14 September 2012

Manager
Contributions and Accumulations Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: strongersuper@treasury.gov.au

Dear Ms. Lilley,

Stronger super SMSF draft legislation

The Self Managed Superannuation Funds Professionals' Association of Australia ("SPAA") welcomes the opportunity to make a submission in relation to the proposed legislation that implements changes to the regulation of self managed superannuation funds (SMSFs). This submission is a response to the three exposure drafts of legislation released by Government on 20 August 2012 regarding:

- Administrative consequences and penalties for trustees of SMSFs.
- Penalties for promoters of early release schemes.
- Roll-overs to SMSFs.

SPAA generally supports the policy intent underlying these three legislative measures.

We support the policy of introducing an administrative penalty regime, including rectification and education directions, to give the Australian Taxation Office (ATO), greater flexibility in regulating SMSFs. The administrative penalty regime will give the ATO more suitable options for penalising SMSFs for minor or unintended breaches than the current, severe measures of making a SMSF non-compliant, disqualifying the trustee or applying to a court to impose a civil penalty.

We also support the new penalties for promoters of early release schemes. While we believe that occurrences of illegal early access of superannuation funds appear to be declining, where it does occur, it is important that the Commissioner of Taxation can respond appropriately. SPAA believes that making the promotion of an illegal early release scheme a civil penalty breach under the *Superannuation Industry (Supervision) Act 1993* will be a significant deterrent for promoters of illegal early release schemes.

Finally, SPAA supports the inclusion of a roll-over of funds from a superannuation fund that is not an SMSF to an SMSF as a designated service under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (the AML/CTF Act). However, we are concerned that some of the material in the explanatory memorandum accompanying the SMSF roll-over draft bill overstates the

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risk of SMSFs being used for money laundering or terrorism financing. We are not aware of this being a significant issue in the SMSF industry. While we think this risk is overstated, we do see the amendment as a useful step in preventing fraud involving SMSFs.

In particular, we believe that this measure may help stop fraud involving SMSFs, where identity fraud is carried out to illegally release funds from a superannuation fund by transferring it to a fictitious SMSF, without the member's knowledge. Requiring verification of the SMSF and member prior to roll-over of the funds will help prevent this type of fraud occurring.

Also, the inclusion of roll-overs as a designated service in the AML/CTF Act is a positive step, as it ensures a consistent, defined standard across superannuation funds for the information that they require and the processes they must carry out in verifying SMSFs for roll-overs. This will make the roll-over of funds to SMSFs more efficient than the current situation where transferring funds often have different standards and requirements for processing roll-overs to SMSFs. This approach is also consistent with our understanding of the proposed SuperStream measures for rollovers to SMSFs.

While we support these measures, we would like to raise some minor issues with the legislation which we believe require clarification or adjustment. We have provided the detailed information in the attachment on the administrative consequences and penalties for trustees of SMSFs and penalties for promoters of early release schemes measures.

The key points of this submission are:

- **SPAA supports the three legislative measures, however, there is ambiguity regarding how the new administrative penalties regime applies that should be resolved.**

- **The early release and unlawful payment legislation should have sufficient discretion to remit penalties in situations where the promotion of a scheme may have resulted in an illegal payment being made, or a person receiving an unlawful payment, which was unintentional or unforeseen.**

About SPAA

SPAA is the peak professional body representing the SMSF sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.

SPAA is committed to raising the standard of professional advice and conduct in the SMSF sector by working proactively with Government and the industry. In doing so, SPAA has contributed to SMSF advisors providing a higher standard of advice to SMSF trustees. This in turn has enabled trustees to make more informed decisions addressing the adequacy, sustainability and longevity of

their own retirement savings. SMSFs offer trustees greater control and flexibility and have become an integral part of the Australian Superannuation landscape by providing significant and viable options for managers, business owners, executives and retail operators alike.

If you have any questions about our submission or would like any further information please do not hesitate to contact us.

Yours sincerely

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Administrative consequences and penalties for trustees of SMSFs

The administrative penalties introduced by the draft legislation apply to SMSF trustees, including individual trustees and corporate trustees, as well as to a director of a body corporate that is a trustee of an SMSF. However, the current drafting of the legislation and Explanatory Memorandum (EM) give rise to uncertainty as to how the administrative penalties will be applied to the responsible entity in certain situations.

Individual trustees

The Exposure Draft legislation and EM do not make it clear whether an administrative penalty for a contravention of a listed provision of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) applies to each individual trustee of an SMSF, or whether it applies to the group of trustees as a whole. If the penalty is to be applied individually will it always be imposed equally on each trustee or will there be occasions where one individual trustee may incur a higher penalty than others? We recommend clarifying this in the EM in order to avoid doubt.

Penalties for corporate trustees – application to directors

The exposure draft and EM are ambiguous about the way administrative penalties will be applied to a corporate trustee. For example, will the administrative penalty be levied on each director of the body corporate independently or will it be levied on the body corporate as a whole with the directors liable for that amount? This is similar to the issue raised above regarding individual SMSF trustees. This issue should be clarified in the EM, possibly with examples that show the application of the law.

Penalties for corporate trustees – amount of penalty

Under the current exposure draft legislation, where a corporate trustee is liable for an administrative penalty it is not clear whether the penalty is that which is specified in the table in draft section 166 or five times that amount due to the effect of section 4B of the *Crimes Act 1914* ('Crimes Act'). Subsection 4B(3) of the Crimes Act states:

> Where a body corporate is convicted of an offence against a law of the Commonwealth, the court may, if the contrary intention does not appear and the court thinks fit, impose a pecuniary penalty not exceeding an amount equal to 5 times the amount of the maximum pecuniary penalty that could be imposed by the court on a natural person convicted of the same offence.

Effectively, this subsection of the Crimes Act can increase the administrative penalty that applies to corporate trustees by a factor of five. For example, the administrative penalty for contravening subsection 65(1) of the SIS Act (contravening the prohibition of lending or providing financial assistance to members) for a corporate trustee will increase from a penalty of $6,600 (60 penalty units) to $33,000. This would seem to be excessive for an administrative penalty, especially where a fund may be liable to multiple administrative penalties for multiple breaches arising from the same fact situation.

It would be inequitable if corporate trustees were exposed to five times the penalty of individual trustees in the SMSF context, bearing in mind that typically a breach of a particular type by a corporate trustee will have the same significance in practice as a breach by individual trustees. Furthermore, as 91.4% of SMSFs have one or two members[1], if a SMSF has a corporate trustee, the increased penalty for a contravention will fall on a small number of directors to pay the administrative penalty. Using the example above of the increased penalty for contravening subsection 65(1) of the SIS Act of $33,000, a two member SMSF with two directors will see each director liable for a $16,500 penalty rather than a $6,600 penalty each. This is a disproportionate penalty, especially for an administrative penalty.

SPAA acknowledges that increased penalties for body corporates have an important place in the regulation of corporate entities, but we believe that this principle is not suitable for the regulation of SMSFs. SMSFs normally have a small number of directors and the function and purpose of the fund has no difference whether it has natural persons as trustees or a corporate trustee with directors who are the SMSFs members.

SPAA recommends that the legislation and EM should make it clear that increased penalties for corporate trustees do not apply under the administrative penalty regime.

Penalties for unlawful payments and promoters of illegal early release schemes

SPAA strongly supports the inclusion of proposed new section 68B of the SIS Act. Although instances of illegal early access appear to be declining, in the event that it does occur, it is important that the Commissioner has the power to take appropriate action. In SPAA's view, making the promotion of an illegal early release scheme a SIS Act civil penalty breach will act as a significant deterrent for promoters of such schemes.

However, it is also important that the legislation provides sufficient discretion to remit penalties in situations where the promotion of a scheme may have resulted in an illegal payment being made which was unintentional or unforeseen by the promoter.

For example, it is common for financial advisors to provide recommendations to clients to commence a transition to retirement pension once they have attained their preservation age. Although these clients have not yet satisfied a full condition of release, the payment of a pension form their preserved funds does not breach the SIS cashing rules as long as the pension continues to satisfy the transition to retirement pension standards as defined in SIS Regulation 6.01.

However, if the pension ceases to satisfy those standards (say for example pension payments totalling more than 10% of the pension account balance are paid to the client during the financial year), the pension payments received for that financial year may be considered illegal payments as defined in the EM. In this situation and consistent with the definitions used in the exposure draft, the financial advisor who provided the advice to commence the transition to retirement pension

[1] ATO Self-managed super fund statistical report - March 2012 —Membership sizes table http://www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00319627.htm&page=10&H10

could be considered to have promoted a scheme which resulted in the payment of an illegal payment.

The EM provides a definition of "*Likely to result*" but only in the context of a scheme which is likely to result, but has not actually resulted, in a payment being made from a regulated superannuation fund otherwise than in accordance with the payment standards.

To avoid doubt about the potential application of section 68B of the SIS Act in these circumstances, SPAA recommends that a new paragraph be inserted in the EM which says, subject to an objective analysis, a person will not contravene section 68B of the SIS Act if an illegal payment was paid which was not the purpose of the arrangement, or it was unintended or unforseen by the person, either at the time the arrangement was put in place or any time after.

SPAA also supports superannuation benefits received in breach of legislative requirements (unlawful early payment remainder) being included in the person's assessable income and taxed at 46.5%.

However the definition of "unlawful early payment remainder" in the EM would appear to include pension payments paid from a transition to retirement pension which has failed to satisfy the transition to retirement pension standards. In SPAA's view it would be unreasonable to impose 46.5% tax on these payments if the breach of the pension standards was clearly unintentional.

To avoid any doubt, SPAA recommends that an "unlawful early payment remainder" should exclude unlawful payments which the Commissioner considers should be excluded after considering all of the relevant factors. The relevant factors could include factors which indicate that the receipt of an unlawful payment was clearly not the intention of the person but merely was the result of an inadvertent breach of the relevant pension standards. Alternatively, the Commissioner could be given the discretion to remit the 46.5% tax on an unlawful payment in situations where the unlawful payment was clearly not intentional. Although we expect such discretion will be available to the Commissioner it is not entirely evident in the EM.