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60 | SMSF Adviser May 2018 Update

SMSF Adviser May 2018 Update is a quick walk through the top trending stories for the SMSF industry that came out in May 2018.

Miranda Brownlee writes for SMSF Adviser and covers over 20 stories a week, all about SMSF. We asked Miranda what happened in May. Here is what we learned.

SMSF Adviser May 2018 Update

May was a huge month for the SMSF industry. With many changes – not as huge as the super reform in 2017 – but still pretty big.

To listen while you drive, walk or work, just access the episode through a podcast app on your mobile phone.

1 Three Year Audit Cycle

The government plans to change the annual audit requirement for certain SMSFs to three years from 1 July 2019. The measure would apply to SMSF trustees who have a history of clear audit reports for three consecutive years. And who have lodged their fund's annual returns in a timely manner.

Would it actually reduce red tape and costs for clients?

BDO superannuation partner Paul Rafton said the proposal puts a lot of onus back onto to the SMSF trustee.

“I don't think it's such a bad thing having a regular heath check on an annual basis from an independent auditor. It could mean that it's three years before the ATO catches up with someone whose compliance history is not as squeaky clean as it used to be. So there's a three-year window really. They might got a good record and then go off the rails. It will be three years before the ATO and the auditor catch up with them.”

The SMSF Association conversely welcomed the change. They describe it as a positive step. SMSF association chief executive John Maroney said the proposal “will cut red tape for the SMSF sector. It is a fitting reward for trustees who strictly adhere to the regulatory regime”.

Nexia Brisbane chief executive Ken Robertson suspects that many firms will still complete interim SMSF audits on an annual basis.

The SMSF Auditors Lobby Group suggests that, rather than changing to a three-year audit cycle, there are other ways to reduce costs for the industry. One alternative is to remove the reporting requirement for certain minor contraventions. Another option is to remove the requirement to review certain documentation and its retention.

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2 Six Member Funds

The government's proposal to increase the SMSF member limit to six could lead to administrative headaches.

While the policy allows larger families to have an SMSF together, Mr Miller of Miller Super Solutions questions whether it's a good idea to have kids in an SMSF.

"For every person who thinks that's a good idea, there are plenty of people that don't. To me there is a good reason why most SMSFs have two or less members. It complicates things by extending the numbers. It's fairly easy to have discord amongst family members. "

SIS regulation require only two members to sign off on the annual accounts.

View Legal founder Matthew Burgess has similar concerns.

"There are enough war stories just with two, three or four members. To then take that to five or six members. Every extra member is an extra complication when you come to the exit arrangements for the fund.

At the moment, even if there are two kids and two parents in the fund, the worst case scenario is that the fund will end up with a stalemate. Now if you bring in three kids or even four kids you've got a situation where if you're counting hands, the parents can be outvoted.

SMSFs might decide to address that by pinning or stapling member balances to voting rights. However, this is not off-the-shelf stuff. You have to amend your constitution and hardwire that in under the terms of the SMSF."

3 Work Test Measure

Australians aged 65 to 74 can currently only make contributions if they meet the work test. For members with a TSB below $300,000 an exemption from the work test is to apply. So these members will have an extra year of voluntary contributions. The measure is to commence from 1 July 2019.

Once eligible, there is no requirement for individuals to remain under the $300,000 balance cap.

During these 12 months individuals can also utilise unused CC space under the concessional cap carry forward rules.

4 SG Opt Out

High-income earners with more than one employer will soon be able to exclude certain wages from SG.

This new measure will apply to individuals with income for SG purposes exceeding $263,157 for a financial year. They will be able to apply for an exemption certificate to release some of their employers from their SG obligations.

From 1 July 2018, eligible individuals will be able to download an application form from the ATO website.

If approved, the individual and their exempted employers will receive a copy of the exemption certificate directly from the ATO.

According to Fitzpatricks Private Wealth head of strategic advice Colin Lewis the industry has been waiting for this measure for years.

"This particularly impacts medical specialists as they can work for a number of different hospitals and private practices. Employers must make the compulsory 9.5 per cent means. So they can easily blow their $25,000 when you add it all up. So that is a good measure."

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 # 5 Changes to Fees and Charges

The government plans to introduce a 3 per cent annual cap on passive fees charged by superannuation funds. And also to ban exit fees for all superannuation accounts. The 3 per cent annual cap on passive fees would apply to accounts with balances below $6,000. The aim is to better protect superannuation balances of young people and those with low balances.

The changes will probably take effect on 1 July 2019.

 # 6 Insurance Inside APRA Funds

The government plans to move some insurance in superannuation from a default framework to an opt-in basis. This is intended for those members with low balances of less than $6,000, members under the age of 25 years. And also for members whose inactive accounts have not received a contribution in 13 months.

Mr Day, Colonial First State executive manager, explains it like this. “A number of years ago the rules changed to basically require an opt out of insurance cover. So you saw people moving around funds. And then they ended up with lots of accounts with lots of duplicated insurance policies.”

This latest announcement is to address this issue. Where a fund is inactive for more than 13 months the insurance will expire. This could impact SMSF members.

Someone sets up an SMSF. They are “perhaps in their 40s and they’ve already got life and disability insurance inside a large fund. It’s not uncommon for them to leave $20,000 sitting inside that large fund and then roll over the balance to commence an SMSF and then redirect their employer contributions into their SMSF. Under these new rules there’s a risk that the old account could be deemed to become inactive. And therefore that insurance policy might see its cancellation. Unless you take action to make sure that this doesn’t happen.”

So members have three options. They could redirect employer contributions back into the APRA fund to prevent this. They can opt into their current insurance cover in the APRA fund. Or they just let the cover go.

 # 7 Testamentary Trust Changes

Minors receive concessional tax rates when receiving income from testamentary trusts. This income from testamentary trusts currently receives normal adult tax rates. And not the higher minor tax rates.

Some taxpayers have injected assets unrelated to the deceased estate into the testamentary trust to benefit from this concession.

The new measures are to counteract such action. And are to start from 1 July 2019.

From then on the concession only applies to income derived from assets transferred from the deceased estate. This includes proceeds of the disposal or investment of those assets.

Does a deceased estate include superannuation assets? View Legal director Matthew Burgess believes this could potentially be a “sleeper issue for SMSFs” depending on the details.

“There are a whole raft of questions here. It could undermine your preferred asset protection strategy,” he explained.

 # 8 Super Consolidation

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The government has revealed plans to strengthen the ATO's consolidation regime. It will require the transfer of all inactive superannuation accounts with balances below $6,000 to the ATO. The ATO will expand its data matching processes. The aim is to proactively reunite these inactive accounts with a member's active account.

This measure will also include the proactive payment of funds currently held by the ATO. These changes are to take effect from 1 July 2019.

The intention is to reunite the majority of accounts transferred to the ATO in the year of receipt.

9 Victims of Crime to Access Super

The government has released two proposals to enable victims of violent crimes to access a perpetrator's superannuation as compensation.

The first proposal is to clawback out-of-character superannuation contributions. A criminal might make these to shield their assets from use in compensating victims of their crimes.

The second is to allow victims of serious, violent crimes to be able to access a perpetrator's superannuation as compensation. Treasury stated that this second measure will only apply where a criminal conviction has been obtained. It would not apply to unpaid civil compensation claims in the absence of a prior criminal conviction.

A perpetrator's entire superannuation balance will only be accessible relating to serious criminal offences involving violence against an individual. There are several proposals up for discussion how to protect the rights of a perpetrator's dependants.

Stakeholders are to comment on the draft proposals by 15 June 2018.

10 SMSF Auditor Deregistrations

There has been a reregistration of 117 SMSF auditors after they failed to lodge their outstanding annual statements.

ASIC sent a final warning to 404 approved SMSF auditors with outstanding annual statements in November 2017.

"Of the auditors sent a final notice, 287 lodged their annual statements," ASIC said. The remaining 117 auditors were sent a notice of cancellation.

SMSF auditors are to lodge an annual statement with ASIC within 30 days of the annual anniversary of their registration.

11 ASIC Releases Findings of SMSF Advice Review

ASIC has completed a review into SMSF advice and unlicensed accountants. It has identified examples of outdated or inaccurate information on websites and promotional material.

"The review found no systemic concerns around the provision of unlicensed SMSF advice. But it did identify significant levels of inaccurate and out of date information on websites and in promotional material."

ASIC used technology to scan accountants' websites for potential compliance issues. It searched social media platforms for statements made re SMSF services or specialisation. And it reviewed online ads.

"Further enquiries revealed that most of the accountants identified were not providing unlicensed SMSF advice," ASIC stated.

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ASIC target accountants without an update to their list of the services since 1 July 2016. The accountants' exemption ended on 1 July 2016.

12 Productivity Commission Report

In its draft report, the Productivity Commission has questioned the quality of SMSF advice being provided to trustees. It suggests that SMSF clients display a lack of scepticism towards their advisers.

While the report acknowledges that SMSFs are mostly satisfied when they actively collaborate with a trusted adviser, the report referred to ASIC's testimony at the financial services royal commission. It indicates that 9 times out of 10, advisers failed to take into account the best interests of their clients when giving advice about setting up an SMSF.

According to ASIC, in 10 per cent of the SMSF client files reviewed, the client 'risked being significantly worse off. And a further 19 per cent of clients were at an increased risk of suffering financial detriment'.

The process of establishing and growing an SMSF builds trust between the adviser and SMSF members. However, clients who form favourable views of advisers tend to maintain those views. Even when the quality of the advice does not justify their decision.

"One survey of SMSF investors found that they had no better financial literacy than other superannuation members, but that 85 per cent rated their skill as at or above average," said the report.

The paper also raised concerns about "an increase in reported costs for SMSFs over recent years. While it noted that the costs for SMSFs with over $1 million in assets were broadly comparable with APRA regulated funds as a percentage of member account balances, may smaller SMSFs have delivered materially lower returns on average than larger SMSFs. The difference between returns from the smallest SMSFs with less than $50,000, and the largest with over $2 million, exceeds 10 percentage points a year. These high costs are the primary cause of the poor net returns experienced by small SMSFs on average."

13 ATO Sets 'sharp focus' on High-balance SMSFs

The ATO will be focusing greater attention on high-value SMSFs. As part of its compliance activities, the ATO will be doing a lot of benchmarking across the SMSF sector. And will also be looking at high-value funds.

The ATO will also continue to monitor auditors who are auditing a high volume of SMSFs. This is to ensure a "high professional standard".

There have been no commutation authorities to SMSFs yet. But the ATO has begun to issue excess transfer balance determinations following the lodgement of around 11,000 TBARs.

14 Market-linked Pensions

Where a member ceases a market-linked pension and commences a new one, it may result in the pension being double counted under the TBC. Market-linked pensions fall under the definition of the capped defined benefit income streams where they were in place before 1 July 2017.

SMSFs looking to roll over market-linked pensions should hold off. Treasury and the ATO are working on a potential solution to the double counting issue under the transfer balance cap.

15 ATO Set to Revise Approach to TSB Calculation

The ATO will look to change its initial approach to the calculation of the total superannuation balance. However, certain types of SMSF members will still need to report both pension and accumulation values.

Originally, SMSFs were going to be required to report both the member's 30 June 2017 pension and accumulation phase values using TBAR. This was a surprise to those in the industry who thought that only the

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member's pension balance would need to be reported.

However, the ATO now looks set to revise this approach. The ATO will now only require the member's 30 June 2017 accumulation phase value to be reported when the member is also in receipt of a capped defined benefit pension or a flexi pension from the fund. This is a good outcome for the SMSF industry.

16 TBAR Experiencing Slow Take-up

Only 2 per cent of SMSFs or 11,000 SMSFs have adopted event-based reporting so far. This represents just 1.9 per cent of the total 592,658 SMSFs, based on the latest ATO statistical report. It is a significant jump from the 900 SMSFs that had commenced event-based reporting in mid-February this year, however.

Around one in five SMSF firms plan to implement quarterly reporting for all clients in their firm. And this regardless of whether their clients are above or below the $1 million threshold, according to a recent poll.

Members close to the $1 million threshold can easily slip into quarterly reporting if there is a jump in earnings. So a buffer amount can help practitioners to keep on top of this.

17 EOFY Extension Traps

The extension of the lodgement date for SMSF annual returns may present some traps for practitioners and clients. Especially where there isn't adequate time to update information for the fund.

The lodgement extensions for SMSF annual returns have been very welcome by the industry. It provided more time to deal with commutations and CGT relief. But there are a few administrative traps that practitioners should be wary of.

"We all love a lodgement extension because it gives people more time to finalise everything from the previous year. But it also means that it takes longer to get funds up to date. So people may not have had adequate time and information to be able to make contribution decisions for the 2017/18 year," said Mr Miller, founder of Miller Super Solutions.

18 CGT Confusion Over Property, Corporate Restructures

Does CGT relief apply where there has been a change in the nature of the asset? For example in property settlements, options and corporate restructures with shares?

There remain a few questions around what assets are eligible for the CGT relief, says BDO superannuation partner Mark Wilkinson.

An asset's holding period must go from the pre-commencement period all the way through to the end of segregation. Or to 30 June if using the proportional approach. "This raises the issue of what happens where there's a change in the nature of an asset," Mr Wilkinson said.

ATO acting assistant commissioner Tara McLachlan explained that it will all depend on the actual asset and its holding period.

With a corporate restructure, this is going to depend on the facts of the particular case, Ms McLachlan said. "If the restructure left the share entitlement unchanged. And it was merely the conditions associated with the shares so it changed from a Class A to a Class B, then potentially the CGT relief could apply. However, if it was a change from one distinct type of share to a different type of share, then obviously it's not the same kind of asset, so you wouldn't get CGT relief."

It is also clear, she said, that an option is different from a share. You hold an "option, you then acquire a different asset being the share, so in that case, our view is that CGT relief does not apply," Ms McLachlan said.

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