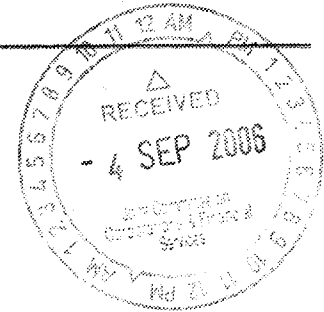


Cassidy, Lauren (SEN)

From: Howe, Julie [Julie.Howe@ato.gov.au]
Sent: Friday, 1 September 2006 11:07 AM
To: Corporations, Committee (SEN)
Cc: Howe, Julie
Subject: SUB 36



Good morning-re the Committee's inquiry into the Superannuation Industry, please find attached from the ATO, a covering letter from the Commissioner of Taxation, publications about self managed superannuation funds and two recent speeches. The two speeches are attached and two publications are available via ATO website.

The two publications are:

'Self Managed Superannuation Funds--DIY Super-it's your money.....but not yet'; and
'Self Managed Superannuation Funds--role and responsibilities of trustees'.

The two publications can be accessed by the following link:

http://atogovau/super/pathway.asp?pc=001/007/122&mfp=001/007&mnu=2213&st=tp#001_007_122
scroll down to *self managed superannuation funds* and publications are listed.

The signed letter and attachments, (including copies of the publications) will be sent across with the courier this afternoon.

Any problems please call me.

Regards

Julie Howe
Parliamentary Liaison Officer
Issues Management and Government Liaison
PMD

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 julie.howe@ato.gov.au

<<JCPFS 310806.doc>> <<National SPAA Conference.doc>> <<Speech by Raelene Vivian, Deputy Commissioner of Taxation to the National SPAA Conference, Friday, 3 March 2006, Sydney..doc>>

IMPORTANT

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The Secretary
Parliamentary Joint Committee on Corporations and
Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600

Dear Sir

Thank you for your letter of 3 July 2006 regarding the Committee's inquiry into the superannuation industry.

The Tax Office role as regulator is to ensure that self-managed superannuation funds comply with the relevant provisions of the SIS Act and the associated regulations along with their income tax obligations. I note that the terms of reference deal mainly with broader policy questions which are more appropriately addressed to the Department of the Treasury.

I am enclosing two publications about self-managed superannuation funds and two recent speeches which the Committee might find useful.

If there is more information which I can provide, please let me know.

If you would like further assistance, please contact Raelene Vivian on 02 62161840.

Yours faithfully

Michael D'Ascenzo
Commissioner of Taxation

31 August 2006

enc.

GENERAL

SPAA

SPEECH

1 MARCH 2006

SEGMENT

AUDIENCE

CLASSIFICATION

DATE



Australian Government

Australian Taxation Office

Self Managed Super Funds – The Tax Office perspective

Speech by Michael D'Ascenzo, Commissioner of Taxation

National SPAA Conference

Wednesday, 1 March 2006, Sydney

Ensuring effective management of money invested in self-managed superannuation funds and safeguarding these assets for the future is a critical issue for the community¹.

The Australian Taxation Office (ATO) has a role in ensuring Self Managed Superannuation Funds (SMSFs) comply with the Superannuation Industry Supervision (SIS) Act and regulations. Our focus is on whether fund investments are in accordance with trustees' stated investment strategies and in accordance with the SIS Act, but it is not our role to look at the overall soundness of the investments from a business perspective.

The Tax Office has on a number of occasions emphasised the need for people considering establishing an SMSF to think long and hard about their ability to take on the role of a trustee. While SMSFs may be beneficial for some people, they may not suit everyone. In May last year my predecessor Michael Carmody and the Chairman of the Australian Securities and Investment Commission (ASIC) Jeffrey Lucy issued a joint press release and fact sheet titled 'Is self managed super right for you?' It was suggested that trustees ask themselves whether they have the time and skills to manage their own superannuation fund.

Among other things, trustees need to prepare and implement an investment strategy that has taken into account risk, return, diversification and cash flow requirements. In other words, trustees are responsible for the risk choices they make in the nature of their investments, within the investment types allowed by the SIS Act.

Organisations such as Self-Managed Super Funds Professionals' Association of Australia (SPAA), which are dedicated to improving the level of knowledge and skills of advisers, also share our commitment to building and maintaining high levels of integrity across the growing SMSF market.

The importance of superannuation is underlined by the fact that Australia faces a pronounced ageing of its population over the next four decades with estimates that a quarter of our population – or 7 million – will be aged 65 or over by 2044-45.²

This poses significant challenges for the ATO and practitioners who play a role in assisting people with their retirement income strategies.

The Choice of Funds initiative has paved the way for more Australians to use SMSFs to receive and invest employer contributions, and may further increase the proportion of retirement assets held in small funds. This initiative will be further expanded with the extension of Choice from 1 July 2006.

As more people with a self managed superannuation fund retire from the workforce, we are noticing that these funds are maturing into long-term, intergenerational retirement vehicles and payers of pensions.

This highlights the need for the ATO to continue to maintain an appropriate level of audit coverage and to respond quickly to emerging compliance risks.

¹ This is evident from events that have occurred over the last few months in the Wespoint collapse that have, it would appear, affected a number of self managed superannuation funds.

² Productivity Commission 2005, Economic Implications of an Ageing Australia, Research Report, Canberra

Today I want to share with you intelligence about what we are seeing in the marketplace, reflecting an approach that adopts the adage that prevention is better than cure. We have little interest in 'catching people out'. If we can provide certainty and confidence to taxpayers and their agents, and arm them with the information they need when making their risk choices, we can help them better protect their investment.

In sharing this information, we would like to work with SPAA and other key stakeholders to consult and co-design solutions that both ensure good compliance and inform taxpayers of their responsibilities and risks, thereby meeting the critical objective of safeguarding Australia's future retirement income.

Snapshot of self managed superannuation funds

The latest statistics on SMSFs provide further evidence of the importance of this market:

- The number of self managed superannuation funds in Australia has grown to over 308,000³
- The SMSF market is currently growing at around 1,800 a month
- Around 580,000 Australians are members of a SMSF
- SMSFs hold \$165 billion in assets.

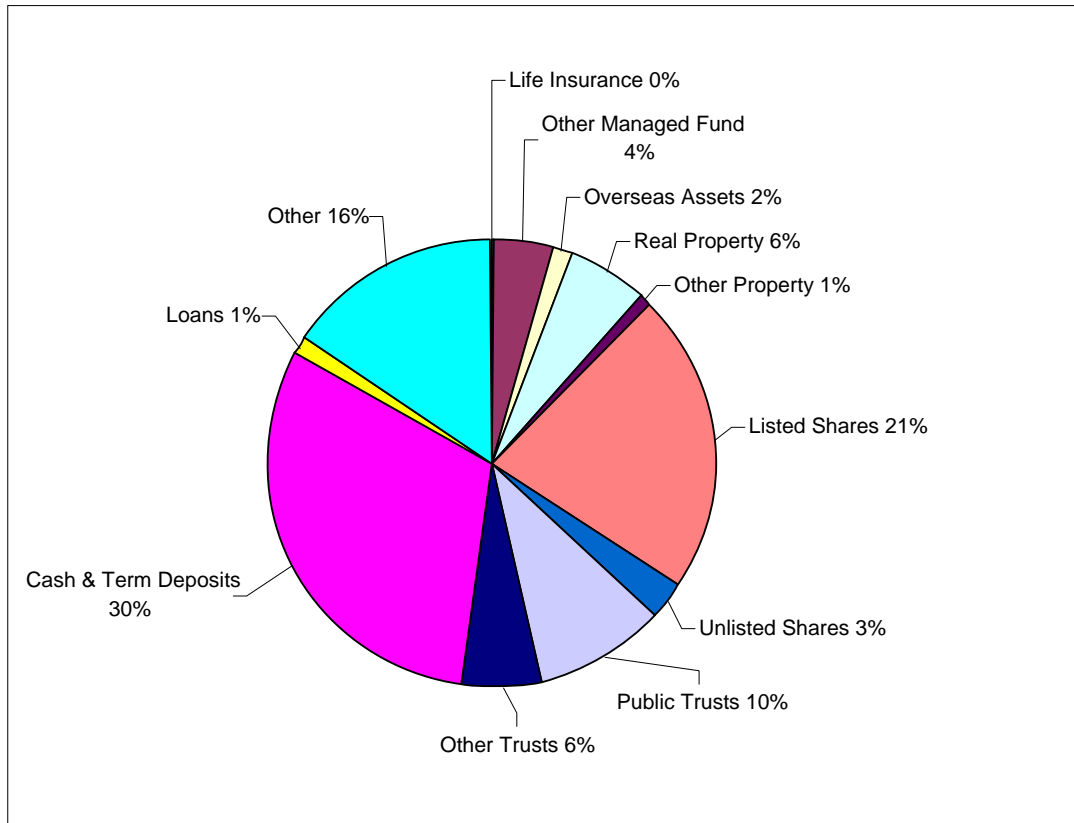
In terms of asset holdings, SMSFs outrank both public sector and industry and corporate funds (who have \$136 billion, \$123 billion, and \$69 billion respectively).⁴

The top five asset classes are: cash and term deposits 30%, listed shares 21%, public trusts 10%, other trusts 6%, and real property 5%.

³ ATO internal report, self managed superannuation fund new registrations

⁴ APRA Quarterly Statistics to September 2005

SMSF investments held in asset classes

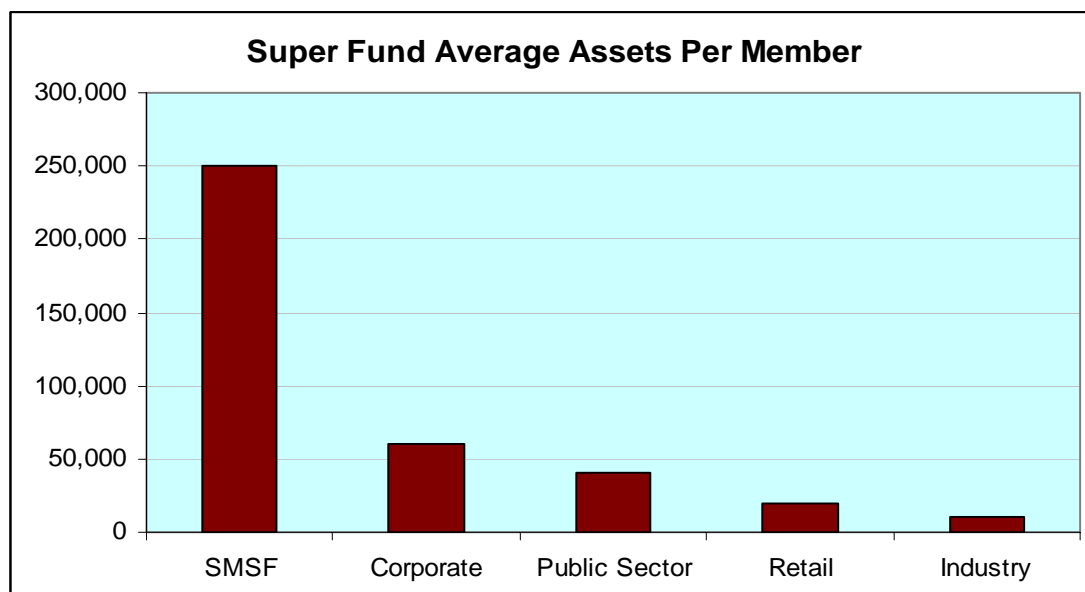


The average total assets per member rose from \$184,490 in June 2000 to \$285,420 in June 2005.

Total assets (average per member)					
June 2000	June 2001	June 2002	June 2003	June 2004	June 2005
\$184,490	\$198,920	\$212,570	\$220,590	\$251,620	\$285,420

In comparison with other superannuation funds, the average assets per member for SMSFs is much higher. For example around \$250,000 per member for SMSFs as compared with around \$40,000 per member for public sector funds.

Super fund average \$ assets per member as at September 2004



Compliance approach

Since 1999 when the ATO was given SIS Act responsibility for SMSFs, we have focused on help and education and will continue to do so.

In 2000, we began the new trustee education program aimed at ensuring trustees of newly established funds understood the rules and regulations governing self managed superannuation funds. This education program included contacting trustees by phone and direct mail to provide information and assistance so they can avoid inadvertent breaches that may risk their fund's compliance status or lead to the trustees themselves being penalised.

We also developed a range of important publications –

- *DIY Super It's your money...But not yet!*,
- *Role and responsibilities of trustees;* and
- *Role and responsibilities of approved auditors.*

As we gained a better understanding of the risks in the SMSF market, we initiated a campaign to warn people against promoters of early access to superannuation schemes. This campaign, which ran from December 2003 to October 2005, incorporated press advertising, editorial, media releases from the ATO and ASIC, and warnings through other ATO channels and publications.

In 2005, we broadened our education efforts to help those considering a self managed superannuation fund. Together with ASIC, we issued a media release and launched a fact sheet titled: *Is self managed super right for you?* In the fact sheet we asked potential self managed fund trustees to consider four questions when deciding whether to establish their own fund:

- Is the fund for retirement benefits only?
- Do you have the time and skills to manage the fund?
- Will the benefits be worth the costs? and,

- How will switching to a self managed fund affect your current super benefits such as life or other important insurances?

We have also published extensive information on our website, electronic newsletter SuperUpdate, the Tax Agent newsletter and in newsletters and bulletins of key industry and professional associations.

Our goal has been to ensure that all trustees of SMSFs and tax professionals are aware of their rights and obligations, and the consequences of non-compliance with the SIS Act and the tax laws.

We also want trustees to know what they can expect from an audit and ensure taxpayers know that it is illegal to access superannuation early.

Where we find that trustees are making a genuine effort to comply, we work with them to rectify any breaches. However, we will take a firm approach with trustees who fail to make a genuine effort to comply, or who set out to deliberately avoid meeting their obligations. As always, we take a person's individual circumstances into account.

Audit activities are aimed at both trustees and approved auditors and range from single issue audits to comprehensive audits to ensure that their tax obligations are met and that they do not contravene the SIS Act.

At present, as part of our program of 3600 audits for 2005-06, compared with 1000 audits two years ago (2003-04), we are contacting trustees and practitioners by phone to undertake 800 specific issue reviews based on auditor contravention reports (discussed in more detail later).

1. Lodgement Compliance

In terms of lodgement, SMSF trustees have a number of superannuation lodgement obligations (comprising income tax and regulatory returns, member contributions and reasonable benefits limit reporting) which must be met on time and trustees also have a responsibility to provide accurate information.

Compliance with lodgement obligations is important for several reasons. Primarily, non-compliance with lodgement might reflect the fact that a SMSF is unaware of their obligation to lodge, or unable to do so or at the other extreme – not willing to lodge in accordance with their statutory responsibilities.

Failure to meet lodgement obligations can also provide early warning of other problems. For example, if you haven't lodged, maybe the fund has not received an external audit assurance.

Because of the value we place on lodgment of Superannuation income tax returns and other Superannuation obligations, we have a dedicated team of 35 officers whose role is to contact, by phone or mail, those funds that are behind on lodgement. During 2005-06 their focus will be on 30,000 high risk APRA and Self Managed Superannuation funds with outstanding income tax/regulatory returns and or member contribution statements.

In terms of the information being provided, we are also seeing a number of errors being made in returns.

Typical errors we have detected include:

- Ticking the non-complying box when in fact the fund is a complying fund (this is a serious matter as making a fund non-complying affects the amount of tax a fund pays).
- Trustees entering incorrect establishment dates where the date differs from that which was notified at registration.
- Labels recording the number of fund members and total investments of the fund being transposed.
- Incorrectly stating that an approved auditor has conducted an audit of the fund when this has not occurred.

2. Active Compliance

The ATO is not able to audit every fund that presents a compliance risk so we target our resources to high-risk funds.

We identify high-risk funds using a Risk Assessment Profiling Tool which assigns a risk rating for every SMSF based on:

- Fund income tax and regulatory returns
- Superannuation member contribution statements
- Registration data
- Annual investment and income reports
- Auditor contravention reports
- ATO debt and lodgement systems (for the fund and associated entities), and
- Various databases and information maintained by us and other government agencies.

While we are still evaluating the 2004-05 audits, results so far show that of the funds identified for audit using the Risk Assessment Profiling Tool, 75 per cent of those rated as 'high-risk' were found to have medium to serious compliance issues.

The ATO has a commitment to being open and accountable to the community. We publish our concerns about risks in the SMSF market in our annual compliance program and have also published our concerns more widely including in the – *DIY Super It's your money...But not yet!*, publication.

To date, all of our compliance activities for self managed superannuation funds planned for 2005-06 are on track.

The 2005-06 Compliance Program outlined the key risk areas in the SMSF market which include:

Breaching the in-house asset rules⁵

⁵ The returns a fund can generate may be limited by providing loans and/or investing in related parties. This is why the in-house asset rule exists. The legislation allows a trustee to do this up to a limit of 5 per cent of the fund's total assets.

We are concerned that a large number of trustees are not complying with the in-house asset rule. Trustees need to ensure the value of in-house assets is never more than 5 per cent of the total assets of the fund. All investments or loans must be made on a commercial basis, and if they are made with a related party, the value of those investments and loans (and other in-house assets) must stay below 5 per cent.

Acquisition of assets from related parties rule⁶

Trustees are prohibited from acquiring assets for their SMSF from a related party of the fund. There are limited exceptions to this rule⁷. Some examples of this contravention we have seen are trustees purchasing residential property from members or purchasing unlisted shares from members.

Personal use of assets

Problems we are seeing in this area include trustees using assets purchased for the fund (to provide for retirement) for their own present day benefit. SMSFs must meet the sole purpose test which requires that a fund must be maintained for the sole purpose of providing benefits upon retirement.

Ownership of assets⁸

In the past, some trustees have wrongly placed the fund's assets in their own name. We raised this issue early last year and allowed a generous period of time for trustees to rectify these issues. Our principal concern is that if the assets are not correctly recorded in the fund's name, then it puts the assets at risk in the event that the trustee, or a related business entity, becomes insolvent - and there are cases where this has occurred.

The definition of a self managed superannuation fund

We have found that some funds do not meet the definition of a SMSF. Most of the identified funds have taken action to fix this problem however we have referred some cases to APRA for regulation. This is an important issue as funds that intend on being classified as a self managed superannuation fund must ensure they continue to meet the legal definition.

Fund Income Tax Return

Our analysis has also shown that funds are claiming deductions to which they are not entitled, for example, not all capital gains tax concessions claimed are allowable to a superannuation fund. Funds are also claiming legitimate deductions at the incorrect label which impacts our risk assessment, and potential compliance costs for the fund.

Funds should also ensure that where appropriate trust distributions, private company dividends and other non-arm's length income are correctly included as special income.

⁶ This rule exists to ensure trustees do not make contributions to the fund that they aren't entitled to make, and to stop trustees contributing personal assets due to the likelihood that they could use those assets for their own personal use.

⁷ See *DIY Super – It's Your Money...But Not Yet!* (pg 9)

⁸ Assets should be in the name of the self managed superannuation fund in almost every instance. This may not be possible in some instances, in that case, we expect the trustee to execute a caveat, or a legal instrument.

Our analysis has shown an under reporting of special income and we are likely to be increasing our audit focus in this area following finalisation of draft ruling TR 2006/D1.

Links to small business

We are examining the link between a self managed superannuation fund and any other related entities. There may be a risk where related companies and trusts are included with self managed superannuation funds in small business structures. In addition, where we have questions about a small business in terms of meeting their tax obligations, we would examine whether the related person is managing their SMSF correctly and complying with their super obligations. Our concern is illustrated by cases where trustees have used money from their SMSF to prop up an ailing business.

Compliance Outcomes

Over the last 18 months there has been approximately 250 enforceable undertakings relating to the issues I have just mentioned. We are working with the Trustees to rectify these issues, however in limited cases we have had to go to the next step and make the funds non complying - this year, so far, six funds have been made non complying and six trustees have been disqualified.

Residency

New analysis that we have undertaken has also shown that trustees may not have understood their obligations regarding the residency of their fund. Advisers have an important role in alerting trustees to their obligations in setting up a self managed super fund – especially when dealing with people who may have employment opportunities offshore.

Early access to superannuation

Schemes promoting early access to superannuation have been a strong focus for us for several years and we continue to work closely with ASIC to discourage these schemes and stop the promoters of these arrangements.

Despite ASIC's success in prosecuting promoters for misleading people (mainly under the *Financial Services Reform Act 2001*) our intelligence shows that some promoters are not heeding the message about the Commonwealth's determination to close them down. The ATO is investigating two promoters with a view to possible referral to the Director of Public Prosecutions (DPP). Assessments of tax and penalties have been raised against these promoters of \$590,000 and \$969,000 respectively. We have compliance activity in various stages with 24 promoters.

In addition, we are auditing the income tax payments of 1200 taxpayers who we suspect have early accessed the superannuation benefits held in a SMSF contrary to the SIS Act. Our analysis shows that a further 4,000 people may be involved. We are also analysing other promoters of early (access) release schemes which we expect may lead to more people being similarly affected.

The early findings of this project have confirmed that illegal early access to superannuation funds has occurred and that in most cases the resulting income was

not included in the taxpayer's income tax return. As a consequence, assessments are being amended to include the benefits obtained as assessable income.

Examples: *Some schemes involve promoters establishing a SMSF and then assisting individuals to roll benefits from their existing fund into the promoter's SMSF after which the benefits were released to the individuals less a commission taken by the promoter – usually 20 to 30 per cent of the benefit.*

Other schemes involve promoters arranging for other persons to establish a SMSF and then roll benefits into the fund after which they accessed them for personal use and paid the promoter a fee. A further arrangement involves promoters arranging for other individuals to become trustees of SMSFs effectively controlled by the promoter that are used to channel benefits to be illegally accessed by a large number of people.

Anyone who has accessed their superannuation benefits early in contravention of the SIS Act is urged to contact the ATO (phone 13 10 20) so that we can discuss voluntary disclosure. When voluntary disclosure occurs we will provide concessions including no penalty on tax shortfalls and the general interest charge will be imposed at a reduced rate of 4.72%. We will amend an individual's income tax assessment to include the total amount released from the previous superannuation fund as assessable income and it will be taxed at the marginal tax rate.

Example: *A person who accessed superannuation illegally was receiving income support payments, and had paid a promoter thousands of dollars to facilitate the release of funds. The person may have been entitled to early release had they made the appropriate application, and could have avoided the promoter's fee.*

If a proposal put to you sounds too good to be true, taxpayers and trustees should consider seeking guidance from professional advisers or from the ATO – 13 10 20 or our website.

Other Promoted Arrangements

With SMSFs, the buyer beware caution is salutary, because we have seen people being targeted by promoters of arrangements that do not have the sole purpose of securing retirement income. A range of risky investments are also being peddled to this market.

Example: Scams and SMSFs

Recently ASIC has taken action against a number of operators who are alleged to have committed fraud by inducing people to roll their superannuation benefits into SMSFs and then invest in entities controlled by the operators. In one case investors were induced to roll over approximately \$800,000 into SMSFs that were established for individuals by the operators and \$700,000 of this amount was invested into joint ventures with companies controlled by the operators that later went into liquidation.⁹

⁹ ASIC Media Releases 05-220, 05-250, August 2005

In another similar case ASIC brought 33 charges against two operators who also induced people to roll over existing superannuation benefits into newly established SMSFs, after which they invested in companies controlled by the operators that went into liquidation. The liquidator advised no funds were available to return to investors.¹⁰

In both cases the operators did not hold a financial services licence but had induced individuals to enter into allegedly fraudulent arrangements where their superannuation benefits were lost. SMSFs were used as the vehicle to facilitate the investments in the operators' companies, highlighting the fact that individuals who are not financially sophisticated may be convinced to establish SMSFs and become trustees when they are not suited or equipped for the role.

Trustees: what is attracting our attention

The role of a trustee should not be taken lightly and for this reason we have a strong focus on trustees of self managed funds. The SIS Act contains rules that impose minimum requirements on trustees and are deemed to be included in the trust deed of every regulated fund. While trustees can engage other people to do certain acts of things on their behalf, it is still the trustee who is ultimately responsible and accountable for running a fund in a way that complies with these obligations¹¹.

As a further step, last year we upgraded checks on trustees during the registration process for SMSFs.

Our concerns are twofold – ensuring trustees are eligible and that they are fit and proper persons. We look at whether banned individuals are still in the industry and if insolvent individuals are still acting as trustees. We also look at whether trustees have been convicted of an offence for dishonest conduct, if a civil order has ever been made on any of the trustees, are any trustees undischarged bankrupts, and have any trustees been notified that they are a disqualified person by the ATO or APRA.

Auditors: what is attracting our attention

We also see approved auditors as a key leverage point in assisting trustees to meet their obligations, particularly in identifying issues of non-compliance and how best the trustee can rectify those issues. That is why we have a significant focus on approved auditors, along with trustees, aimed at identifying those who may not be performing their tasks as expected under the auditing standards or the law.

Most auditors are doing a good financial audit, however there appears to be significant gaps in auditor knowledge of the SIS Act.

An analysis of 9600 approved auditors, identified from tax returns, found that 40 per cent of auditors review just one fund per year and a further 30 per cent review only two to five funds. This becomes a challenge when an approved auditor only does one audit a year as to how to make sure they have the necessary skills and knowledge of the SIS Act to conduct an effective SMSF audit¹².

¹⁰ ASIC Media Release 05-243, August 2005

¹¹ Guidance for trustees is provided in the booklet "Role and Responsibilities of trustees" or from the ATO website www.ato.gov.au

¹² Guidance for auditors is provided in the booklet "Role and Responsibilities of auditors" or from the ATO website.

In view of the problems that we continue to see, auditors can expect that the ATO will be taking a firmer line over the coming year. We are presently reviewing 20 high risk auditors and expect to look at another 200 over the coming financial year. Where appropriate we will, refer poorly performing auditors to their professional associations, and in serious cases we will disqualify the auditor.

Issues from auditor contravention reports

In 2004-05, auditors lodged 5,000 contravention reports covering a range of contraventions. Based on previous benchmarking audits we had expected the number to be higher. This raises concerns about whether auditors are correctly reporting material breaches to us.

The issues identified from these reports include:¹³

- 1) Failure to separate the fund's assets from personal assets
- 2) Providing loans to fund members or relatives
- 3) Trustees failing to provide the necessary documentation to the fund auditor
- 4) Borrowings
- 5) The sole purpose test
- 6) In-house assets

Anyone in doubt about these matters can find further guidance in our publications *Role and responsibilities of trustees*, *Role and responsibilities of approved auditors* and *DIY Super It's Your Money...But Not Yet!*¹⁴

Working with industry and the professions

We are working with the superannuation industry and the tax and accounting profession to further improve auditor knowledge and skills. Significantly, we have found that a better audit result is achieved when checklists are used and we are working with the professional accounting associations to increase their usage.

In addition, organisations like SPAA, are working to ensure professionals have appropriate skills through accreditation programs.

We recognise the important role superannuation organisations play in the administration of the superannuation system. In recognition of this role, we have established consultative forums that concentrate on a range of aspects of our administration.¹⁵

The Superannuation Consultative Committee is tasked with:

- Advising on the implementation of new legislation affecting superannuation,
- Providing input into ATO strategies and programs involving superannuation,
- Agreeing on what issues need further work and commissioning this work, and
- Reviewing progress in implementing agreed approaches concerning superannuation.

¹³ Auditor/actuary contravention report data analysis – October 2005

¹⁴ Available at www.ato.gov.au

¹⁵ Further information on the Superannuation Consultative Committee is available at www.ato.gov.au

SPAA is an active member of that committee and we look forward to their continuing involvement. In addition, we have sub-committees formed as part of this collaborative approach. Two are operating at present – one focused on technical interpretation of the law (National Tax Liaison Group – Superannuation Sub-Committee) and the other focused on resolving practical administrative issues (Superannuation Funds Working Group).

Impact of new superannuation measures

It is important to mention some recent significant changes which affect self managed superannuation funds – Transition to Retirement and Splitting of Contributions. Both measures give more choices to SMSF members and trustees may need to take care to ensure that the fund's trust deed is up to date in the event that members wish to take advantage of these new options, or other measures, such as the Superannuation Co-contribution.

Transition to Retirement

Since 1 July last year, people have been able to access their superannuation benefits upon reaching preservation age, without having to retire or leave their work.

The major condition is that this must be in the form of a non-commutable income stream¹⁶.

Splitting of Contributions

Beginning 1 January this year, splitting of superannuation contribution legislation became effective. Where the fund rules allow, this enables individuals to split their superannuation contributions with their spouse, providing couples with an avenue to share superannuation benefits.

Industry cooperation key to rebuilding superannuation systems

Last year the Government announced that the ATO would receive \$40 million to rebuild our superannuation systems.

Accordingly, we are taking the opportunity to integrate our superannuation systems with the rest of the ATO systems through our *Easier, Cheaper, More Personalised (Change)* program.

The superannuation systems cover, Reasonable Benefit Limits, Superannuation Guarantee, Co-contributions, Member Contribution Statements, Surcharge, Lost Members Register, Register of Complying Super Funds and a number of other products. Each one developed independently rather than looking at the end to end process. We now have an opportunity to bring a number of these systems together which will greatly assist in accuracy and reporting.

Importantly, we will actively seek opportunities to reduce multiple reporting obligations, within the boundaries of the law. The rebuild also provides the opportunity for us to

¹⁶ We have confirmed our position that the general anti-avoidance provisions will not apply when taxpayers are commencing a Transition to Retirement pension, and making salary sacrifice contributions to superannuation. Media Release – 17 November 2005.

offer new facilities in the future, such as electronic lodgement and access to client information through channels such as the portal.

We will be seeking the assistance of industry to adopt a user-centred approach to the redesign of our superannuation systems and will consult with industry through our existing consultative forums.

On a related issue, we are aware of strong interest across the SMSF market in accessing more statistical information about SMSFs. Therefore we will be expanding the range of material we publish in our annual Taxation Statistics publication on SMSFs and will be consulting with industry to better understand what information would be of most value to them.

Conclusion

With an aging population the effective operation of retirement income strategies is of critical importance to the Australian community.

The rules governing self managed super funds are designed to ensure that people's money is used in asset building for their future and that is why we have a strong focus on ensuring people are well supported to meet their obligations under the SIS Act.

The role the ATO plays regarding self managed superannuation funds is an important responsibility entrusted to us.

Our on-going approach is to work with organisations such as SPAA to contribute to our understanding of the industry and to assist us in encouraging high levels of voluntary compliance by SMSFs – that ultimately benefits the taxpayer and the Australian community.

Self Managed Super Funds – our role in the superannuation system

Speech by Raelene Vivian, Deputy Commissioner of Taxation to the National SPAA Conference, Friday, 3 March 2006, Sydney.

I'd like to thank the SPAA board for extending me an invitation to be a part of your conference. The Commissioner presented a paper to this conference on Wednesday. Today I plan to re-cap on a number of his remarks and provide some further observations around key themes he mentioned.

Regulating self managed superannuation funds obviously brings challenges for the Tax Office. We are determined to ensure that this industry works within the legislation; and that tax agents, accountants and financial advisers provide the right advice and knowledge to trustees that meet the regulatory requirements.

The Tax Office is charged with maintaining the integrity of the retirement income system, by ensuring the Superannuation Industry Supervision Act (the SIS Act) and Superannuation Industry Supervision Regulations (the SIS Regulations) are adhered to by self managed superannuation funds. This regulatory role is different to that of tax administrator.

Through our compliance activities, we hope to adopt a shared understanding with trustees about their responsibilities and obligations, however you need to be aware that we will be furthering a hardline approach for those that show intentional disregard for the law – our compliance activities include an increased focus on taking action against trustees who deliberately or recklessly fail to comply with the requirements.

Education also brings challenges. As knowledge and awareness in this market grows my expectation is that our messages for those who interact within the superannuation industry will be more specific and targeted, highlighting key concerns, new treatments, compliance requirements and the reporting and lodgment requirements for each trustee.

The importance of superannuation today should not be taken lightly. It impacts on almost every member of our community in some way.

Saving for a comfortable retirement is now a part of people's life goals, and as the regulator of self managed superannuation funds, we have a responsibility to ensure overall community confidence in our regulatory approach.

Self managed superannuation funds – a closer look

So what does a typical member of a Self managed superfund look like.

A typical member of a self managed superannuation fund is aged between 35 and 59 years¹.

17% of members earn less than \$20,000 per year. 16% earn greater than \$100,000 per year².

108,307 funds have corporate trustees, this is trending down; just over 200,000 funds have individual trustees³.

In the year to June 2004, we had approximately 34,500 registrations. For the following year, to June 2005, we had nearly 24,600 registrations. This year, to 31 January 2006, we have had 12,394 registrations. At current trends, we will once again see total registrations to be less than the previous year⁴.

In December 2005, three quarters of all self managed superannuation funds were registered in New South Wales, Victoria or Queensland⁵.

From our data, self managed superannuation funds seem to invest conservatively⁶.

- 30% of self managed fund investment types are generally in the form of cash and term deposits.
- 21% are in listed shares and equities.
- Together, these two comprise just over \$64 billion in funds.
- Offshore investments against the total SMSF assets have consistently remained well under 1% over the last four years.

Membership growth rates for self managed superannuation funds are close to 12% per annum. They have consistently exceeded the industry average of around 8%⁷.

Over 90% of self managed superannuation funds lodge their income tax and regulatory return through tax agents⁸.

Only 20% of newly registered funds do not register via a tax agent⁹.

In the 2004-2005 financial year, we received around 4,000 requests for written general advice, answered over 90,000 SMSF telephone enquiries, 24,500 newly registered funds received our trustee guide and DIY booklet and around 29,000 funds received lodgment reminder letters from us¹⁰.

Compliance program

We believe our compliance program is comprehensive.

We work in an environment of self assessment. It would be impossible to audit every self managed superannuation fund in the country. To overcome this we employ a risk based approach, which is designed to provide as much leverage for our activities as possible.

Trustees who know their responsibilities and obligations and do the right thing don't concern us. These people are working hard to ensure they run their fund properly, we recognise this and are happy to let them go about their work. Our focus is to provide them with the help and education they need to let them 'get on with it'.

There are some trustees who don't know what do, and sometimes get it wrong. We will work these trustees and help them to get on the right track again.

Then there is a small group of those who deliberately refuse to comply. This is where we will get serious and employ our resources to either resolve the problem, take action to reverse it and prevent it occurring in the future.

We look for leverage points through key groups to help with both compliance and education activities. In the self managed superannuation fund market, we have:

- trustees
- approved auditors
- tax agents
- financial planners, and
- many industry and professional associations

The support and assistance we have had from each group has been fantastic. This helps with both compliance and education activities.

At present, our compliance program will consist of 3600 audits for 2005-06 and we are contacting trustees and practitioners by phone to undertake 800 specific issue reviews based on auditor contravention reports. This is a marked increase from 2003-04 where we did 1000 audits.

High risk funds is where we centre our activity. So far this year:

- we have enforceable undertakings in place for over 80 funds, and another 100 or so in progress

- we have wound up 13 funds
- we have disqualified 15 trustees
- we have made 6 funds non-complying, and are in the process of determining whether we will take this course of action for a further 7.

This is just a snapshot against the more high risk compliance breaches.

To give you some idea as to what we are finding in relation to these breaches, the following is a list of issues identified from cases where an undertaking to rectify the breach was accepted by the Commissioner:

- Loans (Related/unrelated parties)
- In house assets
- Non-arms length Transactions
- Acquisition of asset from related party
- Early access
- Disqualified person (acting as a trustee)
- Vesting (Forfeiture of benefits)

Making a fund non-complying is a decision we will never take lightly. It means that the fund will lose its concessional tax rate of 15%, and we apply a tax rate of 47%.

If a trustee has failed to comply with the obligations, or there are multiple breaches and the fund has shown a complete disregard for the law, our actions may result in this.

Before we make a fund non-complying we consider many factors, and if we choose to proceed we will issue a 'show cause' letter and a position paper outlining why we believe the fund should be made a non-complying fund.

The trustees of the fund are provided with an opportunity to respond. If we are not satisfied, we will make the fund non-complying and remove it from the Register of Complying Superannuation funds.

Lodgment compliance

Lodgment is a point of interaction which provides early warning signals of non compliance. Our compliance strategy for ensuring timely and accurate lodgment is to increase awareness of the requirements and obligations for fund administrators, tax agents and the general community.

Until now, we have not imposed penalties on funds that do not comply. From the beginning of next financial year, we will consider all options around lodgment.

Our lodgment team is responsible for ensuring funds meeting lodgment deadlines for income tax/regulatory returns, member contribution statements and reasonable benefit limits reporting. We will also look at the data quality of lodgments.

Letters are currently being sent to over 30,000 funds and we are directly pursuing around 3,000 of these for a variety of outstanding obligations.

In terms of the information being provided, we are also seeing a number of errors being made in returns.

Typical errors we have detected include:

- Ticking the non-complying box when in fact the fund is a complying fund (this is a serious matter as making a fund non-complying affects the amount of tax a fund pays).
- Trustees entering incorrect establishment dates where the date differs from that which was notified at registration.
- Labels recording the number of fund members and total investments of the fund being transposed.

- Incorrectly stating that an approved auditor has conducted an audit of the fund when this has not occurred.

These simple errors can mean incorrect assessments, risk profiling and additional compliance costs.

Early access to superannuation

On Wednesday, our Commissioner spoke about early access to superannuation. He highlighted that we could be contacting up to 4,000 people who inappropriately accessed their benefits. What concerns us is that self managed superfunds are being used as a vehicle to allow access to super – the participants often believing the promoter that this is ‘legal’.

We have commenced 1,200 audits on cases that involve an early access to superannuation. To give you an indication of the amount of benefits accessed illegally, so far we’ve found 83 instances where there is around \$732,000 in tax shortfall. That’s an average of \$8,800 per trustee.

I thought I would give you two case studies of early access that we are seeing.


Case Studies: early access to superannuation

Case Study – 1

- A promoter established an SMSF for a lady and her ex-husband.
- The husband was employed and earned \$30,000 per year. The lady cared for her intellectually disabled child.
- A fund was established so that her ex-husband could transfer his funds from legitimate superannuation funds to a joint SMSF, so his ex-wife could access the money to purchase a newer car to transport their son.
- Of the \$20,000 rolled over, \$1,800 was paid to the promoter.
- The lady’s bank manager told it might be illegal. She contacted the promoter who assured her that it was her money and everything was ok.
- Now they have difficulty in paying the taxes due on the early withdraw of the superannuation.

Case Study – 2

- A promoter established a SMSF for a husband and wife.
- The wife had recently been made redundant and received an ETP of \$10K. Her husband was a courier earning \$24K and paying child support.
- A SMSF was established so the participants could access the money to purchase whitegoods to replace old items and to pay the rent as they were badly in arrears.
- The couple accessed \$12,000. The promoter was paid \$2,200 in fees.
- The issue first came to light when the wife went to her Tax Agent to complete her income tax return. In all other tax matters they were good citizens and regularly lodged.

 Many of the promoters target individuals who are on low income or Centrelink or other benefits. In some cases the word is spread around the workplace and a pattern of early access is established.

Our priority is to target the promoters of the scheme, and then focus on the trustees of the erring funds.

Trustees of self managed superannuation funds

Speaking of trustees - we are concerned when we notice some of the mistakes trustees are making. This leads us to believe that not all are actually aware of their obligations as trustees of self managed superannuation funds.

Managing your own fund can be a time consuming exercise. If a person sources the expertise available in the industry (such as tax agents, financial planners), then it may also be costly. People from all walks

of life can see the benefits of self managed superannuation funds, however, as we've said before, these funds do not suit everyone.

I am aware of various training and accreditation programs that your industry associations have. I think it is a great way of furthering knowledge and understanding of the requirements for managing your own superannuation fund.

In relation to investment strategies, trustees are required to prepare and implement an investment strategy that has taken into account risk, return, diversification and cash flow requirements. The Tax Office reviews whether trustees have an investment strategy in place but does not review the risk associated with their investments.

Trustees of SMSFs are solely responsible and directly accountable for the prudential management of members' benefits. It is their duty to make, implement and document decisions about the investment of fund assets and to carefully monitor the performance of those investments.

The investment decisions made by a trustee underpin the performance of a fund, and the amount of benefits the trustee can expect upon retirement. Some may prefer to allow a financial planner to recommend or handle investment decisions; others may prefer to do this themselves. Unless one has the knowledge of the financial markets, I can see a degree of risk here for any superannuation fund. A proper risk management strategy should be in place to minimise any risk to the funds assets.

Proper record keeping remains a concern for us. Decisions made by the trustees should be recorded properly. This includes minutes of meetings, investment decisions, changes of trustees and so on. If our compliance team undertakes an audit and finds that proper records have not been kept, we immediately have concerns about the fund.

Trustees should be mindful of when a trust deed may need to change. For example, two recently enacted measures, Transition to Retirement and Splitting of Contributions which may mean a change is required to the trust deed to allow the fund to offer them.

Trustees need to appoint an approved auditor every year. In some instances, we notice that the tax agent or accountant is also the auditor of the fund. Naturally we prefer that the auditor is an independent person. Auditors should seek further clarification from the relevant auditing standards and guidelines.

Approved auditors

The role played by auditors helps us to maintain a healthy retirement income system.

Our communication

We have had regular discussions with industry around approved auditors.

In the course of these discussions to date we have:

- established processes for the escalation of poorly performing approved auditors to their professional associations
- obtained feedback on our publications, including the 'Role and responsibilities of approved auditors', the auditor contravention report and the SMSF audit report. The publication 'Role and responsibilities of approved auditors' is currently being reviewed and updated. We will also be including a more relevant checklist for approved auditors to use while they are conducting the audits. SPAA is just one of the associations that have had input into these discussion
- conveyed our concerns to the associations; and,
- discussed the education approach for auditors in general and poorly performing auditors in particular.

We also carried out a benchmarking study which concentrated on approved auditors in 2004.

Our concerns

When looking at the areas that are of particular concern (investment restrictions - such as, borrowings, in-house assets, lending to members, arms length issues, and charges over assets) we are often unable to identify that an audit of these restrictions has actually occurred at times. And where they do occur our teams identify additional breaches missed by the approved auditor.

We are currently working on a checklist to help auditors with this.

Industry Concerns

In our discussions with your industry and professional bodies, we have been made aware of some concerns around our activities.

One of these is the Australian auditing standards. The concern was that in the normal course of our work, we may run the risk of shaping or influencing these standards. We've acknowledged this concern and recognise our presence in this area is as a stakeholder only.

We are grateful for the assistance SPAA has provided and we look forward to working together into the future on key risks and issues around approved auditors.

Referring auditors to associations

We are in the process of reviewing 7 auditors for possible referral to their professional associations. We only refer an auditor to their association if we have grave concern over their performance. When we are making our decision, we give consideration to:

- Severity of issues
- Materiality of issues
- Repeat issues
- Number of issues
- Documented evidence
- Historical and current behaviour
- Any voluntary disclosure made, and of course
- Our Compliance Model and Tax Payer Charter principles

We are also improving our systems to better risk assess auditors through looking at the overall risk levels of their associated clients. The process we follow for referral to associations is:

- We conduct a review of the approved auditor
- We give consideration to the seriousness of the reporting deficiency
- A 'show cause' letter is sent to the approved auditor
- We receive additional information from the approved auditor
- We give consideration to the information provided; many factors are used to determine whether or not to proceed
- If we believe it should proceed, we will refer the auditor to their professional association
- If the previous step is taken, we will request that the association inform us of any action taken.

Recent announcements

Changes to Superannuation member contribution statement reporting

Before I conclude I did want to briefly mention the changes to superannuation member contribution statement reporting. When the superannuation contributions surcharge was introduced in 1996-1997, superannuation funds were required to lodge certain contribution information so that we could issue surcharge assessments.

In 2003-2004 we implemented the Superannuation Co-contribution measure and changes were made to the member contribution statement to gather personal contribution details so that we could determine who was eligible for a Co-contribution.

The abolition of surcharge meant that some fields were not required anymore. We started preparing new specifications for industry to highlight all the changes.

On 3 February, the Minister for Revenue and Assistant Treasurer, issued a press release notifying superannuation funds that the requirement to report employer contributions to the Tax Office will continue.

Due to this:

- we will **not** issue updated member contribution statement specifications this year, and
- the reporting of employer contributed amounts for accumulation funds is still required.

In closing I would reiteration that it is important for people considering a self managed superannuation fund to help meet their retirement goals to think carefully and ensure they gain professional advice before doing so. Members of SPAA, as well as other associations, are in a good position to assist individuals to make an informed decision.

Self managed superannuation funds are like any other fund; they are designed to provide for one's retirement. The rules and regulations are in place to protect investments and benefits for this purpose. Our compliance activities are simply ensuring the various Acts are adhered to. Our focus is to encourage high levels of voluntary compliance – which ultimately benefits the taxpayer and the Australian community. However where we see continual non compliance we will be taking a firm approach.

Thank you once again for the opportunity to speak here today.

Footnotes

1 2003-04 fund tax return and individual tax return processed in October 2005

2 2003-04 fund tax return and individual tax return processes in October 2005

3 Australian business register, Fund tax return, Regulatory return, APRA, ABS and other

4 Self managed superannuation fund registrations report (internal)

5 Self managed superannuation fund registrations report (internal)

6 SMSF income tax/regulatory return 2004

7 APRA - annual superannuation bulletin 2004 (issued 4 May 2005)

8 Self managed superannuation fund registrations report (internal)

9 Self managed superannuation fund registrations report (internal)

10 internal business segment reporting

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