed)

- In addition to 'grandfathering' pre-1 July 2018 arrangements, the refinancing of existing loans and certain contracts entered into prior to this date will also be **excluded**.

Bills & Treasury

Miscellaneous amendments impacting downsizer contributions

Bills & Treasury

Miscellaneous Amendments Bill (impacting downsizer contributions)

- ***Treasury Laws Amendment (Measures for a later sitting) Bill 2019: miscellaneous amendments*** released for consultation (until 27 September 2019).
- Measures include three (3) proposed changes for downsizer contribution to ensure that the rules within section 292-102 of ITAA 1997 operate as intended.

Bills & Treasury

Proposed downsizer contribution changes

1. **Spouse held pre-CGT property** - an individual can make a DC in respect of the proceeds from a property that was held by their spouse where the property is a pre-CGT asset that would have been subject to the main residence CGT exemption if it had been acquired after 1 September 1985;
2. **Correct cap calculation** - the cap on the amount of DCs that an individual can make is calculated correctly where their spouse has previously made a DC in relation to another property; and
3. **Calculating maximum amount of downsizer contributions** - For working out the maximum amount of DCs that an individual can make, the market valuation substitution rule (s.116-30 of the ITAA 1997), which applies generally in working out an amount of capital proceeds, cannot increase the amount of capital proceeds received in relation to the disposal of their ownership interests in a dwelling.

Bills & Treasury

Deferral of SuperStream for SMSF Rollovers

Bills & Treasury

SuperStream deferral for SMSF rollovers

- Government has formally proceeded with the deferral extension of SuperStream for SMSF rollovers from 30 November 2019 to 31 March 2021
- The deferral means that system changes to update SuperStream will only need to be undertaken once, for both sets of changes, reducing costs for fund and allows for a more integrated design of SuperStream
- The extension will now include release authorities into the SuperStream standard for the ATO to send electronic requests for the release of super.

ATO updates

ATO updates


ATO & single asset investment strategies

ATO updates

Investment Strategies

- ATO has written to 17,700 trustees to highlight concerns where fund holds 90% or more of its assets in one asset, or a single asset class.
- Letter flags the Regulator's concern that fund may be at risk of not meeting the diversification requirements within the fund's investment strategy (SISR 4.09)
- 99% of SMSFs contacted, the asset in question was property, following CFR report released in February 2019.

<PO BOX 908 ALBURY NSW 2640>



Australian Government
Australian Taxation Office

Our Reference: <Investment strategy>
Phone: <13 10 20>
Client ID: <TFNABN>
<Letter Date>

<TITLE> <FIRST NAME> <SURNAME>
<ORGANISATION>
<ADDRESS LINE 1>
<ADDRESS LINE 2>
<LOCALITY> <STATE> <POSTCODE>
<COUNTRY>

+

Is your SMSF investment strategy meeting diversification requirements

Dear <Trustee>.

Our records indicate that your self-managed super fund (SMSF) may hold 90% or more of its funds in one asset, or a single asset class.

This means that your fund may be at risk of not meeting the diversification requirement for your investment strategy as outlined in the operating standard of the *Superannuation Industry (Supervision) Regulations 1994*.

As a trustee you are ultimately responsible for ensuring your investment strategy meets the requirements under the law. You could also be liable for an administrative penalty of \$4,200 if your investment strategy fails to meet these requirements.

What you need to do

You need to review your investment strategy to make sure it complies with the law. In particular, you need to be able to provide evidence, ideally within the written investment strategy itself, of how you considered the following:

- > diversification of your fund investments;
- > the risks associated with inadequate diversification within the context of your SMSF's investment portfolio;
- > the making, holding and realising and the likely return from your investments having regard to your retirement objectives and expected cash flow requirements
- > the liquidity of your investments, meaning ability of your fund to pay benefits as members retire and pay other costs incurred by your fund
- > whether to hold insurance cover for one or more members of your SMSF.

Have your investment strategy ready to provide to your SMSF's approved auditor as part of your next audit. This will help your auditor form an opinion on your fund's compliance with these requirements.

What happens now

We will also be writing directly to the auditor of your fund to notify them of our concerns. You should be aware that if your auditor identifies that you have failed to comply with the requirements listed above, this could result in the imposition of the [above mentioned](#) penalties.

Yours faithfully
<Deputy Commissioner's Name>
Deputy Commissioner of Taxation

NEED HELP?
If you have any questions, you can phone us on <13 10 20> between <9:00am> and <6:00pm>, <Monday to Friday>.

MORE INFORMATION
For more information about investment strategies for SMSFs, visit our website [ato.gov.au/smf/investstrategy](#)

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NAT/DX.DIN/DX-ABA-2019Y

ATO updates

Fund Auditor's role

- ATO has also written to the fund's auditor notifying them of the Regulator's concerns
- It will be up to the auditor to identify and determine whether the fund has failed to comply with the requirements outlined within SIR 4.09 which could result in administrative penalties applying of \$4,200 (20 penalty units).
- It is expected that the ATO will provide further guidance in respect to this topic to assist both trustees, auditors and other SMSF professionals to better understand and meet these investment strategy requirements within the SIS Regulations.

ATO letter to Fund's Auditor

PO BOX 908 ALBURY NSW 2640

Australian Government
Australian Taxation Office

Our Reference: AA-Inv-Strategy
Phone: 13 28 69

SMSF Auditor

4 September 2019

SMSF investment strategy and compliance with diversification requirements

Dear SMSF Auditor,

We have recently written to all SMSF trustees where our records show that their SMSF may hold more than 90% or more of its investments in one asset or a single asset class. This is because the fund's investment strategy may be at risk of not meeting the requirements in regulation 4.09 of the *Superannuation Industry (Supervision) Regulations 1994*.

The letter reminds trustees of the requirements under regulation 4.09 including the need to provide evidence in their investment strategy of having considered diversification of the fund's investments and the risks involved with inadequate diversification. It also advises the trustee to have their investment strategy containing evidence of these considerations, ready to provide to their auditor as part of their next audit. A copy of a generic letter that was mailed to trustees on 29 August 2019 is attached below for your information.

What you need to do

One or more of your clients should have received this letter. In which case you should check that they have an investment strategy that complies with regulation 4.09.

In particular, you should expect to see documented evidence from the SMSF trustee which demonstrates that the following was considered:

- diversification of the fund's investments and the risks associated with inadequate diversification; and
- that other relevant factors were considered such as the risk involved in making, holding and realising and the likely return from the investments having regard to the fund's objectives and expected cash flow requirements;
- the liquidity of the SMSF's investments, having regard to its expected cash flow requirements and ability to discharge its existing and prospective liabilities; and
- whether the trustees considered holding insurance for one or more of the members.

It is up to you to determine whether any contravention of regulation 4.09 on the basis of non-compliance with the above listed factors would amount to a material contravention resulting in modification of the audit report.

NEED HELP?

If you have any questions, you can phone us on 13 28 69 between 8:00am and 5:00pm, Monday to Friday. Ask for SMSF auditor team on extension 88716.

An Auditor-actuary Contravention Report (ACR) should be lodged where the ACR reporting criteria is met. In verifying the trustee's compliance with each of the above listed factors in regulation 4.09 we expect auditors to apply the trustee behaviour tests. This means that an ACR needs to be lodged if the contravention is one that the trustee has received advice about previously and has either breached it again or it has not been rectified at the time the audit is conducted.

If the trustee is receiving advice about the contravention for the first time you should notify them in writing. Best practice would be for the SMSF auditor to notify the trustees in the management letter of any further concerns about the fund's investment strategy.

Yours faithfully
James O'Halloran
Deputy Commissioner of Taxation

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How have the trustees 'considered' their investment strategy decisions and documented this to meet requirements contained within SISR 4.09?

Key ATO focus on lack of diversification where single asset class exists?

ATO updates

Investment Strategies

- Importantly, **does not** prohibit a SMSF investing in a single asset or have heavy asset concentration within an asset class
- ATO's focus is on ensuring that the investment strategy prepared by the trustees adequately considers this decision having assessed and being aware of risks with lack of diversification.
- Area further exposed from outcomes in ASIC's REP 575 on '*improving quality of advice and member experiences*' for SMSFs.



SMSF investment strategy webinar [FREE]
Wednesday, 25 September 2019 at 3:00pm AEST

smartersmf.com/events

ATO updates

Meeting minimum pension requirements - Death Benefit Income Streams

Death Benefit Income Streams

Minimum pension not met

- ATO has released guidance where a member does not meet their minimum pension requirements for a reversionary income stream.
- SISR 6.21 requires death benefit to be paid as either lump sum and/or income stream.
- Where pension fails:
 - ECPI is lost for the income year;
 - All benefits are treated as lump sums;
 - TBAR reporting required on 'failed' pension at end of income year
- ATO now providing some **leniency** where minimum pension not met with a reversionary income stream.

Death Benefit Income Streams

Minimum pension not met

- Requires swift action by trustees to cash the benefit '*as soon as practicable*' to prevent further possible contraventions – in this instance, a new death benefit income stream can be **re-established**.
- Achieved by:
 - immediately cashing the benefit in the form of a new retirement phase income stream as soon as they become aware of the breach (likely to be identified during the annual compliance process);
 - cashing the benefit in the form of a lump sum (either as a single lump sum or as an interim and final lump sum); or
 - rolling over the interest that supported the death benefit income stream pension to another complying super fund for immediate cashing as a new death benefit income stream.

Death Benefit Income Streams

Minimum pension not met

Process where reversionary beneficiary fails to meet the minimum pension:

1. See whether the pension shortfall qualifies to use the Commissioner's General Powers of Administration (GPA); **then**
2. Promptly purchase another death benefit super income stream (further cashing event, following SISR 6.21); **or**
3. Otherwise, lump sum from the super system (cashing of death benefit)

Death Benefit Income Streams

(Unresolved) Issues

Appears to be some 'missing' pieces to ATO guidance at this stage, including:

- If pension ceases, all amounts per TR 2013/5 are lump sums – death benefit payments only allow for an interim and final payment (SISR 6.21)?
 - What if monthly pension amounts paid?
 - **NB.** New income stream will also be a death benefit income stream (due to repeal s.307-5(3) of ITAA 1997)
- ATO updated guidance to confirm it only applies to reversionary pensions?
- Appears the result of decision allows for a reversionary pension to fail **only once** as the beneficiary would be required to purchase a new death benefit super income stream



ATO updates

Status if SMSF Annual Returns are late

ATO updates

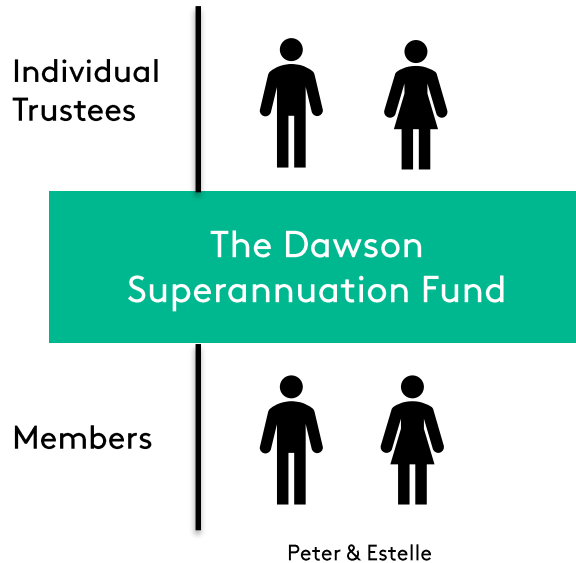
Fund status will change for late SMSF returns

- From 1 October 2019, if an SMSF is more than two weeks overdue on any annual return lodgment due date and hasn't requested a lodgment deferral, the ATO will change their status on Super Fund Lookup (SFLU) to '**Regulation details removed**'.
- Status will remain until any overdue lodgements have been brought up-to-date
- **New process:**
 - On the first business day of each month, two-step process for updating SFLU
 1. Where an SMSF trustee hasn't lodged their SMSF annual return on time and they're more than two weeks overdue, ATO will change their SMSF regulation status to 'Regulation details removed' on SFLU.
 2. Where all overdue lodgments are received for an SMSF during the previous month, ATO will update SFLU to reinstate the SMSF's 'complying' status.

Case law

Case Law

Dawson v Dawson [2019] NSWSC 826



- The Dawson Super Fund was established in 2005 by the late Peter Dawson
- In June 2013, Tony Dawson (**the plaintiff**) appointed as EPA for his father, Peter.
- Due to onset of Dementia, in March 2014, the plaintiff became a trustee of the fund with his mother, Estelle.
- Earlier in 2012, Peter and Estelle separated through family court proceedings, with consent orders made in March 2014
- Peter Dawson died on 24 Nov. At time of death his Will left all of his estate to Estelle, and appointing Estelle's son in law, George Holland as executor - Peter had apparently overlooked up until his death.

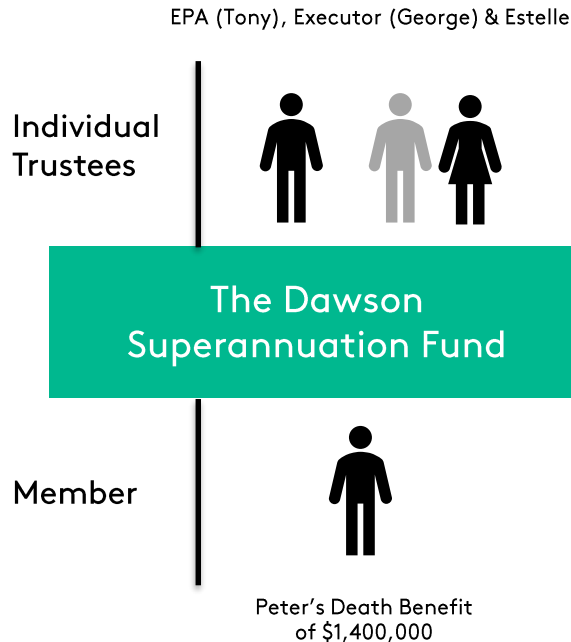
Case Law

Dawson v Dawson [2019] NSWSC 826

- George Holland's role as executor was not discovered until April 2018 when the accountant invited the plaintiff to sign a Deed of Confirmation.
- Up until this time, they mistakenly assumed that the plaintiff (son) was executor of the estate.
- The Deed purported to ratify George Holland as a trustee and to replace the plaintiff as a replacement trustee - an appointment disputed by the plaintiff.
- Despite plaintiff's refusal to resign as trustee, the executor and Estelle Dawson signed the Deed of Confirmation with the **intention of taking control of the fund.**
- **Plaintiff issued proceedings in NSW Supreme Court, arguing executor's appointment was invalid (also issued family provision claim challenging father's Will being paid entirely to his (estranged) mother.**

Case Law

Dawson v Dawson [2019] NSWSC 826



- No valid BDBN in place.
- Executor's position that he and Estelle were correct trustee since death of Peter Dawson – argued that as the EPA ceased on death, the plaintiff's appointment also ended.
- Executor's appointment was necessary in satisfy s.17A to deal with death benefit (*not yet paid out due to selling number of land holdings and dispute on sale of hotel property in the fund*).

Case Law

Dawson v Dawson [2019] NSWSC 826

- Court found in favour of the plaintiff, having undertaken a detailed review of the fund's deed and how it managed the process for the appointment of a trustee.

Conclusions:

1. Consistent with the Fund's deed and the SIS Act, the plaintiff was by definition a "Legal Personal Representative" (LPR) as he held the role of EPA for the deceased member;
2. The plaintiff's appointment as trustee was a personal role which did not cease on the death of the member, even though the EPA ceased on death.
3. There was no express power in the trust deed that ended this role on the death of a member, nor was there any other power in the deed that would operate to terminate the plaintiff's role as trustee. The deed allowed for a LPR to be appointed in the circumstance of the member becoming of unsound mind or on death with the same powers as the member who ceased the office of trustee;

Case Law

Dawson v Dawson [2019] NSWSC 826

Conclusions:

4. The plaintiff was entitled to hold the office as trustee for the deceased member until he ceased office or when he died or became of unsound mind.
5. The role of trustee of the Fund is a separate roll to that of an Attorney, appointed under an EPA;
6. The court agreed with the defendants that although not strictly relevant to the outcome of the case, the fund remained a two member fund until the death benefits commenced to be paid out and this had not occurred at the time the case was presented to the court. The court agreed with the plaintiff that if the fund was a two member fund, the plaintiff remained as trustee as the deceased member's "legal personal representative" for the payment of his father's death benefits; and
7. Estelle Dawson did not have the power under the trust deed to appoint her son in law executor as a trustee, without the consent of the plaintiff.

Case Law

Lessons from Dawson's case

- Courts will **always** carefully review this history of fund documents – from deeds, appointments, updates, agreements (e.g. pensions) and any other associated documentation (*see cases of re Narumon, Cantor Management and Perry v. Nicholson*)
- The appointment of an executor as replacement trustee upon death is permissive and not mandatory (*see case of Ioppolo v. Conti*)
- **If Attorney appointed by EPA as replacement trustee during period of member incapacity and later dies, unless trust deed specifically terminates the attorney's role as trustee, they will remain in office for purpose of the payment of deceased member's death benefits.**
- **Where no valid BDBN, they will be able to exercise a discretion, made in good faith and for a proper purpose, to pay out the death benefits to any qualifying SIS dependant (including themselves).**

Be **smarter** than your average...



Aaron Dunn

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Thank you!

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