Joint Committee of Public Accounts and Audit

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Bi annual Hearing – 21 September 2007

Question	**12**
Topic:	**Intelligence sources for SMSF activities**
Hansard Page:	**PA 16-18**

Senator MURRAY: The question of superannuation has been touched on with respect to the superannuation guarantees, but there has been a much more significant and I think generational—you would almost call it a fracture—shift in the way in which people's assets are now held and the entities in which their funds are carried. I think the whole super change will have effects on our markets, our tax returns and our general understanding of cash flow in this country, which could not be foreseen. It is just very, very difficult when you are dealing figures on that scale. Are there any areas of great concern to the tax office from a tax administration point of view that you are seeing as a result of a very fundamental shift in the way in which much of people's personal funds and assets are now being held—shifting into super vehicles as opposed to shall I call it normal commercial personal vehicles?

Mr D'Ascenzo: Again I would just draw on the discussion we had previously. The sale of assets, for instance, to shift money into self-managed super funds can be an issue for people if ultimately it causes long-term detriment to them as an investment strategy. We are still seeing an increase in the number of self-managed super funds. I think since last year there have been extra self-managed super funds such that I think the current figure is in the order of 360,000. I have to say that for a lot of individuals the use of self-managed super funds does not make much sense and actually there is a lot of cost involved and a lot of risk involved in engaging in those sorts of strategies. But that is a personal choice for people. We see in relation to self-managed funds an increasing need for us to monitor the rules that are under the SIS Act in terms of loans between family members and the super fund, use of in-house assets, sole purpose tests—a whole range of criteria which is in that legislation. That is an increasing focus for us in the following years. They are the areas that I see.

Senator MURRAY: How are you able to get intelligence? Do you have a panel of auditors and accountants around the country who feed you intelligence so that you can understand it better? How are you getting intelligence on what I think is a really big shift in assets and cash?

Mr D'Ascenzo: We have formal consultative processes—and Ms Vivian can say more about that—but we also have at the individual self-managed super fund level the auditor contravention reports that auditors have to provide to us. So there are two areas of information for us.

Senator MURRAY: Are they electronically provided?

Mr D'Ascenzo: I am not sure what the situation is.

Ms Vivian: They are a mixture at the moment, but one of the things under super simplification that we are looking to do is to provide a better tool to encourage most of them to come in electronically but at the same time to give auditors, particularly those who may not quite know what they are doing, a bit more assistance about what they need to report and what help they need.

Senator MURRAY: As you know, if you provide them electronically, it means your fields are more defined and it is easier to aggregate the information. I would have thought manual provision is a very inadequate tool for rapid analysis of a fundamental market shift.

Ms Vivian: That is quite correct. We are hoping that we provide a tool that makes it so much easier and better that there will be a good natural uptake of the tool—and we are working very closely with auditor groups to develop it at the moment. In terms of that question about broader information, as the commissioner said, there are our consultative groups. But in the lead-up to better super, for instance, we had some of our key staff make some visits with a range of funds and financial planners just to see what is going on out in the industry and to get a sense of what was happening out there. Certainly, as we go forward here, there will be a range of things and information that we will look at to try to get some more real-time information about where and what is happening.

Senator MURRAY: ***Could I ask, through the chair, that, for the next meeting between us, you might perhaps cover this area in the information you provide?***

Australian Taxation Office response:

We are sourcing information compiled by major actuarial and accounting firms to inform us of market perception and predictions. We have conducted external consultations in May and June 2007 with a number of large superannuation funds and self managed super funds (SMSF) administrators to discuss patterns, trends, drivers, impacts and opportunities arising from simplification. The market intelligence obtained has been used to inform our intelligence and risk activities as well as our compliance plans. We will be conducting consultation with the market again soon.

We have regular contact with all the major industry groups and this provides an excellent source of information and reference points.

There is little in the way of real time data available in the public domain except for the stock exchange and we use that information to understand fluctuations in overall funds under management.

Risk rating engines and case selection tools are an important component of our strategy to tackle abuse in the superannuation and tax system. A risk rating tool for SMSFs has been released, that will be complemented with the development of a risk rating engine and case selection tool to address issues in the large market. These systems will draw on data held by the Tax Office and information available from other Commonwealth agencies such as the Australian Prudential Regulation Authority (APRA), and State revenue agencies and land title offices.

We regularly use external sources such as the Australian Transaction Reports and Analysis Centre (AUSTRAC) where we can identify the withdrawal and international transfer of benefits from SMSFs.

We have an intelligence project underway focusing on different segments of the market. The aim of the project is to monitor revenue and behavioural shifts by superannuation investors as a result of the introduction of the Better Super changes. It examines the likely and observed behavioural changes of public offer funds, SMSFs and individuals and the risks that will require more focused compliance attention.

Consultative Forums

The Tax Office holds regular meetings with key industry representatives such as the National Tax Liaison Group Superannuation Sub-Committee and the Superannuation Consultative Committee. Through these groups we can obtain insights into trends in the superannuation industry and test some of our hypotheses regarding shifts in behaviour and risk.

The Tax Office, Treasury, APRA, the Australian Securities and Investments Commission (ASIC) and the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) meet regularly as a cross agency consultative forum to discuss superannuation issues of common interest. Memorandums of Understanding (MOU) are also in place with APRA, ASIC and AUSTRAC which support the sharing of information in areas of mutual interest.

Large funds

About 70 per cent of superannuation fund income tax collections come from large funds.

Employer contributions to large funds are growing at a rate of 10 per cent per annum. Contributions for 2006 were $45 billion, an increase of $4 billion over 2005. Although there is considerable data to be returned for 2007, available data shows 2007 employer contributions at $44 billion. It is expected that 2007 employer contributions will be considerably more than 2006.

To understand the drivers and trends in revenue flows we undertake detailed analysis and interpretation of tax return data for all large funds twice a year.

We continue to improve our risk assessment processes by developing risk filters that will allow the identification of outliers for further examination and analysis.

We monitor requests for rulings, the media and survey tax agents to augment our understanding of market advice trends.

To provide real time information, instalment revenue collections from large funds are reviewed monthly against expectations. This information is used to quickly identify and understand events impacting on revenue collections.

We are seeing strong growth in the use of trusts as vehicles for investment at the expense of direct investments. The reason for this is ease of investment as the funds purchase units in trusts, which then buy and sell various investment products.

This behaviour makes compliance review more difficult since the level of franking credits cannot be compared directly against dividend income returned. Problems could arise where fund systems are incorrectly grossing up income to include imputation credit. There is also the question as to whether the gains on sale of investment assets by the trustees of these investment vehicles may be properly characterised as ordinary income rather than as capital gains based on the nature of the activity being carried on by the managed fund. This is a matter that depends on the facts of each case. We plan to provide taxpayers with additional guidance on our view of the law through the issue of a tax determination.

Earnings on assets used to support pension income are tax exempt. Exempt assets are increasing largely as a result of demographic trends and we are concerned about compliance in the future if super funds fail to correctly allocate funds that support pension income.

We are also focusing on personal contributions to superannuation, including those made by the self-employed, to ensure they are being taxed correctly in the fund (depending on whether they have been made from pre or post-tax earnings).

Self Managed Superannuation Funds

Regular reporting to the Tax Office by SMSFs has been reviewed in light of Better Super changes and upgraded. This will improve the quality of information we receive and permit improved data matching.

An analysis of SMSFs is produced twice a year in which the SMSF environment and risks are examined. The focus of our SMSF compliance program each year is a product of this ongoing analysis. The priority risks in the latest analysis are:

- Illegal early release of benefits
- Approved Auditors lacking competence or not detecting breaches and
- The failure of SMSFs to meet their regulatory obligations

Our SMSF compliance activities have increased from 3,600 cases in 2006-07 to over 10,000 cases per year for the next few years, giving us a broader source of intelligence. As an example, we have been able to review 3,000 new SMSFs to gain intelligence on their understanding of their obligations as trustees. The results will shape our strategies for 2008-09.

Auditor Contravention Reports are also a valuable source of intelligence in identifying risk areas and trends in how trustees are managing their obligations, as well as individual SMSFs that represent a high risk.

The number of new SMSF registrations increased in 2006-07 by 85 per cent over the previous year to 46,008 as investors took advantage of the Better Super measures. Registrations in 2007-08 were 23,000, which returns them to the levels of registrations made in 2005 and 2006.

We are concerned about the knowledge levels of new trustees, and the potential this creates for breaches of regulatory requirements such as loans to related parties, borrowings, in-house assets and arms length transactions. We undertook reviews of 3,000 recently established SMSFs to understand their motives for establishing a fund and to quantify the new trustees' level of knowledge. As has been widely reported we are concerned by the high number of trustees whom we consider do not posses the requisite skills to manage an SMSF.

We are also concerned about illegal early release schemes. We are gathering intelligence and pursuing those who promote and take part in these schemes.

There are concerns about the repatriation of undisclosed interests in offshore investments to resident SMSFs who obtain the concessional 15 per cent tax rate. Further analysis is being undertaken to gauge the level of repatriation, impact within SMSFs and potential tax implications.

Individuals

In the case of individual taxpayers we are looking at:

- CGT risks associated with assets being transferred into superannuation funds as in-specie contributions
- the risks relating to the disposal of assets to fund the contributions. These include correct valuation of the assets, non-arms length transactions and market value transactions relating to rental of properties now owned by SMSFs
- the source of funds, to ensure that the funds entering superannuation have been correctly treated for income tax purposes prior to receipt
- significant large contributions made under the transitional contributions cap of $1 million between 10 May and 30 June 2007
- the transition to retirement pension phase including salary sacrifice. The use of transition to retirement strategies will increase over the longer term as members age and take advantage of easier access to more flexible pensions under Better Super
- indications of significant growth in salary sacrifice to superannuation.