SMSF Association Budget Submission 2021-2022

"The Retirement Income System should be as simple as possible"

We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of 1.1 million SMSF members and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF

OUR BELIEFS

- We believe that every Australian has the right to a good quality of life in retirement.
- We believe that every Australian has the right to control their own destiny.
- We believe that how well we live in retirement is a function of how well we have managed our super and who has advised us.
- We believe that better outcomes arise when professional advisors and trustees are armed with the best and latest information, especially in the growing and sometimes complex world of SMSFs.
- We believe that insisting on tight controls, accrediting and educating advisors, and providing accurate and appropriate information to trustees is the best way to ensure that self-managed super funds continue to provide their promised benefits.
- We believe that a healthy SMSF sector contributes strongly to long term capital and national prosperity.
- We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.
- **We are the SMSF Association.**

“The Retirement Income System should be as simple as possible”

The SMSF Association welcomes the opportunity to provide a 2021-2022 Budget submission. In this submission, we focus on three significant themes:

1. Complexity
2. Advice
3. Technical issues

As the Retirement Income Review stated,

‘*The system should not be unnecessarily complex for consumers. The retirement income system should be as simple as possible, although the range of issues covered are such that it will inevitably involve a degree of complexity. The aim, nevertheless, should be to keep the complexity to a minimum. Where complexity cannot be avoided, mechanisms are needed to help people understand and navigate the system, including giving them access to advice and guidance to do so.’*

The SMSF Association’s submission seeks to address these important points. Our submission focuses on reducing unnecessary complexity, improving access to advice and addressing some technical issues with the superannuation legislation.

The superannuation system is complex. Since 1 July 2016, the legislation and complexities in administering superannuation accounts, particularly for SMSFs, has significantly increased. There are now numerous thresholds, caps, indexation methods and limits that require constant monitoring and reporting. This is not only difficult for trustees and members but also their advisers who must be privy to information that is not always readily available.

With Transfer Balance Cap (TBC) indexation now occurring on 1 July 2021, we believe it is imperative that a simpler method of indexation is implemented. Additionally, the Total Superannuation Balance (TSB) thresholds should be streamlined along with allowing financial advisers to access real-time superannuation data when appropriately authorised by their client to do so.

With regards to advice, the SMSF Association continues to advocate for a more efficient regulatory framework for advisory services which is consumer focussed. We have concluded that the current advice process is lengthy, costly and prioritises the needs of Australian Financial Service Licensees (AFSL) over consumers.

We encourage the Government, in conjunction with ASIC, to review the objective of the objectives of complying with the existing regulatory requirements, explore red-tape changes analogous to the ones announced in the credit framework and improve the provision of limited advice through the ability to provide ‘strategic advice’.

Finally, the SMSF Association also continues to prioritise red tape reduction and legislative improvements, particularly in relation to superannuation legislation technicalities. To remove unnecessary complexity and cost the legislative restrictions which apply to SMSF members who reside outside of Australia, and the inefficiencies involved in addressing non-geared unit trust breaches, should be addressed.

Recommendations

1. Remove or simplify TBC proportional indexation
2. Reduce the number of TSB thresholds
3. Provide SMSF advisers and administrators access to ATO portals
4. Modernise the advice process and compliance, exploring analogous changes to those announced in the credit framework
5. Improve the provision of limited advice through the ability to provide 'strategic advice'
6. Improve SMSF residency rules
7. Provide a practical approach to non-geared unit trust investment breaches for SMSFs

We also note that the Government has committed to guaranteeing no new or increased taxes on superannuation. It is important that superannuation fund members continue to experience a period of sustained stability.

After a period of significant change and a number of Commissions and Reviews, superannuation fund members need confidence that their retirement plans and strategies will not be significantly impacted every budget cycle.

1. Complexity

The Retirement Income Review found that the retirement income system is complex and hard to navigate. Additionally, the broader retirement environment is also complex and involves many uncertainties, as can be seen in the context of the COVID-19 Pandemic. This complexity and uncertainty, combined with a lack of assistance, guidance or advice, and low financial literacy, makes it hard for people to make well-informed choices about their retirement income.

It suggested,

'*The system should not be unnecessarily complex for consumers. The retirement income system should be as simple as possible, although the range of issues covered are such that it will inevitably involve a degree of complexity. The aim, nevertheless, should be to keep the complexity to a minimum. Where complexity cannot be avoided, mechanisms are needed to help people understand and navigate the system, including giving them access to advice and guidance to do so.'*

Since 1 July 2016, the legislation and complexities in administering superannuation accounts, particularly for SMSFs, has significantly increased. There are numerous amounts of thresholds, caps, indexation methods and limits that require constant monitoring and reporting. This is not only difficult for trustees and members but also their advisers who must be privy to that information. In many cases, advisers are unable to access this data in an accurate and timely fashion.

The different total superannuation balances (TSB)s, individual transfer balance caps (TBC)s and imminent proportional indexation, lack of SMSF adviser access to ATO portal and intended removal of annual TBC reporting obligations is creating excessive complexity in the superannuation system.

We have three key recommendations:

1. Remove or simplify TBC proportional indexation
2. Reduce the number of TSB thresholds
3. Provide SMSF advisers and administrators access to ATO portals

Indexation and complexity monitoring personal transfer balance caps

Once indexation of the general TBC occurs on 1 July 2021, there will be no single cap which applies to all individuals with a personal TBC. Initially, a member's personal TBC will equal the general TBC in the year they first have a retirement phase income stream counted against their transfer balance account. Currently, this is $1.6 million and rising to $1.7 million on 1 July 2021.

Post 1 July 2021, a member 's personal TBC may differ from the general TBC due to proportional indexation. Under proportional indexation, the unused portion of the member's personal TBC (based on the highest percentage usage of their TBC) will be indexed in line with the indexation of the general TBC. This is an overly complex situation which over time will result in most individuals with a retirement phase income stream having a personal TBC which is different to the general TBC maximum.

Individuals who haven't used their cap will have a maximum TBC of $1.7 million, individuals who have used a portion of their cap (based on their highest percentage usage) will fall somewhere between $1.6 million and $1.7 million and individuals who have used all of their cap will remain at $1.6 million.

Due to the complex nature of proportional indexation, it is inevitable that mistakes will be made leading to inadvertent breaches of the TBC. Furthermore, ATO online (and other online services for tax agents) will be the only place an individual who had a transfer balance account prior to indexation will be able to see their personal TBC. Late reporting and retrospective re-reporting by any provider after indexation has occurred may have significant consequences for the individual as the ATO will be required to go back and reconsider if the individual was entitled to proportional indexation and apply the new information to their affairs.

The indexation of the general TBC will also change other caps and limits that apply to individuals who make non-concessional contributions. However, these caps are not proportionally indexed which further adds to the complexity of the system.

One example of indexation is:

Leanne commenced a retirement phase income stream on 1 October 2017 with a value of $812,000. On 13 May 2019, Leanne commuted $200,000 from her pension and her transfer balance account was debited by $200,000. Although the balance of her transfer balance account when indexation occurs is $612,000, the highest ever balance of her transfer balance account is $812,000.

Leanne's unused cap percentage is 49.25% of $1.6 million. On 1 July 2021, Leanne's personal transfer balance cap will be indexed by 49.25% of $100,000. That is Leanne's personal TBC after indexation on 1 July 2021 will be $1,649,250.

Should Leanne wish to commence another retirement phase income stream in the next income year, she must calculate her personal TBC based on her specific proportional indexation percentage and ensure she doesn't end up with a balance in her transfer balance account which exceeds $1,649,250. Leanne must also be aware that her personal TBC will be different to everyone else's. It is likely she will need advice to calculate it accurately.

The following table from the ATO website clearly illustrates the complexities associated with proportional indexation. As the tables shows, the indexation which is applied to a member's TBC is dependent on the member's highest ever transfer balance which in-turn determines the amount of indexation (between nil and $100,000) that is applied to their TBC. The information in this table is generic and does not determine an individual's exact TBC.

Table 2: Proportional indexation of your transfer balance cap

If your highest ever transfer balance was between	your unused cap percentage will be between	your personal transfer balance cap will increase between	your personal transfer balance cap after indexation will be between
$0.00 and $159,999.99	100% and 91%	$100,000 and $91,000	$1,700,000 and $1,691,000
$160,000.00 and $319,999.99	90% and 81%	$90,000 and $81,000	$1,690,000 and $1,681,000
$320,000.00 and $479,999.99	80% and 71%	$80,000 and $71,000	$1,680,000 and $1,671,000
$480,000.00 and $639,999.99	70% and 61%	$70,000 and $61,000	$1,670,000 and $1,661,000
$640,000.00 and $799,999.99	60% and 51%	$60,000 and $51,000	$1,660,000 and $1,651,000
$800,000.00 and $959,999.99	50% and 41%	$50,000 and $41,000	$1,650,000 and $1,641,000
$960,000.00 and $1,119,999.99	40% and 31%	$40,000 and $31,000	$1,640,000 and $1,631,000
$1,120,000.00 and $1,279,999.99	30% and 21%	$30,000 and $21,000	$1,630,000 and $1,621,000
$1,280,000.00 and $1,439,999.99	20% and 11%	$20,000 and $11,000	$1,620,000 and $1,611,000
$1,440,000.00 and $1,599,99.99	10% and 1%	$10,000 and $1,000	$1,610,000 and $1,601,000
$1,600,000 or more	0%	nil	$1,600,000

Proposed solution: Remove or simplify TBC proportional indexation

One way of addressing the complexities association with proportional indexation would be to lock in a member's TBC at the time they first commence a retirement phase income stream. For example, an individual who commences a pension in the current financial year with $800,000 (which is also their highest ever transfer balance), would have their TBC locked in at this time and would remain at $1.6 million on 1 July 2021 and for all future income years. This is compared to $1,650,000 under the current proportional indexation rules.

Although this option may cause some minor inequities (for example, individuals who commence a subsequent pension may have a lower TBC then would otherwise be the case), we believe these are acceptable to avoid the cost and confusion proportional indexation would cause.

Firstly, individuals who have already used their $1.6 million TBC are not able to access proportional indexation under the current framework. Secondly, individuals who have commenced a retirement phase income stream with a balance below $1.6 million would, in most cases, be unlikely to be in situation where they would need to access a TBC above $1.6 million unless they made significant contributions after commencing their first retirement phase income stream.

Even in a scenario where an individual did intend to commence a subsequent retirement phase income stream which, under a no proportional indexation approach resulted in a smaller TBC than the current framework, the financial impact on the member would be relatively minor.

For example, based on our earlier example where an individual commences a retirement phase income stream with a balance of $800,000 in the current income year and assuming they did have another $850,000 that they could transfer to the retirement phase and commence another retirement phase income stream, the individual would be around $400 per annum worse off (5% earning rate) under this no proportional indexation approach. However, the individual would benefit from the fact they do not need to perform complex calculations.

Importantly, under this no proportional indexation approach, indexation of the general TBC would still occur, but only members commencing a retirement phase income stream for the first time would be eligible to be assessed against the new indexed TBC. For example, $1.7 million for all members commencing their first retirement phase income stream post 1 July 2021.

Should the Government wish to retain proportional indexation, the rules could be simplified by reducing the number of bands (currently 0% to 100%) of proportional indexation to five or some other appropriate number. The table below illustrates how the proportional indexation rules could be simplified by reducing the number of transfer balance thresholds.

Highest ever transfer balance range		Maximum used cap percentage	Proposed unused cap percentage	Proposed personal TBC increase	Proposed personal TBC after indexation
$0	$399,999	25%	100%	$100,000	$1,700,000
$400,000	$799,999	50%	75%	$75,000	$1,675,000
$800,000	$1,199,000	75%	50%	$50,000	$1,650,000
$1,200,000	$1,599,999	100%	25%	$25,000	$1,625,000
$1,600,000		100%	0%	$0	$1,600,000

Under this simplified proportional indexation method, the maximum an individual's TBC would increase by is no more than 25%, compared to the current proportional indexation system.

Assuming a 5% pa return ($1,250) and a 15% tax rate, the maximum tax revenue leakage is estimated to be $188 p.a, per individual in retirement phase.

In this example, we have simplified the number of bands an individual's personal TBC may fall into. Compared to the current proportional indexation approach, we believe this approach would be much easier for members to understand and apply in practice. Additionally, the financial impact of implementing a reduced number of bands is likely to be negligible due to the number of individuals able to take advantage of indexation and the low tax rate paid by superannuation funds.

Furthermore, only individuals who are near the $1.6 million cap will be affected by the impacts of indexation, yet the current system imparts a personal TBC regime that will be difficult to administer for all superannuation members.

This solution is simpler than the current proportional indexation approach but, unlike our earlier 'no proportional indexation' approach, would still require some calculation to be performed.

Whichever TBC indexation approach is adopted the need for access to timely and accurate data is fundamental to ensuring that members comply with their TBC. This highlights the need for Government to ensure that access to this data is not limited and can be accessed by all authorised advisers in an efficient way. This is discussed in more detail later in this submission.

Total superannuation balance threshold complexity

Since 1 July 2017, an individual's total superannuation balance (TSB) has been used to determine an individual's ability to access certain superannuation concessions. The SMSF Association has been supportive of this method as an effective way to target appropriate cohorts of superannuation members.

However, the introduction of multiple TSB thresholds is unnecessarily adding to the complexity of the superannuation system. This has made it increasingly difficult for individuals to understand the superannuation system and their options.

Currently, the following different TSB thresholds apply:

- $300,000 TSB for work-test exemption contributions.
- $500,000 TSB for catch-up contributions.
- $1,000,000 TSB threshold for quarterly TBC reporting.
- $1.4 million, $1.5 million and $1.6 million bring forward non-concessional contribution caps.
    - These thresholds are likely to be indexed resulting in less intuitive figures such as $1.48 million.
- $1.6 million TSB threshold for non-concessional, spousal, and co-contributions.
- $1.6 million TSB threshold for segregated pension assets.

Some of these thresholds are indexed and some are not. The indexing methods also vary. This all leads to great complexity and increase in costs. Not only do individuals find this confusing, but many professionals do as well.

These thresholds have not only added complexity to trustees trying to understand and use the superannuation system but also for their advisers and administrators to administer. It also increases the professional services fees paid by superannuation members as they need specialised advice to understand the multiple different thresholds that may apply to them and when they apply.

Furthermore, when errors are made by trustees it can result in breaches of contribution caps which can be administratively hard to resolve and involve penalties. Seeking to rectify errors within the system typically proves a costly and lengthy process.

Proposed solution: Reduce the number of TSB thresholds

The SMSF Association proposes the following amendments which will help streamline and simplify the use of the TSB:

1. Increase the work-test exemption TSB threshold to $500,000 to align with the catch-up contributions threshold
    a. This will reduce the number of thresholds and provide a single TSB for alternative contribution measures. Given the limited use of the work-test exemption we do not believe this would incur a significant revenue cost to the Government.
2. Phase out the $1 million quarterly TSB threshold within two to three years
    a. This will further reduce the number of TSB thresholds and increase the amount of quarterly reporting to SMSF trustees and the ATO in a timeframe by when a high proportion of SMSFs should be able to undertake this process efficiently.
3. Remove the $1.4 million and $1.5 million TSB bring forward non-concessional contribution (NCC) thresholds.
    a. This will reduce the complexity involved in making bring forward NCCs when nearing the $1.6 million TSB threshold. We believe a simpler superannuation system will allow all individuals who under 65 and under $1.6 million the ability to make the full $300,000 bring forward NCC. This reduces the ability for confusion and complexity in the system and also allows individuals to increase their superannuation and better prepare for their retirement. We do not anticipate that this will incur a significant revenue cost to the Government as individuals are only able to make use of the bring forward rule once every three years.
    b. Additionally, these amounts are likely to be indexed to less intuitive figures such as $1.48 million (currently $1.4 million) as the contribution caps are indexed in July 2021.
    c. This will also result in the use of one single $1.6 million (likely to be $1.7 million) threshold for NCCs, spousal and co-contributions which aligns with the segregated pension threshold and the general TBC.
4. Index the segregated pension threshold with the indexation of the general TBC
    a. This will align this amount with the general TBC.

Provide financial advisers access to superannuation tax portals

Currently, only registered tax agents (typically accountants) are able to access the Australian Tax Office (ATO) portal to obtain total superannuation balance (TSB) and transfer balance cap (TBC) information which is crucial for SMSF advice. Ironically, these advisers are generally not able to provide SMSF advice as they are not licensed or authorised with ASIC. Incongruously, those licensed advisers who have the ability to provide SMSF advice (such as financial advisers) have no reasonable way of sourcing ATO portal information directly from the ATO as they are not, generally, the member's personal tax agent.

In essence, there is a fundamental lack of information for SMSF advisers who need to provide timely advice based on a myriad of complex caps, thresholds and balances. Accountants are able to obtain information but cannot provide advice and financial advisers are unable to obtain information but are the advisers authorised to provide advice. This jeopardises the quality and efficiency of advice that is being provided to members.

Even advisers who are registered with the TPB as a tax (financial) adviser are restricted from this access.

Without direct access to this information, SMSF advisers and administrators must rely on clients accessing the information through their MyGov account, downloading the information and then sending it to their adviser. Some advisers have been forced to send in written requests signed by the taxpayer and wait upwards of six weeks for a written reply. This is hardly conducive to giving timely and affordable SMSF advice.

This problem has been acknowledged by the ATO Deputy Commissioner James O'Halloran[1]. He noted it was a frustrating aspect of professionals dealing with TBC reporting or excess TBC determinations.

For example, advisers are unable to see the information the ATO has relied on when determining their client has exceeded their TBC.

SMSF administrators and software providers are also locked out of this data and do not have efficient ways of accessing it. The majority of SMSFs are administered with the assistance of purpose-built software. If these providers could access relevant ATO application programming interfaces (APIs) (subject to privacy protection and formal authorisations) for all client members, they would have access to the only source of officially consolidated member information across all superannuation funds available. This vital information would enable SMSF service providers to protect the integrity of the superannuation system in general, and the SMSF sector in particular, by minimising the potential for errors in both reporting and action.

In addition, as highlighted earlier in this submission, over time a client's personal TBC may differ from the general TBC due to proportional indexation. This will be a complex situation which will result in most superannuation members in the retirement phase essentially having their own personal TBC which is different to the standard TBC.

If an individual's personal financial adviser is unable to provide them with timely and efficient advice because of restricted access to essential information, this will add further complexity to the system.

Proposed solution: Provide SMSF advisers and administrators access to ATO portals

We understand that this may incur a cost for the ATO and require more resources to implement.

However, we believe it is imperative that access is opened to SMSF advisers. We recommend individuals who are registered with the TPB as a tax (financial) adviser and the fund's appointed SMSF administrator should be provided access to ATO portals for the purposes of SMSF advice.

The level of complexity, some of which has been highlighted in this submission, means that the ATO, should be resourced to provide efficient forms of information to all authorised advisers.

[1] https://www.smsfadviser.com/news/16956-ato-makes-moves-to-fix-unworkable-tbc-data-access

We encourage the Government to adopt this proposal as a high priority ATO project.

2. Advice

The SMSF Association has long called for a more efficient regulatory framework for financial advisory services. This is because the current regulatory advice model prevents SMSF trustees from obtaining the limited SMSF advice they require. After years of continual regulatory change, we now have a framework that is complex and convoluted and hard to unwind.

The Retirement Income Review stated that the evidence suggests that most people do not seek advice about retirement income planning. Barriers against seeking advice include cost, lower superannuation balances and lack of trust.

The SMSF Association has found that the advice process is lengthy, costly and prioritises the needs of Australian Financial Service Licensees (AFSL) over consumers.

Our advocacy priority is for reform that reduces complexity, improves efficiency and drives harmonisation to better enable the provision of affordable, accessible and quality advice to business and consumers.

At an overarching level, this goal can be achieved through improving the quality of regulation and guidance that governs the provision of financial and tax advice, including minimising the burden of regulation on businesses and individuals.

We believe the limited licence framework forms a key part of this assessment.

Additionally, we believe the principles for enabling affordable, accessible and quality finance advice should be underpinned by:

- Appropriate education and experience
- A Code of Ethics
- Individual registration or licensing
- A single regulatory regime and regulator
- Appropriate consumer protection, including access to dispute resolution
- Commensurate compliance obligations and costs
- Ongoing CPD obligations, corresponding to the advisory services provided

The SMSF Association has made the following recommendations to ASIC via CP 332. We encourage the Government to further consider the bolded recommendations which require policy consideration:

Summary of recommendations

1. ***ASIC should take a closer look at the objectives of complying with the existing regulatory requirements and what purpose they are meant to serve for the consumer, adviser, AFSL and ASIC.***
2. *ASIC should explore how the advice process can better utilise and leverage the current file note and recording systems advisers use.*
3. *ASIC should explore what lessons can be learnt from wholesale clients and the advice process relating to these consumers, where consumers generally have a higher level of financial sophistication and greater access to affordable financial advice.*

4. *Within the existing legislative framework, ASIC should introduce a cap on the annual levy for financial advisers (or limit percentage increases), or allow for a lower level of cost recovery in upcoming years.*
5. *ASIC's guidance and explanation of how limited advice can be provided should take a more influential role to support financial advisers to provide limited advice where appropriate, despite current concerns of their AFSL.*
6. *ASIC should explore guidance that clearly explains the 'reasonable' factors that need to be addressed by financial advisers when providing consumer driven limited advice, particularly when providing limited superannuation advice.*
7. ***ASIC should explore if any learnings can be taken from the Government's changes to the credit framework and responsible lending laws which reduce red tape, improve competition and enable a more efficient flow of credit while maintaining strong consumer protections.***
8. *ASIC should review the purpose and usefulness of Statements of Advice (SOA) and modernise the relevant regulatory requirements.*
9. *ASIC should provide further guidance on how to produce an SOA or ROA for limited advice scenarios.*
10. *ASIC should use their 'information sheet' format for updated guidance on providing limited advice.*
11. *ASIC should continue to consult and engage with industry when appropriate on improving accessibility and affordability of financial advice as the marketplace for financial advice continues to evolve rapidly.*
12. ***The limited licence framework has failed and should be removed and transitioned to a new consumer centric framework. This may be in the form of a 'strategic advice' offering.***
13. *SMSF and superannuation advice lends itself to 'strategic advice' and ASIC should explore how this may be implemented in the advice profession as part of the current consultation process.*

It is our opinion that the current compliance burden is not helping the consumer in accessing and understanding advice

Feedback received from members during our consultation meetings listed compliance costs as the single most important barrier that prevents or restricts advisers from providing affordable and accessible advice to consumers.

We believe the current compliance framework has been developed from a previous era of financial advice and has not been modernised. Therefore, ASIC, with the Government, should take a closer look at the objectives of complying with the existing regulatory requirements and what purposes they are meant to serve for the consumer, adviser, AFSL and ASIC.

This could include exploring what lessons can be learnt from wholesale clients and the advice process for these consumers, where consumers generally have a higher level of financial sophistication and greater access to affordable advice.

While ensuring that consumers are still protected, there may be merit in imparting some onus on the consumer when they are requesting limited advice on certain topics such as superannuation which ensures the consumer understands that an adviser is only providing advice on that basis and that fuller comprehensive advice is not required.

The Government's changes to the credit framework and responsible lending laws which reduce red tape, improve competition and enable a more efficient flow of credit while maintaining strong consumer protections provide a framework for such changes.

We believe it is important to simplify what is provided to clients. This could be done by redefining the statement of advice, disclosing headline fees and moving away from granular detail.

The SMSF Association also believes that the limited licence framework has failed and hence should be removed and transitioned to a new consumer-centric framework. This may be in the form of a 'strategic advice' offering as indicated by ASIC in CP 332.

This is because:

a. The exemptions and legal obligations from the limited licence framework are complex

b. FASEA ignored the limited licence framework when designing its standards

c. Poor take up of limited licences / Licensees removing limited licence advisers because they are not profitable

d. Execution only service is occurring frequently

e. The framework prevents SMSF trustees from obtaining the SMSF advice they require in a convenient and affordable manner (such as winding up an SMSF).

Unfortunately, the current framework is restricting the SMSF industry and the professionals who dedicate their time to provide advice.

We believe SMSF and superannuation advice lends itself to 'strategic' advice. In fact, the limited licence framework was built upon this premise. That is, advice is usually centred around making contribution or starting a pension in 'superannuation'.

Currently, there is increasing interest in the SMSF sector and more broadly about 'strategic advice'. This is because many consumers demand strategic advice rather than advice on specific financial products. Additionally, with comprehensive advice out of reach for many Australians due to the costs, it is clear more are seeking piece by piece strategic guidance.

However, the current framework is built on provision of financial product advice, which not all advisers seek to provide.

With improvements to the way limited advice is offered out of CP 332, strategic advice could be the foundation on which a consumer focussed framework is built. This could ultimately allow appropriately educated advisers registered with the single disciplinary body to provide strategic advice on areas such as superannuation, retirement and cashflow without specific reference to financial products.

A strategic advice model allowing suitably qualified professionals to practise under a 'no product recommendation' environment would see advisers given increased ability to provide strategic advice without conflicts of interest. It would also address the false perception that financial advice is simply 'selling products' and in time would help to address the issue of trust in the sector.

Noting the Government's response to the TPB review and recent FASEA and single disciplinary announcement it is clear that all stakeholders agree that regulatory overlap should be reduced. Therefore, we support the current response to Royal Commission recommendation 2.10 which will provide a new single disciplinary system which will cover all financial advisers within ASIC.

The SMSF Association sees this body as a key foundation to a new consumer focused framework.

We also encourage the Government to escalate the priority of Royal Commission Recommendation 2.3 to review the quality of advice and implement improvements earlier than the current scheduled latest date of 31 December 2022.

3. Technical

The SMSF Association also continues to prioritise red tape reduction and legislative improvements, particularly in relation to the technical nature of superannuation legislation.

We highlight two key areas we believe legislative improvements will improve efficiency, understanding and equity in technical application for superannuation members and advisers:

1. Improving SMSF residency rules
2. Providing a practical approach to non-geared unit trust investment breaches for SMSFs.

We also note our support for the MYEFO announcement which will enable retirees with legacy pensions who have been unable to commute amounts in excess of their transfer balance cap to undertake the necessary partial commutation. The measure also ensures appropriate tax outcomes for these retirees given their prior inability to comply with the transfer balance cap rules.

The SMSF Association has long advocated for the modernization of legacy pensions and we welcome the opportunity to consult on draft legislation in the coming months. We believe these reforms can also be used to reduce the number of legacy pensions in the system, in line with previous advocacy and submissions made by the SMSF Association.

Superannuation residency rules and SMSFs

Currently, the definition of 'Australian Superannuation Fund' in section 295-95 of the ITAA 1997 creates administrative difficulties and red tape for members of SMSFs. This issue also equally applies to small APRA funds.

It involves situations where Australians who are temporary residents overseas are being prevented from making contributions to their SMSF due to the penalties involved and the fund potentially being taxed as a non-complying superannuation fund. The alternative to not being able to make contributions to an SMSF is for the individual to make contributions to a large APRA-regulated superannuation fund and on their return to Australia rollover those contributions back to their SMSF. This is cumbersome as it involves making contributions to a fund which is not the preference of the individual and causes significant additional costs to be incurred by having an extra superannuation fund and subsequently transferring the benefit to their SMSF. This increases fund administration and compliance costs for the individual affected, reducing their superannuation balance, which is something the Productivity Commission has highlighted as a concern.

The fact that the residency rules unfairly affect superannuation members who 'choose' to save for retirement in an SMSF but do not affect those who save in a large APRA- regulated superannuation is inequitable.

Failure for a fund to meet the definition of an Australian superannuation fund means that it is treated as a non-complying fund. A complying superannuation fund that becomes a non-complying superannuation fund is taxed currently at 45 per cent on it is taxable income for the financial year and also taxed at 45 per cent on the value of the fund's investments at the commencement of the financial year in which it becomes non-complying, less the amount of broadly any non-deductible contributions (non-concessional contributions).

We believe that the active member test does not provide any additional integrity to the superannuation system as the establishment and central control and management tests already ensure that only Australian based superannuation funds can benefit from the superannuation tax concessions. Instead, the active member test is an unnecessary source of red tape, especially for SMSFs and small APRA funds, adding costs and reducing the efficiency of the superannuation system.

Confusion and complications relating to the active member test is also one of the most popular topic areas for technical questions received from advice professionals through the SMSF Association's Technical Research Service.

Proposed solution: Removing the active member test and provide ATO discretion

It is submitted that the 'active member' test should be removed from the requirement for any superannuation fund to qualify for taxation concessions under the income tax law. Residency of the fund should be determined on the same principles as all other entities for income tax purposes, that is, the place of establishment and the location of the management and control of the entity.

Removing the active member test would ensure that SMSF members who are working overseas can still contribute to their fund where their fund balance exceeds 50 per cent of the fund's assets. This would mean that, as long as the fund was established in Australia and the central control and management ordinarily remains in Australia, then an SMSF member can continue to contribute to a fund of their choice.

Proposed solution: Extend the temporary absent exception for the central management and control test from two to five years

We suggest that the two-year temporary absence exception for the central management and control of a superannuation fund to be in Australia should be extended to a five-year exemption. The existing two-year exemption is too short in the context of modern work arrangements, where executive and other staff are often expected to commit to an overseas placement of greater than two years. Often, what initially starts out as a one or two year overseas assignment also gets extended for greater than the initial period. Extending the central control and management exception will reduce red tape and compliance issues for Australians working overseas while not compromising the integrity of the superannuation or taxation systems.

These proposed amendments will benefit SMSF members who spend time overseas working and wish to still make contributions to their fund to save for their retirement. We do not believe there will be any negatively affected superannuation fund members from the proposed amendments.

In fact, in light of COVID-19 the ATO issued temporary relief if the individual trustees of an SMSF or directors of its corporate trustee are stranded overseas. This has been a successful introduction of a more practical application of SMSF residency rules that has not resulted in negative outcomes.

We believe that these proposed changes would have a negligible impact on revenue as the changes would simply cause concessionally taxed contributions to be redirected to an SMSF instead of a large APRA-regulated fund. In other words, it would simply result in a re-direction of contributions rather than creating an increase in concessionally taxed contributions.

These proposed amendments would remove a source of inefficient red tape in the superannuation system helping SMSF members better save for retirement. It would also support the Government's policy to ensure that all superannuation fund members are able to exercise choice of where their contributions are made. Further, it is consistent with removing the inefficiencies that exist as a result of members having multiple superannuation accounts.

A practical approach to non-geared unit trust breaches

Non-geared unit trusts (NGUTs) are a popular investment structure for many SMSFs. They allow SMSF trustees to pool money with other investors, who may or may not be related, to invest in property. These trusts are permitted under the superannuation legislation if they comply with strict criteria under Division 13.3A of the SIS Regulations. When requirements are not met, the units held by an SMSF in the NGUT are regarded as an in-house asset of the fund.

The SMSF Association believes the practical administrative nature of dealing with breaches to the strict criteria causes an unnecessary cost to SMSF trustees.

The below checklist provides a high-level simplification of the criteria for the unit trust under SIS regulation 13.22C:

- The superannuation fund has fewer than 5 members.
- The trustee of the unit trust does not have a lease with a related party of the superannuation fund. An exception applies if the lease relates to business real property.
- The trustee of the unit trust does not have outstanding borrowings (including small overdrafts).
- The assets of the unit trust do not include:
    - An interest in another entity; or
    - A loan to another entity except a deposit with an authorized deposit-taking institution (eg, certain approved banks); or
    - An asset that is subject to a charge (including a mortgage); or
    - An asset (excluding money) that was ever owned by a related party, subject to certain excluded timeframes. An exception also applies if the asset was business real property acquired at market value.

SIS regulation 13.22B mirrors the above requirement for NGUTs established prior to 28 June 2000.

These criteria must be met at the time of the initial investment by the SMSF. 13.22D regulates trigger events which cause a NGUT to breach regulation 13.22B or 13.22C and render the investment as an in-house asset. These trigger events align with the criteria in 13.22B and 13.22C. For example, if the trustee of the unit trust undertakes a borrowing or invests in a listed share, the unit trust will no longer be a 13.22B or 13.22C unit trust.

Importantly, if any of the requirements of regulation 13.22D are breached, the unit trust ceases to be a 13.22B or 13.22C unit trust. Such a breach can never be rectified. This means a trigger event in regulation 13.22D will taint the unit trust forever for that superannuation fund.

The consequence of this is that the unit trust would then form part of the in-house assets of the SMSF. In that case:

> – if the value of those units breach the 5% limit, ultimately, the fund would need to dispose of its interest in the unit trust (at least up to the 5% limit). This could trigger significant taxation and stamp duty consequences; or
>
> – if the value does not breach the 5% limit, the SMSF has the option to retain its investment in the unit trust and, in which case, it would need to continue to monitor the 5% limit.

The SMSF Association believes the penalty for a breach of the 13.22D in unnecessarily strict and impractical. This is because the usual advised remedy is for SMSF trustees to sell the units they hold in the NGUT as required by the law and then re-purchase the same structure.

Regardless of how small a breach is, such as a $1 overdraft, the unit trust is compromised. This includes the approved SMSF Auditor not being able to apply any prospective green tick of approval.

If we assume a NGUT has commercial property valued at $1.4 million and the NGUT is 100% owned by an SMSF and the NGUT then breaches the criteria in reg 13.22C:

- Despite the NGUT owning business real property ('BRP'), the units will need to be transferred from the SMSF as these constitute an in-house asset. As an example, Victorian stamp duty on transfer of these units is $77,000. An exemption may be possible if the transfer is to a member in kind if they are entitled to be paid (eg, attained 65 years). However, in many instances, duty would be payable unless the value of dutiable property in the NGUT was below the relevant threshold (eg, Vic $1m and NSW $2m).
- Capital gains will also need to be paid on the disposal of the asset
- To facilitate this transfer, the members may wish to retain the property:
    - If we assume it is retained in the SMSF – It would cost approximately $2,000 to establish a new NGUT (including corporate trustee and duty), plus adviser costs of approximately $5,000 and transfer costs of property title to the new NGUT of approximately $5,000.

Therefore, a relatively minor contravention could give rise to around $100,000 in costs.

Alternatively, if the members wish to transfer the property outside super, they may need to arrange borrowings and incur adviser and legal costs. In addition, the usual disposal costs with property would apply.

Proposed solution: Allow trustees to implement a plan to rectify the breach before the end of the following financial year

Therefore, we propose that breaches of regulation 13.22D are able to be rectified in an appropriate period. A breach would still occur but the ability to rectify the breach removes the cost and administrative burden of selling assets and re-purchasing them.

This would be akin to the practical approach taken when trustees breach the in-house asset rules.

The in-house asset rules require the trustees of SMSFs who have assets that exceed the 5% in-house asset limit at the end of a financial year to prepare a written plan to rectify the situation before the end of the following financial year.

The plan must specify the amount that is above the in-house asset limit and set out what steps will be undertaken to reduce the fund's in-house assets to below the 5% limit (generally by disposing or selling excess assets). Each trustee of the fund must ensure that the steps in the plan are carried out within the next year of income.