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New Super Borrowing Rules

Legislation has been passed to amend the borrowing provisions to remove some uncertainties and reduce risk and exposure for super funds. The previous SIS Act borrowing provisions have been repealed and replaced with more comprehensive guidelines.

Acquirable Assets

It has been clarified that the borrowing provisions can only be used to acquire a single asset (e.g. a parcel of ordinary shares in XYZ Ltd). Funds will also be permitted to acquire a collection of identical assets which have the same market value (e.g. collection of gold bars).

Unfortunately super funds will be unable to use a warrant trust to acquire a collection of buildings where each is under separate strata title, irrespective of whether the buildings are substantially the same at the time of acquisition. This may cause practical difficulties as many properties are now acquired with separate titles for the car park, store room etc. To facilitate this arrangement would require multiple warrant trusts.

Permissible Borrowing Amount

Previously funds were only permitted to borrow for the cost of the asset. However it is now possible to borrow to pay the following expenses:



- expenses intrinsically linked to the purchase of the asset (e.g. stamp duty, loan establishment costs, conveyancing fees etc); or
- expenses in maintaining or repairing (but not improving) the asset.

Refinancing

The new rules also allow for outstanding borrowings including any accrued interest, to be refinanced.

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Replacement Asset

As a result of the amendments, assets will only be able to be replaced in limited circumstances including where shares or units are the subject of a corporate action (e.g. takeover, merger etc). Examples of circumstances where a replacement asset is not permitted include:

- securities liquidated or traded as a consequence of implementing an investment strategy
- the replacement of an asset arising from an insurance claim
- the replacement of an asset by way of improvement of real property
- a single title over land being replaced with a series of titles as a result of subdivision
- the replacement of title over real property as a result of re-zoning

Personal Guarantees

Many third party lenders will only lend monies on a limited recourse basis where the fund trustee/members provide personal guarantees to the lenders. The borrowing exemption does not specifically restrict lenders from taking additional security over non-superannuation assets, however the ATO was concerned with this practice.

The new rules restrict the rights of the lender and the rights of the guarantor (or any other person), in the event of a default on the borrowings, to the rights relating to the acquired asset or replacement asset.

Previously there was a concern that the use of personal guarantees put the fund's other assets at risk due to the guarantor's personal right to indemnity against the Super Fund in the event of default.

These new rules limit the guarantor's right to indemnity to the acquired asset with no recourse from the other assets of the Fund and this has consequently resulted in the banks reviewing their SMSF borrowing offerings.

Borrowing arrangements predating 6 July 2010 will be unaffected by these changes but any refinancing arrangement entered into after this date will be subject to the new rules.

Many of the changes above provide greater certainty for trustees, and address some of the concerns held by advisors regarding the uncertainties surrounding borrowing for SMSF.

If you would like to explore the suitability or opportunity for your SMSF to obtain a level of leverage to increase its investment level then please contact one of our licensed superannuation advisors.



Cooper Report Released

On 5 July 2010 the Government released the final Cooper Report, a review of Australia's superannuation system: the Super System Review, headed by Mr Jeremy Cooper.

It is important to recognise that these are recommendations only. The Government will then announce which (if any) of the recommendations it will adopt.

JR, together with our affiliates Pitcher Partners, have and will continue to lobby the Government on certain aspects of the Cooper review that we do not believe are in the best interests of our clients.

We summarise below the main recommendations of the review panel:

SMSF Investments

The panel has made a number of recommendations regarding the investment rules for SMSFs, in particular:

- The borrowing rules for superannuation funds be reviewed in two years' time to ensure that borrowing has not become, and does not look like becoming, a significant focus of superannuation funds.
- The 5% in-house asset limit be removed for SMSFs such that no in-house assets would be allowed. SMSFs with existing in-house assets within the 5% level would have until 30 June 2020 to dispose of all of their in-house assets.
- In relation to transfers of assets between SMSFs and related parties, if any underlying market for the asset exists, all acquisitions and disposals must be conducted through that market (e.g. off market share transfers for ASX listed shares would be prohibited). Where an underlying market does not exist (e.g. business real property), the acquisition or disposal would need to be supported by an independent valuation by a registered valuer (e.g. an opinion by a real estate agent would no longer be sufficient).
- The acquisition of collectables and personal use assets by SMSFs will be prohibited. Examples include paintings, jewellery, antiques, stamp collections, wine, vintage cars, race horses and boats. SMSFs that currently own such assets would have until 30 June 2020 to dispose of those assets.
- SIS currently includes as one of its covenants the requirement for fund assets to be kept separate from assets held by the members or trustees personally. Whilst auditors must report on a contravention of this covenant, the ATO currently has no power to enforce compliance. The panel has recommended this 'separation of assets' requirement be included as a SIS operating standard, meaning funds could be made non-complying and/or trustees fined for breaches.
- The consideration of death and disability insurance to be included as part of the fund's investment strategy. As with the issue of diversification, the requirement would be to consider insurance but it would not be compulsory to have insurance.
- The grandfathering of pre 11 August 1999 unit trusts and leases would remain.

The Government has already responded to the recommendation in relation to collectible assets and confirmed that SMSFs will be able to continue investing in collectible assets provided they are stored appropriately, to prevent them from giving rise to a personal benefit.

The Government announced that new legislative standards would be introduced from 1 July 2011 to ensure that collectible assets do not give rise to a personal benefit and any assets that do not satisfy this requirement must be sold within 5 years.

Integrity of SMSFs

The panel has recommended a number of changes to improve the integrity of SMSFs as a whole including:

- All members joining a SMSF (either new or existing) to be subject to proof of identity checks.
- The SMSF registration process to include identification of any persons who have provided advice in relation to the establishment of the SMSF.
- Controls to be put in place in relation to naming of SMSFs along the lines of ASIC's national names index for company and business names.
- The data captured on Super Fund Lookup to provide SMSF information to APRA-regulated funds (including bank account details) to enable verification of the SMSF before processing rollover requests.
- Rollovers to SMSFs to be caught under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 which would require member identity checks before rollovers could occur.

Trustee Education

The panel does not believe that any particular academic, professional or other qualification requirement should be imposed on SMSF members. Further, the panel does not believe SMSF trustees should be forced to undergo any form of initial or ongoing formal education, training or accreditation.

However, the panel has recommended that trustees who breach the Superannuation Industry (Supervision) Act and Regulations (SIS) be forced to undergo mandatory education, at their own cost.

SMSF Accounting and Member Disclosure

The panel has recommended the SIS legislation be amended to formally require SMSFs to value their assets at market value, with the Australian Taxation Office (ATO) to publish valuation guidelines.

The panel has also recommended the Corporations Act be expanded to require better disclosure of information to SMSF members including the existence of binding nominations, whether a pensioner has nominated a reversionary beneficiary, insurance amounts, investment returns etc.

Standard Trust Deeds

Whilst a majority of submissions supported the idea of an optional standard trust deed for SMSFs, the panel has instead recommended that SIS be amended to automatically deem certain things to be included or not included in deeds. The aim being to reduce the need for deed amendments.

Additional Powers for the ATO

The panel has made a number of recommendations aimed at expanding the ATO's powers including:

- The superannuation legislation to be amended to provide the ATO with the power to issue administrative penalties against SMSF trustees on a sliding scale reflective of the seriousness of the breach. These penalties would be payable by the trustee(s) and not the fund. The aim being to encourage the ATO to apply penalties for contraventions rather than their current 'slap on the wrist' approach.
- The ATO to be given the power to issue trustees with a direction to rectify specified contraventions within a specified reasonable time. At present, the law allows the fund trustee to propose how they will rectify the breach and within what timeframe, with the ATO then accepting or rejecting the proposal.
- In recent years, the ATO has begun issuing SMSF rulings and determinations detailing the ATO's opinion on the workings of various provisions of the superannuation legislation (e.g. what is business real property). Currently these rulings are not binding on the ATO. The panel has recommended the ATO be given the power to make binding rulings in relation to SMSFs.



Independence of Auditors

In a move which will be quite controversial, the panel initially recommended legislating full independence of auditors. Any individual or firm providing any service in connection with an SMSF or its individual trustees or trustee directors in any capacity would be expressly prohibited from auditing that SMSF. This audit requirement is more stringent than that imposed by international audit standards and requires greater independence for SMSF auditors than that required for auditors of listed companies.

Licensing of Auditors

The panel believes that audit independence will be best achieved by adding specific independence requirements in the approved auditor registration process.

As such they have recommended that SMSF auditors be registered and be subject to registration requirements linked to minimum ongoing competency and knowledge standards which would be developed and regulated by ASIC.

Licensing of Accountants

It has been recommended that the current AFSL accountant's exemption in relation to the establishment of SMSFs be removed. If this recommendation is adopted an AFSL license will be required by all to give such advice.

Other

- The panel does not propose recommending a change in the limit on the number of members of a SMSF (i.e. no more than 4). This is despite a number of submissions calling for an increase.
- The panel does not believe there is a need to mandate a minimum SMSF asset size which would only act as an artificial barrier to entry.
- The panel does not propose recommending all SMSFs have a corporate trustee but believe with the requirement for a better standard of advice this outcome will be achieved.

To recap, the above are recommendations made by the Cooper panel and we await the Government's response and implementation.

Minimum Pension Relief Continues

At 1 July 2010, the halving of minimum pension levels were set to cease. However, legislation has been passed to enable the 50% minimum pension reduction to continue for the 2010-11 financial year.

As in the past two financial years, the list of eligible pensions includes:

- account based pensions;
- transition to retirement income streams;
- allocated pensions;
- transition to retirement allocated pensions; and
- market linked pensions.

The extension of the relief is designed to allow retirees to recoup the losses on their pension portfolios as equity markets recover over time.

Superannuation Tax Facts 2010-11

SUPERANNUATION CONTRIBUTIONS

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 the contribution
Age 75 or over	Contributions cannot be accepted unless mandated

Superannuation Guarantee for 2010/2011

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

Rebate for Spouse Contributions

Max Rebate	Income Threshold
\$540	18% rebate on the first \$3,000 of spouse contributions where spouse has assessable income + fringe benefits + reportable employer super contributions <\$10,801. The \$3,000 limit is reduced by \$1 for every \$1 of spouse's income >\$10,800 and cuts out at \$13,800

ATO Warning on Share Schemes

The Australian Taxation Office (ATO) has issued a warning regarding arrangements where:

- a company invites employees / directors / independent contractors to buy shares / options under an employee share scheme;
- the company allows the individual to nominate an associate to buy the shares;
- the individual nominates their SMSF as the buyer of the shares or options; and
- the SMSF trustee pays no considerations or less than market value consideration for the shares or options.

In these situations, there is the risk that:

- the individual may fail to correctly declare for tax purposes the gain made by them on the disposal of their right to acquire the shares/options;
- the fund may breach the acquisition of asset rules of Section 66 of the Superannuation Industry (Supervision) Act (SIS);
- the fund may fail to declare the market value of the shares/options as a contribution to the fund for cap purposes; and
- the ATO may seek to tax any dividends paid to the fund as special income (i.e. at 45%).

A recent case before the AAT supported the Tax Commissioner's view that dividends received on shares, acquired by the Fund at less than market value, was "special income" of the Fund.

SUPERANNUATION INCOME STREAMS

Pension Payment – Taxed Fund 2010/2011

Component	Age at date payment received	Amount subject to withholding	Pension tax offset
Tax Free Component	All ages	Nil	N/A
Taxable Component	Below Preservation Age	Entire amount at marginal rates	Nil
	Preservation age but below age 60	Entire amount at marginal rates	15%
	Aged 60 and over	Nil	N/A

Retirement Income Streams

Minimum Payment Amount (MPA)*:

Age of beneficiary on 1 July (or start of pension if first year)	Standard Percentage Factor
Under age 65**	4%
65 – 74	5%
75 – 79	6%
80 – 84	7%
85 – 89	9%
90 – 94	11%
Age 95 and over	14%

*Minimum payment amounts for account-based pensions have been halved for 2010/2011

**If pension operating under transition to retirement rules, a maximum payment amount of 10% applies

Preservation Age

Date of Birth	Preservation Age
Before 1 July 1960	55 years
1 July 1960 – 30 June 1961	56 years
1 July 1961 – 30 June 1962	57 years
1 July 1962 – 30 June 1963	58 years
1 July 1963 – 30 June 1964	59 years
On or after 1 July 1964	60 years

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The information provided in this newsletter is a guide only and should not be relied upon as advice from Johnston Rorke.

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