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Cooper Review – What's the score for SMSF's?

The federal government released its response to the Stronger Super or Cooper review late last year. In regard to the recommendations adopted for self managed superannuation funds (SMSF), the sector remained relatively untouched by any regulatory changes, however there are some new rules that will make a difference. Most measures will commence 1 July 2012, other than those relating to collectibles and personal use assets which are proposed to apply from 1 July 2011.

1. Regulation

The ATO has been given new regulatory powers in order to achieve more equitable outcomes including:

- the ability to issue more appropriate penalties that will not be payable from the fund's assets but by the trustees personally;

- the power to direct that an SMSF fix its problems; and
- the ability to impose mandatory trustee education in the event of superannuation law breaches.



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The ATO will also now collect and produce SMSF statistics, including information about gearing transactions.

However the government does not support the recommendation that the ATO be permitted to issue binding rulings in relation to SMSF's. The ATO can continue to provide non-binding advice to SMSF's.

2. Compliance (including Investment Rules)

Investment strategies for SMSF's must now consider including life and total and permanent disablement insurance for its members.

An amendment to the law will be made so that SMSF trust deeds will be deemed to include anything permitted under the SIS Act and the tax laws. This should reduce the number of deed amendments required due to law changes.

It will be compulsory to value assets at their market value.

Off market transactions will no longer be permitted in buying and selling of listed securities between SMSF and related parties and a formal process will have to be followed for these transactions.

Transfers of unlisted assets (e.g. business real property, unlisted trust units etc) will need to be supported by an independent valuation, rather than a real estate agent opinion.

The current "separation of assets" covenant will be made an operating standard, which means funds could be deemed non-complying and trustees fined where assets are held in the incorrect name.

Collectibles and personal use assets owned by SMSF's will not be able to be stored on premises owned by related parties. Where such assets were already owned at 1 July 2011, the fund will be given until 1 July 2016 to comply with the new rules. An exposure draft of the legislation to give effect to this change has been released, but there is some debate surrounding the appropriate definition of a "collectible" or "personal use asset".

3. Audit

It is proposed that SMSF Auditors will have to be registered with ASIC.

ASIC will be developing competency, knowledge and independence standards for auditors.

The ATO will enforce the new auditing standards.

This means ultimately audit fees will rise.

4. Gearing

The current rules regarding SMSF limited recourse loans will remain in place.

The rules governing the use of gearing in superannuation will be reviewed in two years time.

5. Anti Money Laundering/Counter Terrorism Rules

Superannuation rollovers into SMSF's will now have to adhere to the anti-money laundering and counter-terrorism financing rules.

This will mean an additional level of annual compliance.

As with any change to an industry there will be advantages and disadvantages. The Cooper Review proposals are intended to improve the integrity of the system and deliver better retirement outcomes for all.



In our view, some of these measures are akin to cracking a nut with a sledgehammer, but in the interest of improving the overall integrity of the system compliance activity will increase. Whilst this means the costs to all SMSF's will rise, we still believe SMSF's are the most effective retirement vehicle for those wishing to control their retirement savings.

Should you have any specific queries about how these changes may affect you, please contact your JR Adviser.

ATO Targets Loans to Members – What is the risk?

In late 2010, the Deputy Commissioner of Taxation, Mr Neil Olsen, detailed that the SMSF compliance activities planned for the year ahead involved a significant focus on loans and financial assistance to members.

Superannuation funds are specifically prohibited from lending money or providing other forms of financial assistance to members or relatives. Superannuation funds are also prohibited from paying benefits to members until the member has met a condition of release (e.g. retirement on or after age 55).

In a situation where amounts are withdrawn from a superannuation fund and the member is not yet entitled to receive payment of their benefits, the payment is often recorded as a 'loan to member'. Depending on the amounts involved and the fund's history, the fund's auditor may then have an obligation to report the breach in an Auditor Contravention Report.

The ATO's focus is now on reviewing funds for which an Auditor Contravention report is lodged. In particular, the ATO will examine the transactions to determine whether the arrangement is actually a loan. In about 25% of cases reviewed, to date, the ATO has formed the opinion that the arrangement is not a 'loan' but rather an early access benefit payment.

Irrespective of whether the amount is regarded as a loan or a benefit payment, the outcome for the fund is generally the same – the fund will be in breach of the Superannuation Industry (Supervision) Act (SIS) and can be made non-complying. However, where the ATO forms the opinion that the arrangement is an early access benefit payment, the member is also required to include the gross amount withdrawn in their personal income tax return and pay tax on the amount at marginal income tax rates.

In a case which appeared before the Federal Court earlier this year, a trustee of a SMSF was personally fined \$15,000 plus \$5,000 in costs for repeated breaches of the benefit payment rules. This was in addition to the ATO taxing the amounts withdrawn.

The Government has also stated that it intends to amend the existing tax laws to ensure future early release amounts are taxed at a flat rate of 45% (rather than marginal rates), with an additional penalty applied depending on the circumstances.

We recommend Trustees exposed to these situations, consider the following:

- For a payment of money to a member to be considered a loan, it must have the characteristics of a loan. In general, at the time of the payment, there must be an intention by both parties that the money will be repaid.
- Documentation which would normally evidence a loan includes a loan agreement and trustee minutes.
- Repayment of the amount is also necessary to substantiate the payment as a loan.
- Interest should be charged at a commercial rate and this rate should reflect whether the loan is secured or unsecured.
- Where a member is in receipt of a transition to retirement income stream (TRIS) and withdrawals total more than the allowable 10% limit, it is unlikely the ATO will consider the excess to be a 'loan'.
- To report the transaction correctly, it is important to identify the recipient of the monies. Whilst superannuation funds are specifically prohibited from loaning monies to members or relatives, loans to entities (such as a related company) are allowed subject to the 5% in-house asset limit. Where a loan is to an entity and not an individual member/relative, the loan should clearly be documented as such and reported as an in-house asset.

Where you may have incorrectly paid expenses from the fund for another individual/entity or your fund may have loaned monies to a related party, please contact your JR Adviser and we can assist in rectifying the situation where possible.



CGT losses in pension phase don't carry forward when your fund is in 100% pension phase

Once a superannuation fund becomes entirely pension phase (i.e. all members are in 100% pension phase) the fund no longer has an obligation to pay tax. All capital gains are disregarded and ordinary income of the fund is exempt from tax. But what happens when the fund makes a capital loss? Well in the same manner that capital gains are disregarded so too are the losses. Capital losses are not available to be carried forward. [N.B. capital losses recorded before the fund converts to 100% pension phase are crystallised and available for future years.]

Whilst the losses represent no immediate value to the fund (due to the tax exempt status) – they could be beneficial in future years if the fund structure reverts to accumulation phase (i.e. pensions are commuted or a member dies.)

Nevertheless this does not apply when a fund is partly pension phase. The income of a part pension fund is assessable in the usual manner, with a portion of this income exempt from tax. The exemption is based on the proportion of the fund which is in pension phase as calculated by an actuary. Capital gains and capital losses are calculated in the same manner as accumulation funds. The fund's exempt income percentage is then applied to the fund's ordinary income (including the net capital gains amount). Any net capital loss will not be included in the ordinary income and can be carried forward in entirety. Further any capital losses carried forward may be used in reducing the fund's future capital gains.

The good news is there are a few simple strategies which can be undertaken to preserve the losses for funds which are 100% pension phase, and managing the timing of capital gain events for funds in part pension phase can be critical when large capital losses are present. Please call our office if you believe that you may require assistance in managing a capital gains event.

Listed Fixed Income and Hybrid Securities

Most investors would be aware of Term Deposits, and the security that these fixed interest investments provide. Another form of fixed interest investment that have become popular for Self Managed Super Funds are listed Fixed Income and Hybrid securities.

There are a wide range of Fixed Income and Hybrid securities listed on the ASX. These securities exhibit characteristics of both debt and equity. In most circumstances, these securities have a lower risk than equities, but offer a higher return than fixed interest.

Being listed, Hybrids provide a higher level of liquidity than term deposits and bonds, but do not have the capital guarantee. The capital price of these securities (usually issued at \$100) may fluctuate due to market forces. In most instances, the volatility is low. However, in times of uncertainty or concern for the viability of the underlying issuer, the capital price of Hybrids may fluctuate. By selecting issuers that are stable and reputable, we hope to minimise the negative influence of capital price movements. Hybrids generally have higher capital stability (and less capital growth) than an equity investment, but will usually pay a higher yield.

Hybrid securities take many different forms, with slight variations to the characteristics. Some of the common forms of Hybrids are Convertible Preference Shares, Reset Preference Securities, Step-up Preference Shares, Income Notes, Perpetual Securities and ASX Listed Debt Securities. Each security has specific terms regarding their maturity – Convertible Preference Shares will generally convert into the ordinary shares of the underlying company based on a pre-set formula; whereas Step-up Preference Shares will increase the rate on offer if rolling over into a new security.

Some Hybrids have fixed coupons, while others offer floating rates that increase in accordance with the Bank Bill Swap Rates. Some securities provide the added benefit of dividend imputation, thereby enhancing the potential after-tax return. This feature is particularly beneficial for Self Managed Superannuation Funds – particularly those in Pension Phase.

Some of the more attractive Hybrid securities at present are:

Code	Security	Rating	Yield	Franking	Grossed Up Yield
ANZPA	ANZ CPS II Converting Pref Share	A+	5.48%	100%	7.83%
SBKPB	Suncorp Converting Pref Share	BBB+	5.82%	100%	8.31%
WBPCB	Westpac SPS II Stapled Pref Share	A+	5.83%	100%	8.33%
MQCPA	Macquarie Fixed Converting Pref Share	BBB	10.33%	0%	10.33%
TAHHA	Tabcorp Bond	BBB+	8.73%	0%	8.73%

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Further Information

The above information is intended as a guide only, and does not constitute personal investment advice. The rates quoted are current as at the time of writing, and are subject to change due to market fluctuations.

If you would like any further information on the above securities, quotes of the current rates, or would like to discuss how listed fixed interest investments may form part of your investment strategy, please do not hesitate to contact David Lane at JR Wealth Management.

Superannuation – Tax Facts Table

Concessional Contributions Limit for 2010/2011

Age on last day of the financial year	Limit
Under age 50 (standard limit)	\$25,000
50 years and over (transitional limit)	\$50,000

Non-Concessional Contributions Limit for 2010/2011

Age at any time in the financial year	Limit
Under age 65	\$150,000*
65 years and over	\$150,000

* Individuals under age 65 at anytime in the financial year may bring forward contributions of up to three times the standard non-concessional contribution limit across a fixed three year period.

Contribution Standards

Age of member at time of contribution	Acceptance conditions
Under age 65	No conditions
Age 65 but less than 75	Member must be gainfully employed for a minimum of 40 hours in any consecutive 30 days of the year of contribution
Age 75 or over	Contributions cannot be accepted unless mandated employer

Superannuation Guarantee for 2010/2011

Rate	9%
Maximum contribution base	\$42,220 per quarter

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