17 January 2013

Institute of Chartered Accountants Australia

Ms Louise Lilley
Manager
Benefits and Regulation Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: strongersuper@treasury.gov.au

Dear Louise,

Acquisitions and disposals of certain assets by SMSFs and related parties

The Institute of Chartered Accountants in Australia (the Institute) would like to take this opportunity to make the following comments in relation to the draft legislation for the acquisitions and disposals of certain assets by SMSFs and related parties.

The Institute is the professional body for Chartered Accountants in Australia and members operating throughout the world.

Representing more than 72,000 current and future professionals and business leaders, the Institute has a pivotal role in upholding financial integrity in society. Members strive to uphold the profession's commitment to ethics and quality in everything they do, alongside an unwavering dedication to act in the public interest.

Chartered Accountants hold diverse positions across the business community, as well as in professional services, government, not-for-profit, education and academia. The leadership and business acumen of members underpin the Institute's deep knowledge base in a broad range of policy areas impacting the Australian economy and domestic and international capital markets.

The Institute of Chartered Accountants in Australia was established by Royal Charter in 1928 and today has more than 60,000 members and 12,000 talented graduates working and undertaking the Chartered Accountants Program.

The Institute is a founding member of the Global Accounting Alliance (GAA), which is an international coalition of accounting bodies and an 800,000-strong network of professionals and leaders worldwide.

If you have any questions regarding our submission, please do not hesitate to contact me on 02 9290 5704 or via email on liz.westover@charteredaccountants.com.au.

Yours sincerely,

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Head of Superannuation

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General Comments

The Institute is not supportive of the introduction of the measures contained in this new legislation. As with previous submissions throughout the Cooper review, we do not believe that a systemic problem exists that warrants the introduction of these new measures. Furthermore, we believe that other measures, such as clearer parameters on how such transactions were undertaken would be more appropriate to ensure that trustees were undertaking these transactions correctly. Other parts of the Superannuation Industry (Supervision) Act 1993 already contain requirements for all SMSF transactions to be conducted on an arm's length basis. This, together with heightened standards of audits being undertaken as a result of the new SMSF auditor registration regime would have given a better result for SMSF trustees and given assurance around any "potential abuse" as suggested by the Cooper review panel in their report.

We make the following comments in relation to the draft legislation, noting that some of the issues may be addressed in forthcoming regulations.

Specific Comments

Acquisition of Assets from a related party

Section 66A – The Institute recognises that this section largely mirrors existing legislation banning SMSFs from acquiring assets from related parties, subject to certain exceptions. There are a number of concerns however with the wording of the new legislation.

The existing Section 66 contemplates an *intentional* acquisition by the SMSF which the new Section 66A does not include. The Institute believes that new legislation should also apply only to intentional acquisitions. It is possible that complex ownership arrangements or structures with related companies or trusts may inadvertently result in a breach of Section 66A. Notwithstanding that the regulator has power to remit any penalties in such cases, it would be a greater integrity measure that such inadvertent breaches not get caught up in these measures at all. Checks and balances with these arrangements would be undertaken by the SMSF auditor.

Section 66A (3) exempts listed securities acquired in a way prescribed by the regulations from these provisions. It is unclear at this time, prior to release of the regulations, exactly what is contemplated under this subsection. A number of scenarios, such as a transfer of assets when a change of trustee occurs (discussed further below) should be considered and addressed in either the legislation or regulations.

Change of Trustee

SMSFs often require a change of trustee. This may be the result of a move from individual trustees to a corporate trustee structure (or vice versa) or to add or remove an individual trustee.

A transfer of assets will be required in these circumstances to ensure that assets are correctly held in the name of the trustee as trustee for the SMSF. Listed securities can be particularly challenging in this scenario. To date, SMSFs have been required to set up a new broker account in the name of the new trustee and carry out an off market transfer of shares to the new account. No change of ownership has occurred, with the fund retaining ownership throughout but an off market transfer is required to effectively update the share registry of a change of trustee. Under the new legislation, no provision is given for this situation. Therefore, a trustee may offend the provisions of Sections 66A and 66B by ensuring the SMSF's assets are appropriately held in the name of the current trustee or alternatively be forced to sell and re-purchase assets on market with capital gains tax and other consequences.

We strongly encourage consideration be given to an exemption from these new provisions under the circumstances described above. We note that the nature of these transactions would require an exemption under Section 66A for acquisition of assets and Section 66B for disposal of assets.

Small or unmarketable parcels of shares

From time to time an SMSF will hold small and/or unmarketable parcels of shares. This could arise because of an allocation of shares under a dividend reinvestment plan following a disposal of the main parcel of shares or because of a significant decline in the value of a parcel of shares (eg following a corporate collapse).

Holding these types of shares and being unable to dispose of them is problematic when a trustee wishes to wind up their fund as they will not be able to wind up the fund until the shares are disposed of. Additional fees for preparation of accounts, audit and lodgement fees may be incurred as a result of an inability to wind up the fund, which may erode members' retirement savings. This could continue for an indefinite period.

It can also cause financial hardship on a trustee if they are unable to dispose of the asset to crystallise capital losses. While the value of the asset may be minimal, the loss may be significant. If the trustee is unable to use these losses to offset against other capital gains, higher taxes will be payable, further eroding retirement savings.

Typically, to overcome the problems outlined above, the SMSF trustee may sell these assets, at market value, to themselves. This then allows the SMSF to be wound up or to crystallise capital losses (or both).

The Institute strongly encourages consideration be given to allowing off market transfers in these circumstances. A dollar value threshold could be introduced to ensure the integrity of such an exemption from the new rules. Auditors would require evidence of the transaction being carried out in an appropriate manner.

Penalties

The Institute does not believe the assigned penalty units for a breach of these measures is appropriate. Notwithstanding the Commissioner of Taxation will have powers of remission where penalties are imposed, a maximum fine of over $10,000 is particularly harsh. We believe the number of penalty units should be at least half this amount. At this level, the fine is still significant enough to act as a deterrent to trustees undertaking inappropriate related party transactions but not so great as to overly impact on retirement savings.

Transfer of assets – relationship breakdowns

Provisions for transfer of assets under relationship breakdowns are not impacted under this new legislation. However, the Institute believes that, as an integrity measure, the market valuation requirements should be inserted into the exception. That is, the transfer of assets between an SMSF and a related party will be allowed where the transfer is as a result of a relationship breakdown, however must still be conducted at market value. No such market valuation requirement exists under current or new legislation.

Ability to access valuations

From time to time, it may become impossible to find a suitably qualified (or independent) valuer. Circumstances can also arise where a valuer declines to provide a valuation. The new legislation makes no provision for these circumstances. The Institute encourages the inclusion of provisions to deal with these scenarios. Without provisions being made, a trustee may find themselves in breach of legislation (and subjected to significant penalties) despite their best efforts to comply. These circumstances have and do occur and should be dealt with under the law. Trustees should not be subjected to audit qualifications, audit contravention reports, potentially an ATO audit (and all associated costs) and rely on the Commissioner of Taxation to remit the penalties, which may be in excess of $10,000.

Application could be made to the Commissioner of Taxation for an exemption where a valuation cannot be obtained. The trustee would also need to satisfy their auditor that they had made all efforts, were unable to get a formal valuation as required and the basis for which a valuation was ultimately determined.

Other difficulties

The Institute is concerned about a number of other issues also. While it may not be appropriate for all to be dealt with in legislation, it will be important that some form of guidance be issued by the regulator to assist trustees understand their obligations under the new provisions. This will include:

- Further clarity on what constitutes a qualified, independent valuer, particularly as this applies to different types of assets
- Guidance on the form of a valuation and the information it would need to contain
- Does the definition of business real property include fixtures and fittings? Trustees may fall foul of the legislation where transactions include such items
- How do the new rules interact with assets covered under Regulation 13.22C
- How the new rules would apply, in a practical sense, to unit trusts where an SMSF may sell down units to a related party over a period of time
- How recent would a valuation need to be for trustees to comply with the new rules
- Guidance for SMSF auditors on their obligations under the new legislation