#NC2019

A regulatory update on practical issues within SMSFs

Dana Fleming
Assistant Commissioner, SMSF Segment, Australian Taxation Office

#NC2019

Dana Fleming

Dana has over 25 years tax experience, specialising in superannuation and managed investments both in Australia and overseas at both KPMG and PwC. For the last 4 years Dana has led KPMG's Asset & Wealth Management Practice in Australia. Her client portfolio included major industry funds and both major retail and managed funds. She advised and worked with them on the tax implications of their strategic planning as well as day to day activities, assisting with tax compliance, dealing with the impact of changing legislation on their systems and products, strategic product development, mergers and unit pricing.

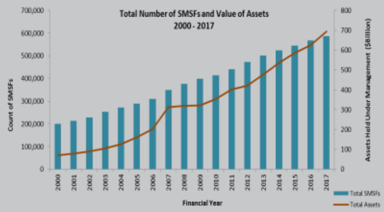
Most recently, Dana has joined the ATO as an Assistant Commissioner, leading the SMSF segment where she hopes to make a positive contribution to the public sector and importantly to the community.

Overview

#NC2019

- The Royal Commission Report
- Compliance program
- Monitoring the health of the SMSF system
- Trustee education
- Visibility of disqualified trustees

The growth of self-managed super funds



The Royal Commission Report

Commissioner Kenneth Hayne

"Compliance with the law is not a matter of choice"

"Negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary. It is not"

"Corporate behaviour moves quickly to take advantage of any perceived softening. Social norms act less upon complex organizations than upon individuals."

The Royal Commission Report

ATO response

- SMSF trustees are managing their own wealth
- The ATO as regulator recognises the difference between regulating individuals and large corporates
- Maintaining the balance between education and enforcement continues to be a focus

Compliance Program

Our current compliance risk focus areas:

- Illegal early release (IER) and promoters
- Non-lodgment
- Regulatory contraventions
- Top 100 SMSFs and tax planning
- Top 100 auditors
- High risk auditors

Our aim is to promote trust and confidence and encourage willing participation

SMSF illegal early release and promoters

- In FY2018 we disqualified 257 trustees who were trustees of 169 funds
  - 70% of these cases were for IER of funds and loans to members
- This financial year of 12,211 new SMSFs:
  - 10% of new registrants were reviewed – IER focus
  - 123 funds had their registration withheld from super fund look up
  - 329 newly registered SMSFs had their registration cancelled

✓ **1/3 of reviews resulted in action**

✓ **$45m in super was protected**

SMSF illegal early release and promoters

Common drivers for illegal early release:

- Individuals have a desire to access money due to:
  - financial stress, or
  - a desire to spend on a present day benefit
- Individuals know little or nothing about setting up or running a SMSF are targeted by unscrupulous promoters

We work jointly with ASIC and share of information in relation to matters that come to our attention, such as organisations or persons who encourage the establishment of a SMSF as the vehicle to invest in their products inappropriately

SMSF non-lodgment strategy

Non lodgment is a risk flag

- ❖ Early difficulties are symptomatic of ongoing difficulties
- ❖ Lapsed lodgment occurs when administrative or regulatory issues arise
- ❖ First time never lodgers high risk of IER

A trustee's most fundamental obligation is to lodge their SMSF's annual return after their records have been independently audited

SMSF non-lodgment strategy

In 2017 we commenced our non-lodgment program which focuses on:

- ➢ lapsed lodgers
- ➢ first time non-lodgers
- ➢ first year non-lodgers, and
- ➢ never lodgers

SMSF non-lodgment strategy – lapsed lodgers

❖ So far this year we have:

- ➢ identified 64k lapsed lodgers
- ➢ average 3.4 years of overdue SARs
- ➢ approx $27b fund assets at risk according to last return lodged
- ➢ 4k had an ACR lodged with the last year's lodged SAR

- ✓ contacted all SMSF auditors and tax agents with a SMSF who failed to lodge (25% now up to date)
- ✓ contacting full population to bring their overdue lodgments up to date
- ✓ removed the SMSF from SFLU

SMSF non-lodgment strategy – non-lodgers

First-time non-lodgers

- So far this year we have:
  - identified 26K SMSFs who have not lodged their 2017 SAR
  - this population had previous good lodgment history

  - ✓ contacting all non-lodgers for FY17
  - ✓ advising them that if they don't meet their regulatory obligation to lodge:
    - compliance status at risk
    - SMSF will be removed from SFLU, and
    - if they are not able to lodge due to a problem, encouraged to use our SMSF early engagement and voluntary disclosure service

SMSF non-lodgment strategy – non-lodgers

New SMSFs - First-year non-lodgers

- So far this year we have:
  - identified over 6.5k
  - these SMSFs registered in 2017 and their first return was due 28 Feb 2018

  - ✓ if they have had a rollover asking them to lodge
  - ✓ If no rollover asking them to cancel their registration as the fund is not operating

SMSF non-lodgment strategy – never lodgers

- Approximately 30,000 SMSFs who have NEVER lodged:
  - over 50% appear to have a rollover from an APRA fund
  - remainder have not had a rollover
  - there is an increasing trend over the past 5 years
  - average rollover increased over the past 5 years from $78k to $140k in FY17
  - average age of members is 36

  - ✓ currently reviewing SMSFs where we know there has been a rollover to determine if the fund is operating or if IER
  - ✓ for those who have not rolled over, asking them to cancel their registration as the fund is not operating

SMSF Auditor Number (SAN) misuse

- ❖ Increased incidence of SAN misuse
  - ➢ genuine errors, or
  - ➢ deliberately trying to conceal that no audit completed
- ❖ 100 SMSFs represented by 22 tax agents under investigation
- ❖ Of the approximately 40% completed, 85% inadvertent errors and 15% deliberate misuse
- ❖ Further 231 cases identified

✓ **5 tax agents referred to TPB FY18 and 1 in FY19**

SMSF Auditor Number (SAN) misuse

- ❖ ATO response will depend on the circumstances of each case:
  - ➢ genuine mistakes – we will work with the trustee or tax agent to lodge an amended return with correct SAN
  - ➢ deliberate misuse – likely penalties for trustee and/or tax agent plus referral to TPB

✓ **93 SMSF lists to approved auditors in FY19**

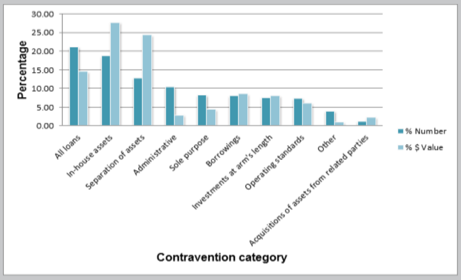
⚠ By the end of this quarter we will notify auditors of all the funds that have quoted their SAN for 2017 so they can cross check for deliberate misuse

SMSF regulatory contraventions

- ❖ FY18 there were 8,215 SMSFs with 16,909 regulatory contraventions
- ❖ FY19 there were 3,549 SMSFs with 8,412 regulatory contraventions
- ❖ The most common contraventions were:
  - ➢ loans (21.1%)
  - ➢ in-house assets (18.7%)
  - ➢ separation of assets (12.8%)

✓ **Approximately 50% self rectified**

SMSF regulatory contraventions



SMSF regulatory contraventions

- Main drivers of regulatory contraventions:
  - financial stress
  - grow wealth and access concessional tax rates, and
  - poor record keeping to substantiate transactions

- ATO response depends on a number of factors:
  - the nature of the breach
  - the penalties imposed under the law and regulations
  - the compliance history of the trustee
  - any previous contraventions

Trustee disqualification

A trustee will only be disqualified after other enforcement actions have been considered

- There are two pathways for trustees:
  1. can they get back on track?
     - direction to rectify
     - enforceable undertaking
     - notice of non-compliance
  2. required to exit the system?
     - disqualification

SMSF regulatory contraventions

For FY18, the following enforcement actions were taken:

SMSF enforcement actions	2017-18
Direction to educate (funds)	21
Direction to educate	32
Direction to rectify	31
Enforceable undertakings	138
Notice of non-compliance	11
Disqualified trustee's	257
Disqualified trustee's (funds)	169
Net admin penalties raised $	$1,743,003

Total: 180

FY19
75 trustees
53 funds

SMSF top 100 & tax planning arrangements

We risk profiled all the top 100 SMSFs representing $7.9b of assets

- 35% warrant a closer look into:
  - use of LRBAs
  - reported contraventions
  - rapid and excessive asset growth rates
  - non arm's length arrangements
  - previously identified risks

We will escalate a SMSF for review where there are transactions requiring formal investigation

Top 100 SMSFs approved auditor program

- Top 100 SMSF auditors:
  - average approximately 1,500 clients
  - audit 31% of SMSFs
  - 170b in assets

The aim of the program is to provide assurance that approximately one third of the sector are receiving an adequate audit

✓ **20% reviewed - all meeting their duties and obligations adequately**

High risk SMSF approved auditor program

- We rely on approved SMSF auditors to perform an **independent** and **adequate** audit
- We review SMSF approved auditors to ensure that they are performing their role satisfactorily and not placing members' retirement savings at risk
- We use our data holdings, information from case reviews and TP intelligence to identify:
  - poor or outdated knowledge and audit skills
  - poor processes or systems
  - a lack of competence
  - intentional failure to comply
  - high volume, low ACR ratios and high volume low cost audits
  - independence breaches including reciprocal auditing arrangements

715 high risk auditors reviewed since 2013

Our Co-Regulator relationship with ASIC

- SMSF auditors found to be deficient in their practices or not complying with their obligations are referred to ASIC

- Reasons for referral to ASIC include:
  - failed to comply with auditor independence standards (80%)
  - failed to comply with Australian auditing and assurance standards (67%)
  - registration condition not met (26 %)
  - displayed a lack of knowledge of the SIS Act and/or the SISR (21%)
  - not fit and proper (10%)

Number of SMSF auditors referred to ASIC has steadily increased

Our Co-Regulator relationship with ASIC

- Since registration to the end FY18, 96 cases referred to ASIC

  Outcomes:
  - 20% disqualified
  - 1% suspended for two years
  - 27% had conditions imposed
  - 46% voluntarily cancelled their registration
  - 5% had their registrations cancelled by ASIC

✓ **37 SMSF auditors referred to ASIC FY19**

SMSF approved auditors

Guidance for SMSF auditors following recent court cases:

- *Cam & Bear Pty Ltd v McGoldrick [2018] NSWCA 110*
- *Ryan Wealth Holdings Pty Ltd v Baumgartner [2018] NSWSC 1502*

These cases highlighted the obligations of SMSF auditors when reviewing asset values and investment strategies in SMSFs

We recently published an article, *The SMSF auditor and verifying market values in a SMSF,* which provides guidance on what is expected of a SMSF auditor in verifying the market values in the SMSF's accounts and financial statements (www.ato.gov.au QC 57668)

Monitoring the health of the SMSF system

The ATO has established a baseline monitoring framework to facilitate the monitoring of SMSF behaviour in response to the super reform measures

The methodology framework is based on:

- a baseline year of 2015/16
- a transitional year of 2016/17
- an outcome year of 2017/18

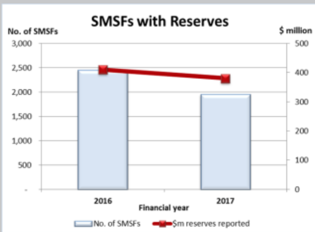
The intent of the framework is to provide evidence based insight about the impacts of the reform measures on the SMSF sector

Monitoring the health of the SMSF system

The baseline monitoring framework is currently used to monitor key focus areas that include:

- reserves
- multiple SMSFs
- transfer balance cap (TBC) compliance
- LRBAs

Reserves



Average value of reserve amounts:

- 2016 income year $167, 000
- 2017 income year $192, 000

Reserves

- ❖ What have we found so far?
  - ➢690 new reserves established in 2017
  - ➢most newly reported reserves are due to misreporting in prior years
  - ➢overall the total amount in reserves declined from 2016 to 2017
- ❖ What's next?
  - ➢ Post lodgment of FY18 returns review the 3 year trend to identify emerging risks

✓ **Low risk**

Multiple SMSFs

- ❖ As at late 2018, our data showed that there were:
  - ➢ 100 individuals who had more than 4 SMSFs
  - ➢ 473 Individuals have 3 SMSFs
  - ➢ 13,057 individuals had 2 SMSFs

- ❖ What have we found so far?
  - ➢ No significant increases in multiple SMSFs over time
  - ➢ The 100 individuals with 4 or more SMSFs are generally bona fide
- ❖ What's next?
  - ➢ Post lodgment of FY18 returns review the 3 year trend to identify emerging risks

✓ **Low risk**

Transfer balance cap compliance

- What have we found so far?
  - High level re-reporting post issuance of determinations and commutation authorities
  - 39% of commutation authorities issued have been revoked due to re-reporting
  - 86% of SMSFs reporting a capped defined benefit income stream in FY18 seem to have failed their withholding obligations

Since 1 July 2017 SMSFs have PAYG withholding obligations capped defined benefit income streams paid to a member over 60 or under 60 where the income stream is a death benefit where the deceased was over 60 at the time of death. Even if the amount withheld is nil, the SMSF must provide the member and the ATO with pension payment summary information.

Transfer balance cap compliance

- What's next?
  - FY19 is a transition year and we do not plan to take any action regarding re-reporting
  - In FY20 we will follow up funds where a member is prima facie in excess of their TBC and their SMSF re-reports **after** we have issued the member with a determination or the SMSF with a commutation authority such that no excess exists by:
    - amending the starting value of a pension
    - reporting a commutation of a pension on the same day it started, especially where the value of the commutation is the value of the excess of the determination or commutation authority
    - removing the pension completely

✓ **Medium risk**

Limited recourse borrowing arrangements

- What we have found so far?
  - ATO has concerns with the number of funds entering into an LRBA on the basis of poor or conflicted advice
  - Our analysis tells us that in FY17:
    - LRBA assets are 5.6% of total SMSF assets ($42b)
    - borrowings are 3.2% of total SMSF assets ($24bn)
    - approximately 95% LRBAs are for real property
    - split between residential and non-residential property is relatively even
    - 30% of borrowings secured by personal guarantee
    - concentration risk exists

Limited recourse borrowing arrangements

❖ What's next?

ATO action will be based on a number of factors:

- Report of the Council of Financial Regulators on leverage and risk in the superannuation system represented by LRBAs
- up coming election

⚠ Trustees are legally obliged under the SIS Act to consider diversification and liquidity risk as part of their Investment Strategy and **where we identify potential concentration risk we will write to trustees** ensure they adequately understand and mitigate the associated risks

✓ **High risk for affected population**

A proactive focus on trustee education

"How can we can encourage SMSF trustees to be better informed about their role and obligations?"

❖ Current tools and strategies:
- ATO website
- Formal advice and guidance products
- Subscription to ATO SMSF pages and newsletters
- Education directions

❖ Potential future direction:
- Productivity Commission recommended mandatory training for trustees

⚠ Upfront declaration by new trustees that they have familiarised themselves with the introductory information on our website and completed an ATO on-line self assessment

Improved visibility of disqualified trustees

It is important that advisors and auditors can readily identify when a trustee has been disqualified

❖ Disqualifications are currently gazetted but there is no simple way to search to see if a particular trustee has been disqualified

❖ We will be publishing a register of disqualified trustees that will enable people to easily search and check to see whether a trustee has been disqualified

✓ **Disqualified Trustees Public Register March 2019**

Questions?

Disclaimer

This presentation is for general information only. Every effort has been made to ensure that it is accurate, however it is not intended to be a complete description of the matters described. The presentation has been prepared without taking into account any personal objectives, financial situation or needs It does not contain and is not to be taken as containing any securities advice or securities recommendation. Furthermore, it is not intended that it be relied on by recipients for the purpose of making investment decisions and is not a replacement of the requirement for individual research or professional advice. Actions, reactions and interpretations cannot be relied upon. The presentation is purely the opinion of the presenter on the day and this presentation is record of that opinion. This presentation was accompanied by an oral presentation, and is not a complete record of the discussion held. No part of this presentation should be used elsewhere without prior consent from the author.