



Explanatory Memorandum

August 2010

CURRENCY:

This issue of Client Alert takes into account all developments up to and including 20 July 2010.

Tax Office Sets Compliance Focus Areas for 2010/11

The Commissioner has released the ATO's Compliance Program for 2010/11. Despite acknowledging that Australia has a tax and superannuation system with high levels of voluntary compliance, the ATO's latest compliance program flags ATO attention on numerous risk areas including international and cross-border financial arrangements, wealthy individuals, and incorrect or fraudulent refunds. An overview of the ATO's main target areas are set below.

Tax agents

There are about 26,000 registered tax agents who lodge around 73% of income tax returns for individuals and more than 95% of business tax returns. The ATO says that this year, it will place particular emphasis on delivering relevant information electronically and providing timely advice to agents on emerging issues of concern.

The Commissioner said the ATO will continue to closely monitor the level of compliance in tax agent dealings with clients. Where the ATO sees trends it considers 'outside the norm', it will check client tax returns as well as the agent practices.

Individuals – compliance issues

The Commissioner says there is 'strong evidence' that some people, struggling to understand basic tax obligations, are using unregistered preparers to assist in making false claims. The ATO plans to continue to closely scrutinise returns lodged by unregistered preparers and will remind taxpayers to check the accuracy of their claims. The ATO considers that people working for the same employer or in a particular occupation are at risk of over-claiming work-related expenses or claiming a combination of deductions, credits, rebates or offsets.

Data matching

Each year, the ATO extensively cross-references information that people report in their tax returns with information provided by other parties in order to verify income received from employment, welfare, interest and dividends. Last year, the ATO data-matched over 500 million transaction records reported to it by third parties and this year expects to analyse a similar volume of records, including details of:

- employment, welfare and investment income;
- property and share ownership and disposals;
- superannuation information, including member contribution statements, lost member reports, auditor contravention reports and SMSF annual returns;
- significant cash transactions captured by AUSTRAC, including a focus on tax haven-related transactions;
- so-called 'indicators of wealth', such as ownership of luxury motor vehicles, boats and aircraft;
- partnership and trust income, including managed funds;
- employee share schemes; and
- health insurance policies including the level of cover held by an individual.

Work-related expenses

The ATO says the most common mistakes concerning claims for work-related expenses include:

- keeping insufficient documentation to support motor vehicle and travel expenses;
- incorrectly claiming motor vehicle expenses on the basis that the taxpayer's vehicle is carrying bulky equipment;

- incorrectly claiming travel or motor vehicle expenses when the taxpayer is required to travel from home to work more than once a day; and
- incorrectly claiming home office, mobile phone and internet expenses.

The ATO says it intends to focus on claims made by tax agents outside the norm for their client base, and to write to 'at-risk' taxpayers who may over-claim work-related expenses to provide information before they lodge their tax returns.

Investors

This year, the ATO plans to contact taxpayers it believes are at risk of over-claiming rental expenses. It says it may alert taxpayers who have had capital gains events from the sale of shares or property to their CGT reporting obligations. The ATO will also identify taxpayers who have declared dividend income and remind them of their entitlements and obligations.

High wealth individuals

The Commissioner says the global mobility of Australian executives and other highly paid individuals employed overseas is 'of significant interest' to the ATO. The ATO says its concern is that some may not be reporting all the benefits they receive as income. Consequently, the ATO will:

- closely scrutinise reporting of income from employee share schemes by company executives and directors, and remuneration payments received from overseas entities or paid from Australia to overseas accounts; and
- contact executives, directors and other employees it identifies as being involved in employee share schemes due to a restructure, demerger or takeover, to remind them of their obligations.

The ATO will also scrutinise tax-minimisation strategies used by individuals with income over \$1 million, including alienation of personal services income and claiming large deductions and credits. It will also review the tax records of entities controlled by these individuals.

Superannuation

Issues under the ATO spotlight for individuals here include:

- correct application of the law when individuals claim income tax deductions for personal contributions to super funds eg ensuring the requirements for lodging a valid notice of intent to claim or vary a deduction for personal superannuation contributions have been met;
- the ATO will follow up people who exceed the superannuation caps and raise assessments where necessary; and
- the ATO will continue to ensure the early access to super rules are complied with.

Micro businesses (turnover under \$2 million)

The cash economy continues to be a major ATO focus here and it plans to review and audit more than 26,000 micro businesses. Concerns include the use of cash transactions to hide income and evade tax obligations. This includes businesses:

- paying cash-in-hand wages or treating employees as contractors;
- skimming some or all of the cash takings;
- running part of their normal business activities off the books;
- not reporting the exchange of goods and services for other goods and services (barter); and
- operating underground, avoiding obligations by not registering or not lodging returns.

The ATO also plans to expand its range of small business benchmarks. It expects to contact around 100,000 micro businesses because their reported income is outside the published benchmark ranges.

Other issues

Other ATO target areas for micro businesses include:

- **lodgment of correct BASs** — the ATO says it will focus on omitted or incorrectly reported property sales and acquisitions, and incorrectly applied margin scheme rules. It expects to verify over 48,200 refund claims from micro enterprises this year;
- **employer obligations** eg super guarantee, FBT — this year, the ATO says it expects to take action on over 17,500 employee complaints about unpaid superannuation. The ATO will also undertake 800 compliance reviews targeted at industries and employers showing a pattern of non-compliance, including the road freight transport, automotive repair and electrical services industries;

- **property assets** — the ATO will focus its review and audit activities on reporting capital gains and GST on the sale of shares and real property. The ATO said it will also undertake specific reviews on the application of the CGT small business concession rules;
- **losses** — where micro enterprises incurred a loss for the first time in 2009, the ATO will contact them and provide information about incurring and using losses. It will also review the tax affairs of businesses using losses to ensure that tax payable is not incorrectly reduced in current or future years;
- **contractors** — the ATO is concerned that some contractors might seek to alienate their personal services income through entities such as companies, partnerships and trusts. The ATO says it will continue its test case program to clarify the law and provide further information to contractors and their tax agents. Specifically, the ATO will:
 - match data from labour hire firms and the mining industry to identify and target contractors, particularly engineers and computer technology specialists; and
 - also review the tax affairs of contractors identifying themselves as a personal services business and businesses in receipt of government stimulus payments;
- **superannuation** — this year, the ATO will audit or review around 10,800 SMSFs and will focus on loans to related parties and follow up on undertakings given in previous years to rectify breaches.

SMEs (turnover \$2 million – \$250 million)

ATO focus areas in the SME sector for 2010/11 include:

- **a continuing focus on private groups** — and the tax compliance of the individuals controlling those groups and the entities within them. The ATO says it intends to increasingly use external data to automatically detect and link private groups and the individuals controlling them;
- **a focus on wealthy Australians** — to promote voluntary compliance by individuals and business groups with a net wealth of \$5 million – \$30 million;
- **continued focus on businesses with turnover of \$100 million to \$250 million.** ATO target areas include international transactions, CGT, trusts and tax-reconciliation items. The ATO is also concerned that some of these companies may not appropriately adopt and apply the new TOFA rules from this year;
- **CGT** — the ATO says most CGT issues centre on the incorrect reporting of a capital gain in assessable income. This can occur as a result of not including a capital gain, inflating the cost base to reduce the amount of a capital gain, or incorrectly accessing one of the various concessions or rollovers;
- **GST** — the ATO will focus on serious evasion. The ATO will continue its focus on businesses making sales of property and is keen to ensure these transactions are correctly reported on BASs. The ATO says it will increase its focus on taxpayers selling property and disengaging from the GST system by not lodging their BASs;
- **FBT** — the main areas of concern to the ATO for FBT are: failing to identify taxable fringe benefits (motor vehicles in particular); failing to correctly value fringe benefits; failing to lodge FBT returns; and exploiting concessions and areas of weakness in the law;
- **phoenix activities** — the ATO will continue to focus on evasion of tax and superannuation guarantee through what it describes as the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities;
- **international** — target areas here include: profit-shifting through understating income or overstating deductions, usually through non-arm's-length pricing; thin capitalisation; offshore disclosures and international shipping.

Division 7A

The ATO is concerned that private companies and their tax advisors sometimes do not understand their obligations in relation to shareholder loans. It says that some knowingly make distributions to connected entities, and these distributions are not correctly repaid or declared as taxable income. Some are not amending their returns once a deemed dividend is identified. The ATO says it intends to adopt a mix of strategies to promote voluntary compliance with Div 7A.

Trusts

The ATO says it is looking to see a 'marked improvement' in the completeness and accuracy of reporting by trustees, both about the income of the trusts and how that income was distributed to beneficiaries. While the ATO says it recognises there is some uncertainty in the law about the income and capital of trusts and the distribution of those amounts (and it says it will 'provide further clarity'), it considers the basic requirements for trust returns to be lodged on time and for distributions to be properly recorded are not

affected by uncertainty in the law and the ATO intends to ensure these fundamental requirements are properly met.

The Compliance Program is on the [ATO Website](#).

ATO is Contacting Participants in Collapsed Agribusiness MIS

During June to August 2010, the ATO says it will be contacting approximately 60,000 identified participants of recently collapsed Agribusiness managed investment schemes (MIS) to help them understand the tax consequences of their investments. The ATO says the letter advises participants to visit the ATO website or contact their tax agent for information specific to their situation.

The Tax Office has advised tax agents that they will need to factor in any changed tax implications for investors in these schemes when they prepare their tax returns.

The Tax Office notes that investments may have been managed by Great Southern Limited, Timbercorp Limited, Environinvest Limited, Palandri Wines Pty Ltd, Australian Bight Abalone Pty Ltd, Forestry Enterprises Australia (FEA) or Rewards Group Limited. It says the collapse of, or financial difficulties being experienced by, these companies may have changed the tax consequences for taxpayers' investments.

The ATO suggests taxpayers review their records as the companies listed above managed a variety of agricultural and forestry businesses and their names might not be immediately familiar. The investments included grape, berry, avocado, mango, citrus, olive, almond, beef, abalone and forestry projects.

Information on the tax consequences of specific schemes and general information for Agribusiness MIS investors is on the [ATO Website](#).

GST and Requirements for Tax Invoices

The [A New Tax System \(Goods and Services Tax\) Amendment Regulations 2010 \(No 1\)](#) were registered on the Federal Register of Legislative Instruments on 12 July 2010. The Regulations amend the GST Regs by removing regs 29-70.01 and 29-70.02 which previously specified the requirements for documents to be tax invoices or recipient created tax invoices. The removal of the regs follows the recent enactment of Sch 3 to the Tax Laws Amendment (2010 GST Administration Measures No 2) Bill 2010.

Date of effect

The Regulations commenced on 1 July 2010 and apply in relation to net amounts for tax periods starting on or after 1 July 2010.

Reportable Employer Superannuation Contributions Definition: Changes Proposed

On 30 June 2010, the Minister for Financial Services, Superannuation and Corporate Law announced that the Government will amend the law to clarify the scope of the reportable employer superannuation contributions (RESC) definition (see s 16-182 of Sch 1 to the TAA), which is used in determining eligibility for a range of government financial assistance programs.

'The Government has become aware that contributions made on behalf of an individual, which the individual or their employer have no real capacity to influence, are being captured by the RESC definition and hence being considered income for means-tested tax and transfer system programs,' Mr Bowen said. These contributions typically include additional employer contributions that are prescribed in legislation and not capable of being influenced by the individual or their employer.

The Minister said this is not the Government's intention and that the law 'will be amended so that RESC does not include contributions made on behalf of an individual pursuant to legislation or other requirement that the individual and their employer cannot directly control.' The changes are proposed to apply from 1 July 2009 to ensure that the contributions are not captured by the RESC definition and assessed as income for means-tested tax and transfer system programs.

Source: [Minister for Financial Services, Superannuation and Corporate Law's media release No 080, 30 June 2010](#)

Minimum Pension Drawdown Amounts — 50% Reduction to Continue

On 30 June 2010, the Prime Minister announced that the Government will extend for another year the 50% reduction in the required minimum payment amounts that must be made from account-based, allocated and market-linked pensions. The SIS and RSA regs will need to be amended and the Government says this will be done as soon as possible in the new financial year.

The minimum amounts had been reduced by 50% for the 2008/09 and 2009/10 financial years — that will now be extended for the 2010/11 financial year. This means, for example, that the minimum annual drawdown for 2010/11 for someone aged 64 years or less will remain at 2%; and for those aged 65/74, will be 2.5%.

Source: *PM's interview with Alan Jones, Radio 2GB*; [Minister for Financial Services joint media release No 079, 30 June 2010](#)

Division 7A Benchmark Interest Rate

Taxation Determination TD 2010/18, released on 30 June 2010, states that, for the income year that commenced on 1 July 2010, the benchmark interest rate for the purposes of ss 109N and 109E of the ITAA 1936 is **7.40%** per annum (up from 5.75% for 2009/10).

The benchmark interest rate is relevant to private company loans made or deemed to have been made after 3 December 1997 and before 1 July 2010; and to trustee loans made after 11 December 2002 and before 1 July 2010. It is used to:

- determine if a loan made in the 2009/10 income year is taken to be a dividend (s 109N(1)(b) and as applicable, s 109D(1) or s 109XB); and
- calculate the amount of the minimum yearly repayment for the 2010/11 income year on an amalgamated loan taken to have been made prior to 1 July 2010 (s 109E(5)).

Trust's Unrealised Gains can Be Treated as Income

The NSW Court of Appeal has confirmed that it was permissible for a trust, in terms of its trust deed and accepted accounting principles, to treat unrealised gains made on share investments as income of the trust: *Clark v Inglis* [2010] NSWCA 144 (NSW Court of Appeal, Allsop P, McColl JA, Macfarlan JA, 29 June 2010).

Background

In September 1982, the deceased established a discretionary family trust, the beneficiaries of which included himself, his second wife and his children from both his marriages. By the time of his death in October 2007, the share portfolio that formed the corpus of the trust was worth over \$2 million.

For many years, the trust accounts were prepared on the basis that the share portfolio was valued at the lower of cost and net realisable value. However, following a change of accountants in 1999, the trust accounts were prepared on the basis that the share portfolio was revalued each year to market value and the net increase in the value of the investments (in effect the unrealised capital gains) was treated as income, which was distributed to the deceased (and certain other beneficiaries) and credited to their loan accounts with the trust. At his death, the deceased's loan account stood at almost \$1.25 million, of which just over \$1.17 million represented unrealised capital gains.

Following the deceased's death, a number of the beneficiaries of the family trust decided that the accounting treatment based on revaluing the investments was inappropriate and the directors of the trustee company passed a resolution effectively reversing the distribution of the unrealised capital gains to the deceased. As a result, the deceased's loan account was reduced by just over \$1.17 million to some \$46,000. However, one the beneficiaries (the deceased's surviving wife) subsequently refused to agree to this treatment of the unrealised capital gains.

The primary issue was whether the trustee could, consistently with the trust deed, lawfully treat upward movements in the value of investments as income and distribute it to beneficiaries. It was also necessary to determine if such distributions had in fact been made. If so, the amounts would be included in the deceased's loan account and thus form part of his estate to which his second wife was entitled as residuary beneficiary. Otherwise, the relevant amounts would remain an asset of the trust.

Importantly, the trust deed did not define the term 'income', but cl 6(f) empowered the trustee to make a binding determination that any property or moneys held by the trustee constituted capital or income. That clause also provided that the trustee's treatment of income and capital in the trust accounts did not have to accord with their treatment for income tax purposes.

Previous decision

At first instance, in *Wood v Inglis* [2009] NSWSC 601, the NSW Supreme Court held there was nothing in the trust deed, nor any relevant accounting rule or regulation, that prevented the trustee from treating the unrealised capital gains as income. Furthermore, it said that by adopting the market revaluation method of accounting, it would have been inappropriate not to treat increases in the value of investments as income. The Court also found that the trustee had made the relevant distributions and that, in any event, the deceased would have been entitled to the relevant amounts by way of a default clause in the deed.

On appeal, it was argued that while the unrealised gains on the shares could be 'profit', they could not be treated as 'income' of the trust. It was also argued that no determination had been made to treat the gains as income under cl 6(f) of the trust deed.

Decision

In unanimously dismissing the appeal, the Court of Appeal said the question of whether the unrealised gains could be treated as income of the trust was 'a legal proposition derived both from the terms of the trust deed and independently from the law' and that it was not constricted by concepts available in taxation law. The Court then found that while the notion of profit was different from income, neither the trust deed nor the law prevented the unrealised gains being treated as income of the trust (despite the appellants' arguments that only unrealised gains on certain static assets such as trading stock could be recognised as income).

In arriving at this conclusion, the Court said reliance should be placed on commercial accountancy principles and practice to decide the issue. In this regard, it noted that the expert accountancy evidence at first instance had concluded that while it was 'imprudent' from a financial management and taxation perspective to apply the market revaluation approach, this approach was 'permissible' from an accounting perspective. Therefore, the Court said that in the absence of a definitive legal standard to the contrary, the concept of income could encompass unrealised gains.

Having reached this decision, the Court said it was unnecessary to decide whether determinations had been made under cl 6(f) of the trust deed to treat the unrealised gains as income. This was because, as the Court found, the accounts of the trust had properly treated the unrealised gains as income under accepted accounting concepts. Nevertheless, the Court found that for the reasons identified at first instance, there had been clear acts by the trustee determining that increases in the value of investments would be treated and held as income. In short, the Court of Appeal concluded that the trustee had treated the unrealised gains as income, and had done so in accordance with accepted accounting principles.

Finally, in view of its conclusion that the unrealised gains were income that had been distributed to the deceased, the Court indicated that following the decision of the High Court in *FCT v Bamford* [2010] HCA 10, these amounts were income of the trust to which the deceased was presently entitled. Accordingly, it said that relevant disclosures should be made to the ATO if they were necessary.

ATO Sends Warning to SMSFs Regarding Employee Share Schemes

The ATO has released [Taxpayer Alert TA 2010/3](#) warning taxpayers of an arrangement where an individual nominates his or her SMSF as the acquirer of shares or share options under an employee share scheme and the trustee of the SMSF pays no consideration or less than market value consideration for the shares or options.

The Taxpayer Alert warns that the arrangement could have superannuation and income tax law implications for both the SMSF and the individual.

Mr D'Ascenzo warned that, for individuals who have nominated their SMSF, there can be penalties if the discount on the shares and options isn't accounted for in their tax returns. The Commissioner added that, for an SMSF, acquiring an asset from a related party can put the fund at risk of being made non-compliant and taxed at 45%.

The Tax Office notes that its view about what is a contribution is contained in Taxation Ruling TR 2010/1 and its guidance on acquisition of assets from related parties is in Self Managed Superannuation Funds Ruling SMSFR 2010/1.

Source: [ATO media release No 2010/13, 30 June 2010](#)

Reasonable Travel and Meal Allowance Amounts

Taxation Determination TD 2010/19, released on 30 June 2010, sets out the amounts the Commissioner considers are reasonable for the 2010/11 income year in relation to claims made for:

- overtime meal allowance expenses — the amount is \$25.80;
- domestic travel allowance expenses. The reasonable amounts are given for: (i) accommodation at daily rates (for domestic travel only); (ii) meals (showing breakfast, lunch and dinner); and (iii) deductible expenses incidental to travel;
- travel allowance expenses for employee truck drivers; and
- overseas travel allowance expenses.

Superannuation and Instalment Warrant Rule Changes

The Superannuation Industry (Supervision) Amendment Bill 2010 has passed all stages of Parliament without amendment and received Royal Assent on 6 July 2010 as Act No. 100 of 2010.

The Bill has inserted ss 67A and 67B of the SIS Act (replacing s 67(4A) from 7 July 2010, ie the day after Royal Assent) to reduce the prudential risks for superannuation funds investing in limited recourse borrowing arrangements (eg instalment warrants). However, the amendments do not apply retrospectively to existing arrangements in place before 7 July 2010 (although ss 67A and 67B apply to any subsequent refinancing of existing arrangements).

Prudential risks clarified

The new provisions in ss 67A and 67B clarify that:

- **single asset per borrowing** – a borrowing under a security trust arrangement can only be referable to a single 'acquirable asset' (or a collection of assets which are identical and have the same market value). That is, non-fixtures (in relation to a property) must be acquired through separate limited recourse borrowing arrangements over a single acquirable asset or bought outright (but not held as security under the borrowing arrangement over the property);
- **borrowing can include incidental expenses** – associated expenses in acquiring the underlying asset can be included as part of the borrowing, eg conveyancing fees, stamp duty, brokerage or loan establishment costs, maintenance and repair costs (but not improvements);
- **refinancing** – the trustee can refinance an existing limited recourse borrowing: s 67A(1)(a)(ii);
- **personal guarantees** – the recourse of the lender (or any other person) against the superannuation fund trustee for default on the borrowing is limited to rights relating to the acquirable asset;
- **replacement assets** – a borrowing applied to the original acquirable asset can only be replaced with a 'replacement asset' according to the circumstances in s 67B.

For the purposes of the borrowing exception in s 67A, an 'acquirable asset' must be held on trust to quarantine the other assets of the superannuation fund. An 'acquirable asset' is considered to be 'acquired' at the time when the trustee of the holding trust (security trustee) gains a legal interest in the asset. At the same time, the fund trustee gains a beneficial interest in the asset upon the creation of the security trust over the acquirable asset. The fund trustee then has a right to acquire the legal interest upon repayment of the loan.

Note that investments in instalment warrants are still required to comply with other superannuation rules, eg they must not result in fund assets being subject to a charge.

Cooper Super Review Makes 177 recommendations

On 5 July 2010, the Government released the *Super System Review Final Report*. The Review Panel, chaired by Mr Jeremy Cooper, has made a total of 177 specific recommendations aimed at improving the governance, efficiency, structure and operation of Australia's Superannuation System, including 29 recommendations in relation to self-managed superannuation funds (SMSFs).

This final report supersedes all of the Super System Review Panel's preliminary reports. It comprises:

- [Super System Review Final Report — Part One: Overview and recommendations](#) — includes a consolidated list of all the Panel's recommendations and a summary of how they impact members;
- [Super System Review Final Report — Part Two: recommendation packages](#) — the Panel's 10 recommendation packages, each in its own chapter.

The Minister for Financial Services, Superannuation & Corporate Law, Chris Bowen, welcomed the 'MySuper' and 'Superstream' initiatives which he believes could lower fees for a typical superannuation member by 40%, lifting their retirement savings by \$40,000. It also needs to be easier to do simple things like consolidate multiple accounts, compare different funds and pay superannuation for employees, he said.

Mr Bowen noted that the Cooper Review is the third stage of the Government's superannuation reforms. The first stage, the Government's 'Future of Financial Advice' reforms, has proposed a ban on commissions and a statutory fiduciary duty for financial advisers from 1 July 2012. The next stage, the 'Stronger & Fairer' reforms announced on 2 May 2010 in response to the Henry Tax Review, propose to increase the superannuation guarantee from 9% to 12% phasing in from 1 July 2013. The third phase will be the Government's response to the Cooper Review, Mr Bowen said. (*Source: [Minister for Financial Services, Superannuation & Corporate Law, media release No. 084, 5 July 2010.](#)*)

Government to respond within two months

Mr Bowen indicated that the Government will respond to the report in the 'coming weeks; certainly over the next two months'.

The Minister said the release of the final report enables the Government to enter into more intensive and focused discussions and consultations with the superannuation industry about the recommendations. Mr Bowen said he'll be working methodically through the recommendations in close consultation with the industry to ensure the right balance on each and every recommendation. He noted that the objective is clear — a simpler, more efficient, better streamlined superannuation system for the benefit of all Australians. (Source: [Minister for Financial Services, Superannuation & Corporate Law, press conference, 5 July 2010.](#))

Review highlights

The Review Panel completed consultation in three phases: Governance; Operation and Efficiency; and Structure (including SMSFs), and received over 450 formal submissions amounting to nearly 7,300 pages of opinions, ideas and data. During the course of its work, the Panel issued nine documents which included issues papers, preliminary reports and a statistical summary of the SMSF sector: see also the [Super System Review Website](#).

Highlights from the final report include:

- **choice architecture model** — the fundamental design of the super system should encourage and facilitate members who want to engage and make choices about their retirement savings. However, for members who are not interested, the system should still work to provide optimal outcomes for them;
- **MySuper** — a simple super product is proposed with the objective of lowering overall costs while maintaining a competitive market-based, private sector infrastructure for super. MySuper seeks to draw on the rules for default investment options and enhance them by adding scale, transparency, comparability and a 'whole of life' focus;
- **SuperStream** — package of measures designed to modernise the back-office functions in superannuation administration. Key components are the increased use of technology, uniform data standards, use of TFNs as a key identifier and the straight-through processing of transactions;
- **APRA standard-making powers** — APRA would be given a standards-making power in superannuation;
- **SMSFs** — the Review Panel found that significant changes are not required as the SMSF sector is largely successful and well-functioning. However, the report made 29 recommendations relating to SMSF service providers, auditors and the regulatory framework (including a proposed ban on SMSFs investing in collectables and personal use assets: see further below);
- **governance** — a Code of Trustee Governance is proposed;
- comparing products — standard product 'dashboards' and standardised investment performance reporting would help members to make 'like with like' comparisons between products;
- **insurance** — commissions should be banned on all insurance products in super, including group risk and personal insurance. Trustees will continue to be able to offer life, TPD and income protection insurance in MySuper and choice investment options;
- **systemic transparency** — each fund would be required to provide free of charge on its website, detailed financial and operational information about the fund (including its portfolio holdings) and about the fund's management;
- **data integrity** — APRA should have regulatory powers to improve data quality and the availability of data and research;
- **cost savings** — Treasury estimates short-term annual system savings of about \$1.55 billion and long-term annual system savings of around \$2.7 billion as a result of MySuper and SuperStream;
- **improved retirement incomes** — Treasury estimates that the MySuper and SuperStream proposals would, in the long-run, see a cut of around 40% in fees for the average member. This is expected to lift final superannuation balance by around \$40,000 or 7% after 37 years in the work force.

Key recommendations

The Panel has made a total of 177 specific recommendations, contained in 10 'packages' (each being a chapter in Part Two of the report) making up a comprehensive blueprint for reform. Some of the key recommendations to note include:

- **transition period** — MySuper and the new choice architecture should be subject to a transition period of at least two years;

- **default funds** — the SGAA should be amended so only a MySuper product is eligible to be a 'default' fund nominated by an employer. For default funds approved by Fair Work Australia, only MySuper products should be eligible to be nominated (and all MySuper products should be able to be nominated). In 2012, the Productivity Commission should conduct a review of the processes by which default funds are nominated in awards;
- **MySuper trustees: statutory duties** — the SIS Act should be amended to apply statutory duties to MySuper trustees to formulate and give effect to a single, diversified investment strategy;
- **MySuper advice** — advice to members of a MySuper product (other than intra-fund advice) should only be provided on request and trustees should only be able to deduct the costs of advice about superannuation from a member's account with the member's written agreement;
- **statutory duty** — the SIS Act should be amended to create a distinct new office of 'trustee-director' with all statutory duties to be fully set out in the SIS Act and supported by a Code of Trustee Governance (to be developed by an industry council);
- **tax consequences** — the taxation consequences of the fund's investment strategy should be included in s 52(2)(f) of the SIS Act as one of the factors to which APRA fund trustees must have regard;
- **reporting standards** — should be developed as an overlay to the existing accounting standards AAS 25 and Exposure Draft ED 179;
- **Super Complaints Tribunal** — should be able to consider complaints in respect of TPD claims when the claim has been lodged with the trustee within six years of the member ceasing employment and the complaint has been made to the SCT within two years of the trustee's decision;
- **binding death nominations** — the SIS Act should be amended so that binding death nominations would be invalidated when certain 'life events' occur in respect of the member. The SIS Act should also be amended so that binding death benefit nominations only have to be reconfirmed every five years;
- **self-insurance** — after a suitable transition period, self-insurance of any fund benefits, including death and TPD benefits, should not be permitted in any large APRA fund except defined benefit funds that are currently allowed to self-insure;
- **capital requirements** — new capital requirements for trustees on a risk-weighted basis should be phased-in over time. The governing rules for all large APRA funds should be deemed to include a provision enabling the trustee to maintain a dedicated and identifiable operational risk reserve;
- **SIS Act restructure** — to separate and identify clearly those provisions that are common for all sectors of the superannuation industry and those provisions that are only applicable to particular sectors;
- **superannuation administrators** — the SIS Act should define 'superannuation administrator' and empower APRA to license superannuation administrators.

Self-managed super funds

The final report included 29 recommendations in relation to SMSFs, building on those measures included in its preliminary report, *Self-managed super solutions*, released on 29 April 2010. Some of the key SMSF recommendations include:

- **SMSF membership limit** — should not be increased from the current four member limit;
- **administrative penalties** — the ATO should be provided with the legislative power to issue administrative penalties against SMSF trustees on a sliding scale reflecting the seriousness of the breach. The penalties should not be payable from the corpus of the fund, and may be applied jointly or severally against the trustees/directors;
- **directions to rectify breaches** — the ATO should have the legislative power to issue relevant persons with a direction to rectify specified contraventions within a specified reasonable time;
- **binding SMSF rulings** — the ATO should be given the power to issue binding rulings in relation to SMSFs;
- **in-house assets prohibited** — SMSFs should be prohibited from holding any in-house assets (ie the current 5% limit should be cut to 0%). A five-year transitional period would apply to enable SMSFs to dispose of existing in-house assets;
- **lifestyle assets prohibited** — investments in collectables and personal use assets should be prohibited. Examples include (but are not limited to) paintings, jewellery, antiques and stamp collections, wine, exotic cars, yachts, golf club memberships, race horses and boats. SMSFs that own collectables or personal use assets would be provided a five-year transitional period in which to dispose of those assets;
- **licensed SMSF advice** — advisers should be required to hold an AFSL where they provide advice in relation to the establishment of an SMSF. The accountants' licence exemption should not be replaced by

any new exemption or restricted licensing framework. Note that the Government's Future of Financial Advice reforms propose to remove the accountants' exemption for certain SMSF advice under reg 7.1.29A of the Corporations Regulations 2001 from 1 July 2012;

- **approved auditors** — ASIC should be appointed as the registration body for approved auditors and given the power to determine the qualifications (including professional body memberships as appropriate) required for eligibility to be registered, set competency standards, develop and apply a penalty regime including the ability to deregister approved auditors. The ATO should also be tasked to police the approved auditor standards;
- **auditor independence** — ASIC should develop approved auditor independence standards, which auditors must meet as part of their ongoing registration requirements;
- **asset valuations** — the Government should legislate to require SMSFs to value their assets at net market value. The ATO should also publish valuation guidelines to ensure consistent and standardised valuation practices;
- **SMSF registration** — proof of identity checks should be required for all people joining an SMSF, whether they are establishing a new fund or joining an existing fund. However, identification measures should not apply retrospectively except for existing SMSFs wishing to organise rollovers from an APRA-regulated fund;
- **illegal early release** — existing tax laws be amended so that amounts illegally early released be taxed at the superannuation non-complying tax rate (rather than the individual's marginal rate). An additional penalty, based on a sliding scale of penalties that takes into account the individual circumstances, should also apply. Legislation should also be enacted to provide for criminal and civil sanctions for scheme promoters.