



Australian Government

Australian Taxation Office

SELF MANAGED SUPERANNUATION FUNDS

DIY SUPER IT'S YOUR MONEY... BUT NOT YET!

This overview explains our position on self managed superannuation funds.

JULY 2004



More information at
www.ato.gov.au/super

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COMMISSIONER'S FOREWORD

Self managed superannuation funds, like all superannuation funds, are there to provide for retirement. There are around 300,000 self managed super funds, representing 560,000 Australians managing their own funds. Currently about 2,500 new self managed super funds are established every month. I'm keen to ensure the money invested in these funds is managed effectively and is available at retirement.

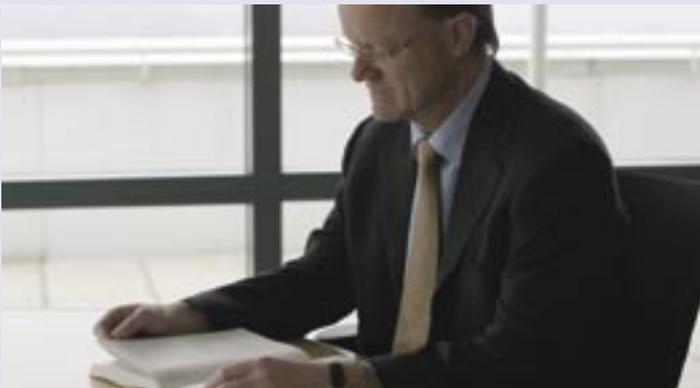
I use the line: 'It's your money, but not yet'. This isn't to say people who set up self managed super funds can't control their investment. But it is to say that the money is not to be accessed early. The rules governing self managed super funds are designed to ensure your money is an asset building for your retirement. It's the role of the Tax Office to ensure you 'play by the rules'.

We want to make sure trustees, auditors, tax practitioners and financial advisers are aware of the rules governing self managed super funds. Since November 1999 we have focused on education and we will continue to do so. However, we are concerned about how some self managed super funds are managed, so we are increasing our audit activity on high-risk funds to ensure all tax obligations are met.

Where we find that trustees are genuinely making an effort to meet their obligations, we will work with them to rectify any breaches. However, we will take a firm approach with trustees who fail to make a genuine effort to comply, or who set out to deliberately avoid meeting their legal obligations. As always, we will take a person's individual circumstances into account.

I have made a commitment for the Tax Office to be open and accountable in its dealings with the community. We publish our compliance program annually, detailing the areas of compliance we are focusing on in that financial year. Our latest *Compliance program* is available at www.ato.gov.au The publication of this booklet on self managed super funds is an extension of that commitment. I urge all trustees, auditors, tax practitioners and financial advisers – as well as those thinking about setting up a self managed super fund – to read this booklet and ensure they understand their obligations.

I welcome your feedback on this booklet and encourage you to provide feedback by emailing us at smsf_feedback@ato.gov.au



Michael Carmody
Commissioner of Taxation

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SELF MANAGED SUPERANNUATION FUNDS IN CONTEXT

01

Self managed superannuation funds comprise 20% of the superannuation industry and, at 31 December 2003, had approximately \$125 billion in assets under management.

There are around 300,000 self managed super funds, and the number of funds is growing at about 2,500 a month.

An average of 160 self managed super funds close each month.

The average account balance of a self managed super fund is \$235,000.

The membership spread among self managed super funds is:

One member	21%
Two members	65%
Three members	7%
Four members	7%

SUPERANNUATION AND THE AUSTRALIAN RETIREMENT INCOME SYSTEM

Superannuation is a savings arrangement whereby employers, employees, people who are self-employed, and family members (on behalf of their spouse or children) contribute over a long period to a superannuation fund. The superannuation fund holds the contributions in trust for members and invests these contributions to increase the fund's assets. These assets are then used to provide benefits to members when they retire or suffer a serious disability, or to a member's family if the member dies.

The government taxes superannuation savings at a lower rate than normal savings if the superannuation fund complies with certain conditions. This gives superannuation funds the opportunity to provide increased retirement benefits.

WHAT IS A SELF MANAGED SUPERANNUATION FUND?

Australians can choose to contribute their personal superannuation contributions to an independently managed superannuation fund or to a self managed superannuation fund.

Self managed super funds (also known as DIY funds) perform the same role as other funds, by investing contributions and making them available to members on retirement. The difference is, generally, that the members of self managed super funds are also the trustees – they control the investment of their contributions and the payment of their benefits. With all members being trustees, they are in a position to ensure their interests as members are protected.

Generally, a superannuation fund is a self managed super fund if (with a few exceptions):

- it has a trust deed that meets the requirements of the *Superannuation Industry (Supervision) Act 1993* (SIS Act)
- it has four or less members
- each member of the fund is a trustee
- no member of the fund is an employee of another member of the fund, unless they are related, and
- no trustee of the fund receives any remuneration for their services as trustee.

For more information about self managed fund structures and rules, see our publication *Self managed superannuation funds – role and responsibilities of trustees* (NAT 11032).

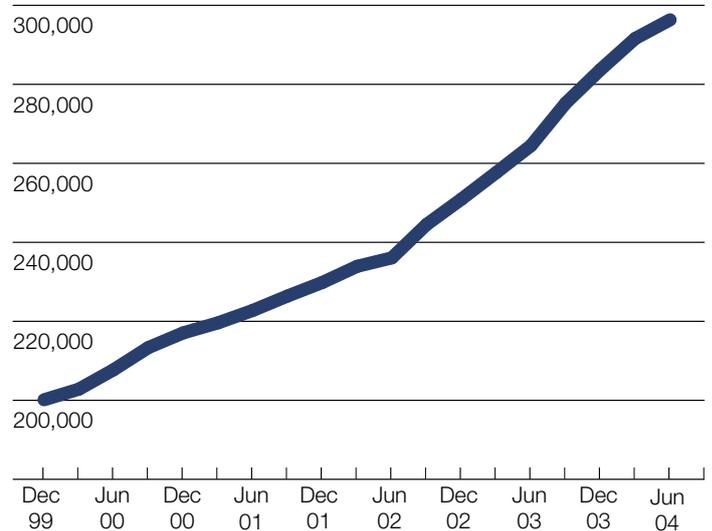
OUR INTEREST IN SELF MANAGED SUPERANNUATION FUNDS

Superannuation exists to provide income to a person on retirement. To ensure superannuation savings are protected, there are rules that must be followed. The Tax Office's role is to ensure that self managed super funds apply these rules correctly, thereby protecting members' superannuation. These rules are outlined in section 02.

GROWTH IN SELF MANAGED SUPERANNUATION FUNDS

There has been a steady increase in the number of self managed super funds since the Tax Office became the regulator in November 1999, from 190,000 to around 300,000 to the end of June 2004. The number of funds is currently growing at approximately 2,500 funds a month.

Growth of self managed superannuation funds, December 1999 – June 2004



Source: Tax Office database, July 2004

PLAYERS IN THE SYSTEM

Trustees

All members of self managed super funds are trustees – they control the investment of their contributions and the payment of their benefits.

The role of a trustee should not be taken lightly. Trustees of self managed super funds are ultimately responsible for the running of their fund.

Trustees should familiarise themselves with the legislative requirements and administrative responsibilities of running a fund. These rules exist to ensure a fund's assets are protected until they are needed at retirement. There are significant penalties imposed on trustees who fail to perform their duties.

Approved auditors

Trustees of a self managed super fund are required, for each year or part year that the fund is in existence, to appoint an approved auditor to audit the operations of the fund.

An approved auditor may be a registered company auditor, the Auditor-General of the Commonwealth, a state or a territory, or a member of a professional organisation.¹

Auditors play a critical role in helping to ensure that trustees comply with the legislative requirements of the SIS Act and the Superannuation Industry (Supervision) Regulations 1994 (regulations).

Tax agents

Trustees of a self managed super fund are required to lodge an income tax and regulatory return for the fund each year. They may get a tax agent to complete and lodge the return for them. Trustees must ensure that the tax agent has enough information to complete the return.

Accountants

Trustees of a self managed super fund must keep accounting records that record and explain the transactions so that a statement of financial position and an operating statement can be prepared. Trustees may get an accountant to help with these duties. Often a fund's accountant will also be the fund's tax agent.

Financial advisers

Trustees of a self managed super fund may obtain help from a financial adviser. A financial adviser can:

- help draft an investment strategy
- provide advice on types of investments, and
- help ensure that members' investments and level of contributions meet their retirement needs.

 Ultimately, the trustees of a superannuation fund are responsible for the investments of their fund.

¹ CPA Australia, The Institute of Chartered Accountants in Australia, National Institute of Accountants, Association of Taxation and Management Accountants, National Tax and Accountants Association Ltd.

THE ROLE OF THE TAX OFFICE AND THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

The Tax Office began regulating self managed super funds in 1999. Our role as the regulator of these funds is to ensure they comply with the SIS Act and regulations. Other complying funds are regulated by the Australian Prudential Regulation Authority (APRA) under the same Act.

APRA takes a prudential and risk based approach in an endeavour to prevent failure of the financial sector entities it regulates, including failure by superannuation funds to meet their existing and prospective liabilities.

Both the Tax Office and APRA are concerned that fund investments are in accordance with the trustees' stated investment strategy and that the trustees can demonstrate that they have taken into account risk, return, diversification and cash flow requirements when preparing and implementing their investment strategy.

The Tax Office is also responsible for ensuring that trustees meet other obligations, including lodgment of an income tax return and surcharge member contributions statement, reporting reasonable benefit limits, applying the income tax provisions and, where applicable, lodging an activity statement.

HELP AND EDUCATION

Since 1999, we have focused on help and education activities for self managed super funds. Our goal is to see all trustees and tax professionals aware of their obligations and the consequences of non-compliance. We also want trustees to know what they can expect from an audit and ensure the general community is aware that it is illegal to access superannuation early.

We make contact with the trustees of newly established self managed super funds shortly after they set up their fund, alerting them to some of the more important issues they need to be aware of. Statistically, we have established that trustees who participate in this process have a better record of compliance than those who do not.

We provide a lot of information at www.ato.gov.au/super, as well as through newsletters, the media, and seminars in both urban and regional Australia. We also have client relationship managers who deal exclusively with superannuation professionals.

MOVE TO ACTIVE COMPLIANCE

With the continued growth in the number of self managed super funds, we are rebalancing our compliance efforts and focusing more on active compliance.

We have a range of enforcement options available, depending on the nature of the breach and the circumstances. For more serious cases, we can make a fund non-complying. This has the significant tax consequence of the fund assets and income being taxed at 47%, rather than 15% for complying funds. We can also move to prosecute the trustees.

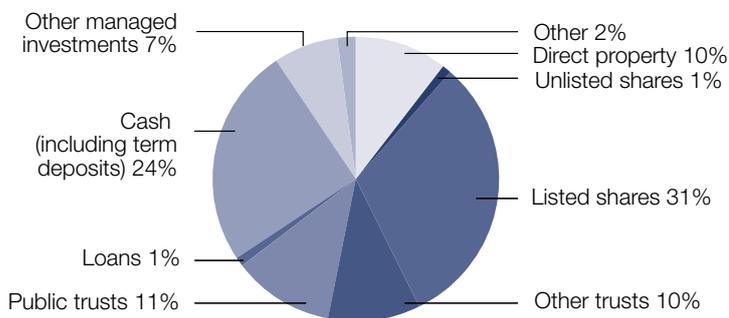
Another option we have is to disqualify trustees, which prevents them from acting as a trustee of any superannuation fund (see page 19). If we believe a trustee is unable or unwilling to perform their role adequately, we will disqualify them. We may take this action in conjunction with other enforcement options.

HOW SELF MANAGED SUPERANNUATION FUNDS INVEST

Self managed super funds have the largest proportion of their assets invested in listed shares, but only a small proportion invested directly in international shares. Currently these funds have a much greater proportion of their assets invested in cash than do other superannuation funds.

The following graph represents asset allocations of self managed super funds, based on information provided in regulatory returns lodged for the 2002 financial year.

Asset allocations of self managed superannuation funds, 2002



Source: Tax Office database, Dec 2003

REQUIREMENTS AND OBLIGATIONS

02

Under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), trustees and auditors must meet specific obligations in relation to self managed superannuation funds.

Tax agents and financial advisers also have certain responsibilities in dealing with self managed super funds.

TRUSTEES' OBLIGATIONS

All members of self managed super funds are trustees – they control the investment of their contributions and the payment of their benefits. As trustees, they are ultimately responsible for the running of their fund.

Trustees of a self managed super fund must meet their regulatory (SIS Act and regulations) and administrative (income tax, GST, reasonable benefit limit and surcharge) obligations. These rules exist to ensure the fund's assets are protected until they are needed at retirement.

There are significant penalties imposed on trustees who fail to perform their duties. There is more information on the role of trustees in our publication *Self managed superannuation funds – role and responsibilities of trustees* (NAT 11032).

Trustees must meet the following requirements when running a self managed super fund.

SAVE ONLY FOR YOUR RETIREMENT

Self managed super funds must meet the sole purpose test under the SIS Act. The sole purpose test means that a self managed super fund must be maintained for the sole purpose of providing benefits to members upon their retirement, or to their dependants if a member dies before retirement.

The sole purpose test is based on the premise that superannuation benefits provide for a person's retirement, and any investment decision must be clearly made for future rather than present benefit.

Common breaches of the sole purpose test are:

- purchasing an investment that gives a benefit to a member or associate – the sole purpose test means that the members cannot enjoy a benefit from the investment before they retire
- running a business within the fund – a possible indication that the sole purpose test has been breached is where a fund is running a business as part of its investment strategy. Our view is that if a superannuation fund is running a business it is not being administered for the sole purpose of providing benefits for the members and beneficiaries, and
- providing financial assistance or a benefit to a person or entity outside the fund.

Do:

- make investment decisions that will generate income for your retirement.

Don't:

- run a business within your fund
- provide financial assistance to friends or family
- make investments to help someone else out
- buy art as a fund investment and then hang it on your wall
- buy wine as a fund investment and then drink it
- buy jewellery as a fund investment and then wear it
- buy art, wine or investment jewellery for capital growth or to rent out to unrelated parties unless these approaches follow your fund's investment strategy (see the next page)
- use any of the assets of your fund for your own personal use or allow members or related parties² to use those assets.

EXAMPLE

The trustees of a self managed super fund pay a substantial amount to purchase shares in a golf club that entitle them to membership rights in the club. The trustees are regular golfers and the benefits of membership for them as individuals have attracted them to the investment.

The purchase of the shares does not meet the sole purpose test as the decision to invest in the club was made, at least partly, for private reasons, not retirement benefit purposes. Investment decisions by trustees must be made for the sole purpose of providing retirement benefits and should not be influenced by the trustees' personal considerations.

² Related party of a fund

A related party of a fund covers all members of the fund and their associates, and all standard employer-sponsors of the fund and their associates.

Associates of members would include their relatives, business partners and any companies or trusts that they control (either alone or with their other associates). Associates of standard employer-sponsors would include business partners and any companies or trusts that the employer controls (either alone or with their other associates) or companies and trusts that control the employer.

HAVE AN INVESTMENT STRATEGY AND INVEST RESPONSIBLY

Trustees of self managed super funds are required to prepare and implement an investment strategy for their fund, and regularly review the strategy. This requirement is to help ensure that the best possible investment decisions are being made for the fund.

The investment strategy must reflect the purpose and circumstances of the fund and consider:

- investing in such a way as to provide sufficient member returns, taking into account the risk associated with the investment
- appropriate diversification and the benefits of investing across a number of asset classes (for example, shares, property, fixed deposit) in a long-term investment strategy
- the ability of the fund to pay benefits as members retire and pay other costs incurred by the fund, and
- the needs of members (for example, age, income level, employment pattern and retirement needs).

An appropriate investment strategy should set out the investment objectives of the fund and detail the investment methods the trustees will adopt to achieve these objectives. An investment strategy should be *unique* to the requirements of a particular fund and its members, and should be reviewed regularly and updated as required. It should allow trustees to be able to measure investment performance against their retirement income goals.

Trustees must make sure that all investment decisions are made according to the investment strategy. If in any doubt, they should seek investment advice or appoint an investment manager in writing.

Do:

- develop an investment strategy and review it regularly
- ensure your investment strategy takes into account your retirement goals
- take into consideration the risks involved in certain investments
- take into consideration what bills the fund has to pay and allow enough cash to meet these expenses
- take into consideration when benefits will need to be paid out
- consider diversifying the fund's investments.

Don't:

- invest without considering your strategy and your overall goals for retirement.

EXAMPLE

The trustees of a self managed super fund are approaching retirement age. As a result, they have decided to amend their investment strategy with the aim of investing in assets which give a lower return but have less risk. They believe this will provide more stability for their benefits until they are paid out.

KEEP PROPER RECORDS

Trustees must keep some records for a minimum of five years and other records for a minimum of 10 years. This is to ensure that they can verify their decision-making processes and an accurate history of the fund can be established. If problems arise in the future, these records can be used to determine the right course of action.

Records to be kept for five years are:

- accurate and accessible accounting records that explain the transactions and financial position of the fund, and
- an annual operating statement and an annual statement of the fund's financial position.

Records to be kept for 10 years are:

- minutes of trustee meetings and decisions (where matters affecting the fund were discussed), records of all changes of trustees and the members' written consent to be appointed as trustees
- copies of all annual returns lodged, and
- copies of all reports given to members.

Do:

- keep minutes outlining investment decisions
- keep minutes to show how decisions are made
- keep records to explain the transactions of your fund
- keep annual operating statements and annual statements of your fund's financial position
- keep records to show who the trustees of your fund are and their consent to act as trustees
- keep copies of returns and information provided to members.

Don't:

- make decisions without documenting the decision
- throw out documents that explain what your fund has been doing
- throw out documents after returns have been lodged.

EXAMPLE

A married couple has a self managed super fund. They decide to buy some Australian mining shares. They prepare a minute to explain all the details of their decision to buy those shares, including the amount they are investing.

KEEP YOUR SUPERANNUATION ASSETS SEPARATE

Trustees of self managed super funds must keep money and other assets of the superannuation fund separate from their personal assets and the assets held by employers who contribute to the fund.

Money belonging to the fund must not, under any circumstance, be used for personal or business purposes. The fund's assets must not be viewed as a form of credit or a contingency when faced with a sudden need. This is to ensure that fund investments are made for the sole purpose of providing for retirement.

Do:

- have a separate bank account for your fund and pay the expenses of the fund from that bank account only
- have all fund assets in your fund's name. In doing this, we prefer the fund's assets to be held in the names of *all* of the individuals as trustees for the fund. However, where a fund asset is held in the name of only one individual as trustee for the fund, there should be supporting documentation to demonstrate that the asset belongs to the fund (for example, in trustee meeting minutes)

 In certain states, legislation may prevent you from holding assets using the fund's name at all. In this circumstance, a caveat, instrument or declaration of trust must be executed for the asset.

- have your fund, not a related entity, pay the fund's expenses
- ensure the correct name is on share certificates so that dividends are paid directly to the fund.

Don't:

- mix your fund money with other money
- have the assets of your fund in another entity's name.

EXAMPLE

The trustees of a self managed super fund decide to take out life insurance policies for each of the trustees. In order to conform with the requirements of the SIS Act, they make sure the policies are in the name of their super fund, not in the names of the individual members.

DO NOT LEND SUPERANNUATION MONEY TO MEMBERS OR RELATIVES

Trustees must not lend money, or provide direct or indirect financial assistance from the fund, to a member or a member's relative. For example, a member or a member's relative using a fund asset as a guarantee to secure a personal loan would breach this rule.

This is to ensure that investments are made solely for the purpose of providing for retirement. Further, trustees may not be inclined to pursue money owed to the fund by themselves or their relatives.

In relation to a member, a relative means:

- a parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the member, or
- a spouse of the member or of any person specified above.

A spouse includes another person who, although not legally married to the person (that is, a de facto spouse), lives with the person on a genuine domestic basis as a husband or wife of the person.

Do:

- leave your money in your fund until retirement.

Don't:

- lend money from your fund to yourself
- lend money from your fund to members or their relatives
- provide financial assistance from your fund to members or their relatives
- use an asset of your fund for yourself or let a relative use an asset of the fund.

EXAMPLE

A couple has set up a self managed super fund as a means of providing for their retirement. Their youngest son decides to start his own business and asks them to lend him some money to finance his business venture. As he is a relative of the members, they are prohibited from lending him money from their super fund.

DO NOT BORROW MONEY

Self managed super funds are prohibited from borrowing money, except in some limited circumstances. This is to ensure that there is money available to pay out all member benefits when members retire. Not allowing funds to borrow reduces the risk of members losing their benefits.

The limited circumstances in which self managed super funds can borrow money are:

- trustees can borrow for a maximum of 90 days to meet benefit payments due to members or to meet a surcharge liability as long as the borrowing does not exceed 10% of the fund's total assets, and
- trustees can borrow for a maximum of seven days to settle security transactions if the borrowing does not exceed 10% of the fund's total assets (although this can only be done where it was unlikely that the borrowing would have been needed at the time the transaction was entered into).

Do:

- ensure your fund has enough money to pay bills
- put in place procedures to monitor cash flow and the use of cheque books
- ensure the fund's bank accounts are easily identified to avoid confusion.

Don't:

- borrow money
- use assets of your fund as security
- allow your fund's bank account to go into overdraft.

EXAMPLE

A self managed super fund receives a surcharge assessment that is due on 15 June, but the fund does not have sufficient cash to pay the assessment. The trustees of the fund take out a loan to pay the assessment. To avoid breaching the SIS Act, they arrange to liquidate some of the fund's assets so that they can repay the loan within 90 days.

BE AWARE OF THE RULES WHEN BUYING ASSETS FROM A RELATED PARTY

Trustees are prohibited from acquiring assets for their self managed super fund from a related party of the fund. There are a number of reasons for this rule. It is to ensure that trustees are not making contributions to the fund that they are not entitled to make. It also discourages trustees from contributing personal assets to the fund as it is likely that they would use those assets themselves. In addition, if trustees acquire assets from a related party of the fund, they may pay too much for the asset (rather than pay market value), therefore allowing money to be withdrawn from the fund earlier than allowed.

Limited exceptions to this rule are where:

- the asset is a listed security (for example, shares, units or bonds listed on an approved stock exchange) and acquired at market value
- the asset is business real property and acquired at market value. This exception enhances the ability of small business owners to use their superannuation savings to invest in their own business premises
- the asset is money contributed to the fund
- the asset is an in-house asset (see the next page) and the acquisition would not result in the in-house assets of the fund exceeding 5% of the fund's total assets.

Do:

- purchase assets for your fund at market value.

Don't:

- give personal assets to your fund
- sell personal assets to your fund.

EXAMPLE

A couple with a self managed super fund decided to sell some listed shares that one of them owned to the fund. After checking with their accountant that this was permitted, they obtained the market value of the shares and sold them to the fund for this amount. They then decided to sell their family home to the fund, at market value. However, they were correctly advised that this would breach the SIS Act.

DO NOT ALLOW IN-HOUSE ASSETS TO EXCEED 5% OF TOTAL ASSETS

An in-house asset is any of the following:

- a loan to a related party
- an investment in a related party, or
- a lease of a fund asset to a related party.

An in-house asset is also an investment in a related trust of the fund. A related trust is a trust controlled by individuals or corporations who are related to, or associates of, the fund trustees.

In general, self managed super funds are restricted from lending to, investing in, or leasing to, a related party of the fund more than 5% of the fund's total assets. Remember that loans are prohibited if the related party is a member or a relative of a member.

This is to ensure that money contributed to the fund and fund investments are made for retirement purposes. Fund returns may suffer if trustees were able to lend to, invest in, or have a lease arrangement with, a related party as there is a greater risk that these transactions may not be made on a commercial basis. The risk is reduced by setting the allowable level at 5%.

There are some exceptions. For example, 'business real property', such as commercial premises, can be subject to a lease between a self managed super fund and a related party of the fund. Certain investments in related non-g geared trusts or companies are also allowed. These are excluded from being counted for in-house asset purposes in the fund. For more information, refer to our fact sheet *Investment strategy and investment restrictions* (NAT 2063) on www.ato.gov.au or phone **13 10 20**.

Do:

- ensure that the value of in-house assets is never more than 5% of the total value of your fund's assets
- regularly monitor the value of your fund's assets
- ensure investments or loans are made on a commercial basis and, if made with a related party, do not result in the level of in-house assets exceeding 5% of the fund's total asset value.

Don't:

- allow the in-house asset level of your fund to exceed 5% when investing in a related party's business.

EXAMPLES

- 1 The trustees of a self managed super fund purchase a residential investment property valued at \$340,000 with the intention of allowing their son to move in and pay rent at a market rate. The trustees are advised by their accountant that this arrangement would result in the value of the house being counted as an in-house asset. This would lead to the trustees exceeding the allowable in-house asset level of 5% of total fund assets. It would also raise concerns over whether the investment meets the sole purpose test as the investment was made with the intention of allowing the trustees' son to occupy the property.
- 2 A self managed super fund has total assets of \$1,000,000. One of the assets of the fund is a holiday home at the beach, valued at \$138,000. The trustees of the fund want to pay market rent and stay in the house for six weeks over summer. But they are correctly advised by their accountant that they cannot do this as the value of the house is more than 5% of the total value of their fund's assets.
- 3 A self managed super fund has total assets of \$100,000. The trustees lend \$200 from the fund to the related employer to pay a bill. As the loan to the employer is under 5% of the total assets of the fund, this is allowable. The trustees take steps to ensure the loan is repaid, with interest, on normal commercial terms.

BUY AND SELL ASSETS AT TRUE MARKET VALUE

The purchase and sale price of self managed super fund assets should always reflect a true market value for the asset. Income from assets held by the fund should always reflect a true market rate of return.

This ensures that trustees have their full entitlements available when they retire. If trustees do not maintain fund investments on a commercial basis, they may lose money.

Do:

- pay market value when purchasing or selling assets for your fund and obtain an independent valuation report
- have a written contract when leasing, and pay market value for lease payments
- ensure loans are made on commercial terms, including the period of the loan, repayments and interest rate
- check that returns on investments are at commercial rates
- make sure people pay what is required
- pursue legal action if a contract is breached.

Don't:

- sell or lease assets from your fund for less than they're worth.

EXAMPLE

The trustees of a self managed super fund lease a commercial property to a related party. They have all the necessary paperwork, including a lease agreement and a repayment schedule. If there is a default in payments, the fund must pursue its legal right to recover the debt.

MAKE SURE CONTRIBUTIONS ARE ALLOWABLE

There are standards in the SIS regulations relating to the acceptance of contributions by a self managed super fund. These standards are designed to ensure that contributions are made for retirement purposes only, and not to avoid paying tax. These are minimum standards only, and the trust deed of a particular fund may prescribe more restrictive acceptance rules. The rules are different for contributions made under a law or an industrial award and those that are not.

Do:

- check a member is entitled to make a contribution to the fund
- accept only allowable contributions.

Don't:

- accept contributions if a member is not entitled to contribute.

EXAMPLE

A 76-year-old retired woman wins a large sum of money in a lottery and decides to contribute some of it to her self managed super fund. The contribution would not meet the standards of the SIS regulations, as people 75 years of age and over cannot make personal superannuation contributions.

DO NOT ALLOW DISQUALIFIED PEOPLE TO BE TRUSTEES

A disqualified person may not act as a trustee of a superannuation entity or as a responsible officer of a body corporate that is a trustee of a superannuation entity.

This is because a disqualified person may not look after members' superannuation benefits or comply with the requirements of the legislation.

An individual is disqualified if they:

- have ever been convicted of an offence involving dishonesty
- have ever been subject to a civil penalty order under the SIS Act
- are an undischarged bankrupt, or
- have been disqualified by a regulator (see page 19).

A company would not be permitted to act as trustee if:

- a responsible officer of that company is disqualified (a responsible person includes a director, secretary or executive officer)
- a receiver, official manager or provisional liquidator has been appointed to the company, or
- action has commenced to wind up the company.

If you are a disqualified person:

- write to us for a waiver if you are disqualified for committing a criminal offence and believe you have valid grounds. The application must include the information required by the SIS Act, including details of the offence and certified copies of relevant court documents. Phone **13 10 20** for more information.
- remove yourself as a trustee or change the fund to be an APRA-regulated fund, by appointing an approved trustee.

 Another person cannot act as trustee on your behalf if you are disqualified.

EXAMPLE

A couple and their two children plan to set up a self managed super fund. However, one of the four people has been declared bankrupt. The bankrupted person must wait until the end of their bankruptcy period before they can become a trustee. The self managed super fund could be established with the other three family members as trustees, but the bankrupted person would need to wait until their bankruptcy is discharged before being eligible to join the fund.

DO NOT TAKE YOUR MONEY OUT EARLY

Trustees must not take money out of their self managed super fund earlier than legally permitted as it is meant for retirement.

Early access or release of preserved benefits is permitted only in cases of severe financial hardship or on tightly restricted compassionate grounds. These situations occur only in very limited circumstances.

Using a self managed super fund to gain improper early access to superannuation is illegal. Significant penalties apply to both the fund and the recipient of the early release if a benefit is unlawfully released. Trustees may expose themselves to disqualification and/or prosecution and the fund may be made non-complying, which would result in the fund losing up to 47% of its assets in tax. The trustees may also be assessed on the withdrawn amounts at their marginal tax rate.

Beware of the following schemes:

- Advertisements, seminars and websites stating that you can use your superannuation benefits.
- Claims that you are able to use your preserved superannuation benefits for paying personal expenses.
- Claims that you can access your super benefits before you retire by setting up a self managed super fund, having the fund invest overseas, and then using an offshore credit or debit card to access the money.

HOW TO REDUCE THE RISK

Promoters sometimes claim that self managed super funds can be used to 'get around' the above requirements. If you are considering an arrangement that would breach any of these requirements, you should seek independent advice from an Australian tax professional who is familiar with superannuation legislation. Make sure the professional advice is independent of the promoter of the product or arrangement.

If the arrangement or investment being considered sounds too enticing, you should remember the old adage that 'if it sounds too good to be true – it probably is'. See the warnings on our website at **www.ato.gov.au/super**

If you need assistance, you should seek independent advice or contact the Tax Office.

A person must be licensed to give financial advice about self managed super funds.

Do:

- take control of your superannuation for legitimate investment within your fund.

Don't:

- withdraw the benefits before retirement.

EXAMPLE

While surfing the internet, the trustees of a self managed super fund came across a scheme offering to help them get access to the money in their fund before they retired. As they were keen to travel abroad and needed some cash to do so, they decided to follow up the offer.

The details on the website made the whole process sound very easy, so they contacted the promoter to check that it was in accordance with the rules for self managed funds. The promoter assured them it was. To double check, they contacted their financial adviser, who told them that it was illegal to access their funds early.

MEET YOUR LODGMENT AND PAYMENT OBLIGATIONS**Fund income tax and regulatory returns**

All self managed super funds must lodge a combined *Fund income tax and regulatory return* (NAT 0658) with the Tax Office each year.

The lodgment and payment date for all self managed super funds that prepare their own return is 31 October each year. Self managed funds that use a tax agent may get an extended period in which to lodge.

For the regulatory return, trustees are required to have the financial accounts and statements of their self managed super fund audited each year by an approved auditor. The approved auditor must also conduct an audit of the trustees' compliance with the SIS Act and regulations.

Trustees must not lodge the *Fund income tax and regulatory return* until after the audit of the fund has been finalised, as information from the audit report is required to complete the regulatory return.

Trustees of self managed super funds must pay an annual supervisory levy (currently \$45) to us when they lodge the return.

Do:

- lodge the combined income tax and regulatory return for your fund each year, providing all the information required in both parts
- seek an extension to lodge if you are having trouble lodging by the due date
- correctly calculate capital gains tax in the income tax return, for example, make sure you calculate the discount correctly
- use the tax statement guide provided by managed trusts to ensure capital gains are calculated correctly. The tax statement guide instructs you on how to correctly calculate and declare the capital gain
- hold life insurance policies in your fund's name so that you can claim a deduction for the fund in the income tax return.

Don't:

- lodge incomplete returns or lodge the income tax return and the regulatory return separately
- lodge the return late
- lodge the return before you have received the report from your approved auditor.

EXAMPLE

A self managed super fund is established on 10 June. Even though this is only a few weeks before the end of the financial year, the fund must lodge an income tax and regulatory return, together with an audit report from an approved auditor, for that financial year.

Surcharge lodgment

All self managed super funds are required to report *all* member details to us by 31 October³ following the end of each financial year. We use this information to determine whether members have a surcharge liability in a particular year. A fund must report even if no contributions are received so that we know which funds haven't lodged their member contributions statement and which haven't received any contributions.

The fund is required to pay any surcharge liability within one month of receiving an assessment from the Tax Office.

Do:

- lodge a member contributions statement so that we can assess your fund's surcharge liability – otherwise you run the risk of substantial penalties
- lodge a member contributions statement even if your fund has not received any contributions for a member during the year
- lodge a member contributions statement to enable a member's super co-contribution to be paid.

Don't:

- lodge a paper member contributions statement if you are a self-assessing superannuation provider – you must lodge electronically. Phone **13 10 20** to check if you are a self-assessing superannuation provider and to find out how to lodge electronically.

EXAMPLE

The two trustees of a self managed super fund lodge a member contributions statement for the fund. They provide details of only one of the members as the other member did not make any contributions for the year. Their accountant advises them that they must also provide details for the member who did not contribute so that the Tax Office can assess the fund's surcharge liability for the year.

REPORT INFORMATION ABOUT BENEFITS PAID TO MEMBERS

The reasonable benefit limit system limits the amount of benefits a person may receive at the concessional tax rate during their lifetime. Part or all of a benefit received may be subject to a higher rate of tax. We record benefits paid to members of superannuation funds and eligible termination payments paid to employees to calculate whether they have exceeded their reasonable benefit limit.

All self managed super funds are required to report information about benefits (superannuation pensions, annuities and eligible termination payments) paid to members. This is to ensure that we can determine if a taxpayer has exceeded their reasonable benefit limit, and that the correct tax is paid.

Information relating to payments must be sent to us within 14 days of the end of the month in which the payment was made. For example, a benefit payment made on 1 July would have to be reported by 14 August. Information can be lodged electronically or in paper form. For more information on reporting see *Reasonable benefit limits (RBLs) – new or amended benefit reporting form* (NAT 2933) at www.ato.gov.au

Do:

- report payments made to members
- report within the required time.

Don't:

- leave out pension payments.

EXAMPLE

The trustees of a self managed super fund pay benefits to members on 1 April, 13 April and 29 April. They complete the relevant reasonable benefit limit forms and send them to the Tax Office by 14 May.

³ Except for self-assessing superannuation providers who are required to report electronically when they lodge their income tax and regulatory return.

COMPLETE AND LODGE AN ACTIVITY STATEMENT FOR GST

If the annual turnover of a self managed super fund exceeds \$50,000, the fund is required to register for GST and lodge a *Business activity statement* at the end of each reporting period.

The majority of self managed super funds will not reach the turnover threshold for mandatory GST registration as the following are not counted as turnover:

- contributions received by the fund
- dividends
- interest
- unit trust distributions
- death and/or total and permanent disability payments
- bank deposits or loans
- amounts related to acquiring or disposing of securities such as shares, bonds, debentures and units in managed funds
- rents received on residential property (but rental of commercial property is included in the turnover calculation)
- amounts related to transferring capital assets (for example, the sale of commercial property or other fund assets, such as shares and investments)
- supplies to associates for no consideration
- supplies not connected with Australia
- supplies not connected with an enterprise (for example, private sales)
- payments of money made to settle a claim under an insurance policy.

A self managed super fund is not required to be registered for GST if its annual turnover is less than \$50,000 and therefore is not required to lodge an activity statement to account for GST.

Do:

- lodge an activity statement if required, and lodge on time.

Don't:

- leave out relevant information.

For more information on GST, please refer to the *Guide to the ABN, GST and PAYG for the superannuation industry* (NAT 2944). This publication and other information relating to GST and superannuation funds are available on our website at www.ato.gov.au

AUDITORS' OBLIGATIONS

Trustees of a self managed superannuation fund are required, each year or part year that the fund is in existence, to appoint an approved auditor to audit the operations of the fund.

The audit of a self managed super fund covers two areas: a compliance audit that assesses the fund's overall compliance with the SIS Act and regulations, and a financial audit to assess the fund's financial statements.

Trustees must provide the auditor with any relevant documentation requested to enable the auditor to finalise the audit.

The auditor must:

- provide an audit report in the approved form for the trustees to use when completing the regulatory section of the combined *Fund income tax and regulatory return*, and
- bring to the attention of trustees any concerns about the fund's financial position or its compliance with the SIS Act and regulations, and inform the Tax Office if they are not satisfied with the trustees' response.

Since 1 July 2004 changes to the SIS Act (as a result of the *Superannuation Safety Amendment Act 2004*) expand the role of auditors and provide us with direct information about fund non-compliance.

Under the legislation, auditors must now advise us of certain breaches of the SIS Act and regulations that they become aware of during any audit they conduct on or after 1 July 2004, regardless of the year they are auditing. This is in addition to the existing auditor obligation to report breaches to trustees.

Most significantly, auditors must advise us if they form the opinion that:

- a breach has occurred, may be occurring or may occur in the future, and it is of such a nature that it may affect the interests of members, and/or
- the financial position of the fund may be, or may be about to become, unsatisfactory.

We have worked with professional associations to provide auditors with guidelines that detail the specific breaches they must report.

We have prepared forms, instructions and a guide to help auditors report these breaches. These publications contain a full list of the breaches that must be reported, and are available at ato.gov.au/super or by phoning **13 10 20**.

We are also working with key professional bodies to ensure that auditors are aware of their new obligations.

TAX AGENTS' OBLIGATIONS

Tax agents who prepare or lodge a document with the Tax Office on behalf of another person, and receive a fee for that service, must be registered under the *Income Tax Assessment Act 1936*. This also includes giving advice about these documents and other transactions with the Tax Office.

Registration is administered by each of the state Tax Agents' Boards. The location of a tax agent's main office determines which Tax Agents' Board is responsible for their registration. Trustees can check if a tax agent is registered by going to www.tabd.gov.au and searching the 'List of tax agents'.

Trustees must provide their tax agent with a signed declaration before the tax agent can lodge documents with the Tax Office. Trustees must also declare the information provided to their tax agent to be true and correct in accordance with sections 388-70 and 388-75 of the *Taxation Administration Act 1953*. When a notice of assessment is sent to the address of the trustee's tax agent, the tax agent must forward the notice, or a copy of the notice, to the trustee.

Other information regarding the responsibilities of a tax agent can be found on the Tax Agents' Board website.

FINANCIAL ADVISERS' OBLIGATIONS

When using the services of a financial adviser, trustees should confirm that the planner is appropriately licensed or authorised to provide advice.

A person who provides financial advice is required to be either licensed or authorised under the *Corporations Act 2001* (although there are certain exemptions). These requirements are administered by the Australian Securities and Investments Commission (ASIC). Trustees may use the searching facility on ASIC's website at www.asic.gov.au to confirm whether a particular person holds an Australian Financial Services Licence or is an Authorised Representative of an Australian Financial Services Licensee.

Under an Australian Financial Services Licence, financial advisers have obligations relating to:

- conduct and disclosure
- the provision of financial services
- the competence, knowledge and skills of responsible officers, as well as their good fame and character
- the training and competence of representatives and authorised representatives
- compliance and risk management
- the adequacy of financial, technological and human resources, and
- dispute resolution and compensation arrangements (if clients are retail clients).

These obligations are explained further in ASIC's policy statements and guides at www.asic.gov.au

WHAT YOU CAN EXPECT

03

There are consequences if trustees, auditors, tax agents and financial advisers do not meet their obligations in relation to self managed superannuation funds.

CONSEQUENCES OF BREACHES BY TRUSTEES

Where we find that trustees of a self managed superannuation fund are making a genuine effort to meet their obligations, we attempt to work with them to help them rectify the situation. However, we take a firm approach with trustees who fail to make a genuine effort or set out to deliberately avoid meeting their legal obligations.

In some instances there are mitigating circumstances and we consider these on an individual fund basis. Initially, all we may do is work with the trustees to rectify the breach. If they can do so satisfactorily, we will not take any further action.

Where the breach is not rectified satisfactorily, there are a number of penalties we can apply. Trustees can expect us to be progressively more rigorous and severe in applying penalties if the breach is deliberate, repetitive or reckless.

If trustees breach the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and/or the *Superannuation Industry (Supervision) Regulations 1994* (regulations) we can:

- accept an undertaking from the trustees to rectify the breach
- freeze the assets of a fund
- disqualify trustees
- suspend or remove trustees
- make a fund non-complying, and/or
- seek civil and/or criminal penalties through the courts.

This section explains these powers and their consequences.

ACCEPT AN UNDERTAKING

We recognise that breaches may occur as a result of the lack of knowledge of trustees or due to other difficulties that trustees may face in fulfilling their obligations. Therefore, where we find that trustees are genuinely making an effort to meet their obligations, we work with them to rectify the situation.

The SIS Act allows us to accept a written undertaking from trustees to complete certain actions. When we accept an undertaking from trustees, that undertaking then becomes enforceable. If the trustees do not comply with the conditions of the undertaking, we can apply to the court for an order directing the trustees to comply.

An undertaking involves us working with the trustees to return a self managed super fund to a complying position. For example, if the fund acquired a residential property from fund members, the undertaking would need to include the fund disposing of that property.

CASE STUDY

The Tax Office accepted an undertaking from trustees in the following circumstances.

An elderly couple who were the trustees of a self managed super fund did not have a bank account for the super fund. Instead, they had one bank account in the name of a unit trust that held money of the fund, the unit trust and a related company.

We contacted the trustees and explained that they had breached the SIS Act because they did not keep the money of the fund separate from that of other entities. They explained that they did not know they needed a separate bank account for each of the entities and had maintained the one account because they did not want to open new accounts.

The trustees were not willing to open a separate bank account for the fund and instead proposed via an undertaking that they wind the fund up within 60 days, ensuring that all superannuation fund moneys were paid out correctly, and that they provide evidence of this. Given that their age would allow them to legally take the benefits out, we accepted this undertaking. The trustees provided proof that the undertaking had been complied with and we took no further action.

Had the trustees failed to comply with the terms of the undertaking, we would have applied to the courts to enforce the undertaking and/or take whatever action the court deemed appropriate, which may include an additional monetary penalty.

FREEZE ASSETS OF THE FUND

Where we investigate potential breaches and determine that the assets of a self managed super fund are at risk, we can, with ministerial consent, direct the trustee or investment manager not to dispose of or otherwise deal with any fund assets.

We would generally take steps to freeze fund assets where complex breaches are involved and members' benefits are likely to be eroded during the course of an investigation. In these situations, we would probably impose other penalties, such as disqualifying trustees and making the fund non-complying, once we had concluded the investigation.

CASE STUDY

The Tax Office froze the assets of a fund in the following circumstances.

As a result of information received from the community, we became aware that trustees of a self managed super fund had rolled benefits from an independently managed fund into their self managed super fund and were accessing the fund's money earlier than they could legally do so. After receiving ministerial consent, we froze the fund's assets. This meant that the trustees could not dispose of or deal with these assets.

We then conducted an investigation, confirming that the fund's assets were being accessed early under a scheme. We worked collaboratively with the Australian Securities and Investments Commission, which commenced its own investigation.

Court injunctions were imposed on the scheme promoters involved, restraining them permanently from:

- advertising or promoting any business facilitating the early release of superannuation interests
- maintaining, promoting or marketing any business that facilitates the rollover, redemption or transfer of superannuation interests
- receiving or dealing with the redemption of a superannuation interest, and/or,
- charging a fee or commission for facilitating the redemption, rollover or transfer of superannuation interests.

If the promoters do not uphold these conditions, they would be in contempt of court and face prosecution.

The individuals who rolled their money into the self managed super fund will have their income tax returns amended. They will also need to include the amount as assessable income in their income tax returns. The benefits paid to the individuals will be taxed at their marginal tax rate, rather than the concessional tax rates allowed for eligible termination payments. This could result in them paying 48.5% tax on the amount, rather than no tax. The trustees of the self managed super fund will be disqualified, which means they cannot be a trustee of any superannuation fund. If they do act as a trustee, the maximum penalty is two years imprisonment.

DISQUALIFY A TRUSTEE

Where a trustee has intentionally disregarded the law or has a poor history of compliance, we will take a firmer approach by disqualifying the trustee. This means that the trustee will be prohibited from acting as a trustee of a superannuation fund. That person's benefit must be transferred to an independently managed superannuation fund. Further, the fund that the trustee was a member of may need to make certain arrangements if the remaining trustees wish the fund to continue to meet the definition of a self managed super fund. This could mean appointing a corporate trustee or appointing another individual trustee. Alternatively, the trustees may decide to wind up the fund.

We disqualify a trustee to ensure that a person who has failed to fulfil their trustee obligations is prevented from carrying out these duties in the future.

Before we disqualify a trustee, we send them a 'show cause' letter and a position paper, outlining the reasons why we believe they should be disqualified. The trustee has an opportunity to respond before being disqualified. Once they are disqualified, we publish a notice in the Commonwealth Gazette, giving details of the disqualification. Where a disqualified person acts as a trustee, the penalty is two years imprisonment.

⚠ Please note, once we notify a person that they are disqualified, they are permanently prohibited from acting as a trustee of a superannuation entity or as a responsible officer of a body corporate that is a trustee of a superannuation entity.

CASE STUDY

The Tax Office disqualified trustees in the following circumstances.

The trustees of a self managed super fund did not have the property of the fund in the fund's name. Rather, the asset was in the name of a company that went into liquidation. The liquidator seized the asset but was then shown evidence that the fund did in fact own the property.

The trustees sold the property privately to repay some of the company's debts and lent a portion of the money to one of the trustees. The property was the fund's only asset.

The trustees breached the SIS Act because they did not keep the fund's assets separate from the assets of other entities, because they lent the fund's money to members of the fund, and because they lent money to a related company.

We issued a 'show cause' letter outlining reasons why we believed the trustees should be disqualified. The trustees did not respond and were disqualified, so they can no longer act as trustees of a superannuation entity. We also referred the trustees to the Australian Government Solicitor for consideration for prosecution.

SUSPEND OR REMOVE A TRUSTEE

We can also take steps to suspend or remove a trustee, or all of the trustees, of a self managed super fund. This would generally occur if an individual has inadvertently been fulfilling the role of a trustee while they were disqualified. We would move to suspend a trustee if their disqualification was for a set period of time, and would remove a trustee where their disqualification was ongoing.

If we suspend a trustee, a company or an individual must be appointed to act as trustee during the period of suspension. The appointee is called the acting trustee.

If we remove a trustee, that trustee's benefit must be transferred to another complying superannuation fund and the remaining trustees must make further arrangements to ensure the fund meets the definition of a self managed super fund. This could mean appointing a corporate trustee or appointing another individual trustee. The fund could also be wound up.

CASE STUDY

The Tax Office removed a trustee in the following circumstances.

A person who was bankrupt set up a self managed super fund. Bankrupts are not allowed to act as a trustee of any superannuation fund. We wrote to the trustee requesting further information and instructing that they resign as trustee. The trustee responded, stating that he does not intend to resign.

We removed the trustee of the fund and appointed an acting trustee. We then required the acting trustee to wind up the self managed fund and roll the remaining superannuation benefits into an independently managed super fund. The trustee who was removed may be subject to additional enforcement action, such as prosecution.

MAKE A FUND NON-COMPLYING

Where we identify that a self managed super fund has repeatedly failed to comply with its obligations under the SIS Act, there are multiple breaches, or a breach is significant, we may take steps to make the fund non-complying. Due to the harshness of this penalty, the decision to make a fund non-complying is not taken lightly.

Where we make a self managed super fund non-complying, the fund's income is subject to a tax rate of 47%. If a fund moves from being complying in one year to non-complying in the next, the amount subject to the 47% tax rate includes the total of the fund's assets at the start of the year that the fund was made non-complying (less undeducted contributions).

Before we make a fund non-complying, we send a 'show cause' letter and a position paper to the fund outlining reasons why we believe the fund should be made non-complying. The trustees are given an opportunity to respond. If we are not satisfied with the response, we will make the fund non-complying and remove it from the Register of Complying Superannuation Funds. We also amend the fund's income tax returns accordingly.

CASE STUDY

The Tax Office made a self managed super fund non-complying in the following circumstances.

A married couple set up a self managed super fund, invested in a related trust (a trust they managed), and then used the money to pay off the mortgage on their home.

We sent a letter to the trustees explaining that they had breached the SIS Act's sole purpose test as the members used the money in the fund to pay for their own residential property. They had also breached the Act by receiving financial assistance from the fund.

When the trustees did not respond, we made the fund non-complying. This meant that the fund's income was taxed at 47%, resulting in it owing significantly more than it would have owed had it been complying and taxed at 15%.

This fund was made non-complying from the date of its establishment, which meant that the fund's income from the date of establishment was subject to tax at the rate of 47%. It's important to note that if a fund is treated as 'complying' in one year and becomes 'non-complying' in the next, the amount subject to the 47% tax rate includes the fund's total assets (less any undeducted contributions).

IMPOSE CIVIL AND CRIMINAL PENALTIES

At times, we will also seek civil and criminal penalties under the SIS Act. We generally seek such penalties where disqualifying the trustee or making a fund non-complying is viewed as an insufficient deterrent in the community. For instance, there have been circumstances where trustees of a self managed super fund have lent all the fund's money to themselves and spent it. In these situations, we may seek civil and/or criminal penalties, depending on the circumstances of each case.

Civil and criminal penalties apply to the majority of breaches under the SIS Act. A maximum penalty of \$220,000⁴ (civil proceedings) and/or five years imprisonment (criminal proceedings) may apply.

CASE STUDY

An accountant identified numerous compliance issues with a self managed super fund and referred the details to the Tax Office.

The trustees of the fund lent money to themselves on several occasions in a financial year. A loan contract and repayment schedule were prepared. In the following year, they again lent money to themselves. Lending to members is prohibited and a civil penalty applies under the SIS Act.

We informed the trustees that they were not allowed to lend money to themselves and instructed them to repay the loans, with interest. They refused. As a result, we informed them that if they did not repay the money, their fund would be made non-complying. In addition, they could face prosecution, with a maximum penalty (civil proceedings) of \$220,000.

IMPOSE PENALTIES FOR FAILURE TO MEET LODGMENT OBLIGATIONS

In addition to breaches of the SIS Act outlined above, a number of lodgment obligations detailed in section 02 will result in the Tax Office taking specific action if trustees fail to comply. While we review the circumstances of each breach on an individual basis, the likely consequences of these breaches are as follows.

- If we find that a self managed super fund has not lodged the necessary returns, and providing the fund does not have a poor compliance history, we will explain to the trustees the fund's obligations and the penalties that can be imposed for failure to lodge. The general interest charge will apply to the late lodgment of income tax returns.
- If the trustee has a poor compliance history or has failed to respond to an informal request to lodge, we will pursue prosecution action and may impose penalties.

⁴ Based on a penalty unit of \$110 at time of printing. Penalty units are subject to change.

CONSEQUENCES OF BREACHES BY AUDITORS

Auditors also have a requirement under the SIS Act to perform certain duties. These duties include, from 1 July 2004, reporting to the Tax Office any breaches affecting the interests of members of a self managed super fund.

We view auditors as critical to the integrity of the self managed super fund system and take the obligations of auditors very seriously. We constantly review the work of auditors to ensure that they are complying with their duties and obligations to identify and report breaches, both to trustees and to us.

If we find that an auditor has failed to identify and report a breach or has reported incorrect information, we will look at the circumstances of the case and determine appropriate action. We may:

- request the auditor to undertake remedial training
- report the auditor to their professional body
- disqualify the auditor, and/or
- prosecute the auditor.

REQUEST AN AUDITOR TO UNDERTAKE REMEDIAL TRAINING

Where an auditor has made a genuine attempt to fulfil their responsibilities but has failed to meet their obligations due to a lack of knowledge, we will encourage them to undertake additional training through their professional association.

We will then monitor future audit reports to ensure that the auditor is capable of meeting their obligations.

CASE STUDY

The Tax Office reviewed an approved auditor who had audited their first self managed super fund during the financial year. The auditor was unaware of our guidelines specifying that the audit report had to be in an approved form. Instead, they performed a traditional financial audit of the fund. They did not undertake a compliance audit because of their lack of knowledge.

The auditor had a good record with the Tax Office, and the fund did not have any breaches. We recommended that the auditor attend a one-day workshop to ensure they had sufficient skills to undertake future audits of self managed super funds.

CASE STUDY

While auditing a self managed super fund, an auditor identified a lease agreement involving a motor vehicle purchased by the fund and leased on commercial terms to a member's relative. After checking the arm's length nature of the transaction, and confirming that the total annual lease payments were less than 5% of the fund's assets, the auditor concluded that the fund was not being disadvantaged and that no breach of the SIS Act had occurred.

However, we found that the market value of the leased asset was more than 5% of the fund's value and, as such, the fund had breached the in-house asset provisions. The auditor had not realised that the value of the asset subject to the lease, rather than the value of the lease payments, must be counted for in-house asset purposes. We felt the auditor's failure to identify the breach warranted further training and recommended they attend a one-day workshop.

REPORT AN AUDITOR TO THEIR PROFESSIONAL BODY

At times, an auditor's lack of knowledge or quality control procedures place at risk the funds they are responsible for. In these situations, we will immediately report the auditor to their professional association for appropriate disciplinary action.

We will also report an auditor to their professional association where we identify that they have repeatedly failed to fulfil their obligations during multiple audits in the same year.

CASE STUDY

While reviewing a self managed super fund, the Tax Office examined the auditor's procedures and working papers. While the fund had not breached the SIS Act or regulations, we found that the auditor's opinion was not supported by sufficient working papers. In addition, there was no evidence of any audit plan and program to direct the audit procedures. Our examination of other audits done by that person identified similar problems. We referred the auditor to their professional association for disciplinary action.

DISQUALIFY AN AUDITOR

Where an auditor has failed to adhere to professional standards, or failed to identify substantial breaches that a competent auditor would have identified, we will disqualify the auditor. This means that the auditor is prohibited from acting as an approved auditor of any superannuation fund. We will also notify the auditor's professional associations.

Before we disqualify an auditor, we send them a position paper, outlining reasons why we believe they should be disqualified. A 'show cause' letter gives the auditor an opportunity to respond. Once they are disqualified, we publish a notice in the Commonwealth Gazette, giving details of the disqualification.

If the auditor is dissatisfied with our decision, they may request an internal review, within 21 days of receiving notice of their disqualification. If the auditor continues to be dissatisfied with our decision, they may apply to the Administrative Appeals Tribunal for a review.

CASE STUDY

While reviewing the audit of a self managed super fund, the Tax Office identified a number of serious breaches. These included a loan to members of \$80,000 and the acquisition of a residential rental property from a member. The auditor failed to detect these breaches. We selected for review a further two funds audited by the same person. We found that both had inadequate working papers. Further, in one case the auditor demonstrated a lack of independence as they were also the fund accountant and had been involved in the day-to-day running of the fund. We intend to issue a 'show cause' letter to the auditor, advising our intention to disqualify them and refer them to their professional body.

PROSECUTE AN AUDITOR

An auditor can also face prosecution for committing certain offences in relation to their responsibilities for superannuation funds. These 'prosecutable offences' can be found in the SIS Act. An example of a prosecutable offence is the failure of an approved auditor to advise us of serious breaches identified during a fund audit. Another example is where an individual falsely represents themselves as an approved auditor.

Where an approved auditor commits a prosecutable offence, we will consider any mitigating circumstances, then decide whether to prosecute.

CASE STUDY

While cross-checking an auditor's professional association membership number with the records of their professional association, we found that the auditor was not actually a member of that association, or of any recognised professional association. As a result, the individual was prosecuted for falsely representing himself as an approved auditor.

CONSEQUENCES FOR TAX AGENTS NOT PERFORMING THEIR DUTIES

Tax agents must diligently attend to the business of their clients in income tax matters, including obligations in relation to lodging of returns, passing on correspondence, responding to phone calls and releasing documents.

Further information can be obtained from the Tax Agents' Board website at www.tabd.gov.au

CONSEQUENCES FOR FINANCIAL ADVISERS NOT PERFORMING THEIR DUTIES

The Australian Securities and Investments Commission (ASIC) will act to ensure that financial advisers who act dishonestly and in breach of the law are removed from the industry.

Financial advisers must ensure that they comply with their obligations as an Australian Financial Services licensee. Find out more by visiting the ASIC website at www.asic.gov.au and reading:

- section C of Policy Statement 164, *Licensing: Organisational capacities* [PS 164]
- Australian Standard AS 3806-1998: *Compliance programs*. This is a useful benchmark to use as a guide in planning and implementing compliance measures, processes and procedures. To get a copy of AS 3806-1998, visit the Australian Standards website at www.standards.com.au
- *Small business and your AFS licence: Compliance with Policy Statement 164*, which provides examples of checklists and measures that small businesses can tailor to their needs.

WHAT ATTRACTS OUR ATTENTION

04

Our compliance activities identify self managed superannuation funds and individuals for further investigation.

HOW WE IDENTIFY FUNDS FOR AUDIT AND TRUSTEES FOR REVIEW

In 2004–05 we are increasing our compliance focus on self managed superannuation funds. Under recent changes to the SIS Act (as a result of the *Superannuation Safety Amendment Act 2004*) auditors must now advise us of certain breaches of the SIS Act and regulations that they become aware of during any audit they conduct on or after 1 July 2004, regardless of the year they are auditing. We will closely examine the information we receive from approved auditors about breaches they identify during the fund audit. This information will be a major component in our assessment of the risk of fund non-compliance. However, we will also use information from income tax and regulatory returns, referrals from the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) and the community.

As part of this, there are a number of fund characteristics we use to help select funds for audit. Research shows that funds with one or more of the following characteristics may be at a higher risk of non-compliance.

A fund's assets include a linked (or related) trust.

A linked or related trust is a trust controlled by individuals or corporations who are related to, or associates of, the fund trustees. This potentially presents a conflict of interest, as transactions may not be made on a commercial basis. It may also indicate that the fund has not been established solely for providing retirement benefits for its members, thereby putting members' benefits at risk.

A fund has been in existence for more than five years and has not yet been selected for review.

We have found that funds that have not been reviewed for more than five years are at greater risk of not meeting their obligations, thereby endangering members' retirement benefits.

A fund has a low asset value (under \$40,000) and has not yet been selected for review.

Funds with low asset values can have diminished potential to generate returns due to their operational costs. Funds with low asset values are also at risk of not having a sufficiently diversified portfolio of assets, therefore subjecting members' benefits to increased risk. Our experience also shows that funds with low asset values are sometimes used for early access.

A fund claims non-specified deductions that appear to be high compared to its asset value.

We expect that most deductions should be able to be specified. Large non-specified deductions may indicate that deductions are not legitimate claims.

A fund claims amounts at the salary and wages label.

A claim for 'salary and wages' on a fund income tax return may indicate that the fund is running a business and potentially not meeting the sole purpose test.

A fund claims excessive management and investment expenses.

Much larger than average deductions claimed for management and investment expenses may indicate that the expenses need to be substantiated.

A fund reports employer contributions in its income tax and regulatory return, but does not send a corresponding member contributions statement to the Tax Office.

Employer contributions to a fund must be reported annually on a member contributions statement. We use this statement to assess a fund's surcharge liability. Failure by a fund to lodge a member contributions statement may therefore indicate deliberately avoiding paying the surcharge.

A fund that pays a lump sum or begins to pay a pension to a member.

Funds must report both these payments to us. We require this information to determine if reasonable benefit limits have been exceeded. Failure to notify us of such payments may indicate a deliberate attempt to avoid reasonable benefit limit liabilities.

A fund is established and wound up in the same year.

This may indicate that the fund was established for purposes other than accruing benefits for retirement.

A fund has experienced a significant drop in asset value but has no reported benefit payouts.

This may indicate that benefits have been accessed illegally.

A fund has the same address for service as the reported auditor.

This may indicate that the auditor is also responsible for preparing the fund's accounts and financial statements, and therefore would not be acting independently.

A fund reports offshore investments.

We are aware of certain schemes involving offshore investments through self managed super funds that result in illegal early access to preserved benefits.

A fund reports substantial borrowings in relation to the asset value of the fund.

Large borrowings suggest that the fund has breached the borrowing restrictions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), and may be putting the fund's investments at risk.

A fund reports an acquisition from a related party.

Acquisitions from related parties are prohibited because of the risk that market value may not be obtained and the subsequent risk that the fund's investment returns will suffer. There are certain exceptions to this rule (see page 9).

The areas that we consider to be high risk do change. For the latest information on the risks we are targeting, please refer to our annual *Compliance program* available at www.ato.gov.au

HOW WE IDENTIFY AND INVESTIGATE EARLY ACCESS SCHEMES AND THEIR PROMOTERS

Self managed super funds are sometimes promoted as a way of accessing superannuation before retirement. This is illegal. In 2004–05 we are increasing our focus on promoters who target individuals to use self managed super funds as vehicles to gain 'early access' to retirement income. We identify these types of scheme arrangements through various means, including:

- monitoring advertisements on the internet, in newspapers and on radio
- monitoring AUSTRAC data
- obtaining information from the community and from other government agencies, and
- obtaining feedback from financial institutions, superannuation funds, administrators and financial advisers.

We use this information and data held on our own systems to identify promoters and individuals participating in these schemes, and determine our compliance approaches.

Our approaches could include:

- disqualifying trustees of self managed superannuation funds who participate in these schemes
- assessing promoters on the income they derive through early access activity
- referring promoters to ASIC with recommendations for their follow-up action
- taxing the superannuation funds as non-complying
- removing suspect funds from Register of Complying Superannuation Funds
- assessing individuals who have participated in the schemes – the withdrawn benefits will be taxed at the individual's marginal rate and penalties will be imposed where applicable.

WORKING WITH OTHER GOVERNMENT AGENCIES AND PROFESSIONAL ASSOCIATIONS

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We collaborate with other agencies that have an interest in superannuation.

The Tax Office collaborates with other federal agencies that have an interest in superannuation. In some cases, there are memorandums of understanding between government agencies to exchange data and information.

AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION (ASIC)

ASIC regulates and enforces laws that promote honesty and fairness in financial products and services, in financial markets, and in Australian companies. As the consumer protection regulator for financial services, ASIC protects investors, superannuants, depositors and insurance policy holders. Information and warnings for investors about protecting their investments and dealing only with licensed financial advisers can be found at www.fido.asic.gov.au

We collaborate in joint investigations with ASIC regarding superannuation. We also exchange data relating to illegal early access to superannuation. Where we suspect that promoters or individuals are using self managed superannuation funds to gain illegal early access to superannuation, we may recommend criminal investigations of both promoters and participants. This is often done jointly with ASIC. Such investigations may lead to the referral of matters to the Commonwealth Director of Public Prosecutions.

In the course of these investigations, we may liaise with other agencies such as the Australian Competition and Consumer Commission, and internal Tax Office groups such as the Tax Agent Integrity Unit, Serious Non-Compliance and Aggressive Tax Planning Groups.

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA)

For superannuation matters that overlap their respective jurisdictions, the Tax Office and APRA have an agreement to exchange confidential information and data in accordance with the relevant statutory provisions, and cooperate on other matters relating to superannuation. We also work closely on superannuation circulars, other information products and media activities. We work together to administer legislation consistently and provide guidance to the superannuation industry and related practitioners.

PROFESSIONAL ACCOUNTING ASSOCIATIONS

We are working with professional associations to ensure the proficiency of auditors of self managed super funds. We often attend seminars conducted by professional associations and, when invited, also present at these seminars. In addition, we conduct workshops that focus on specific topics of superannuation to hear and collate feedback from the superannuation industry.

SUPERANNUATION INDUSTRY LIAISON GROUP

We have always placed importance on the need to work closely with industry so that our policies are developed and implemented in a manner that meets the expectations of the community and government.

We established the Superannuation Industry Liaison Group to consider ways to re-design existing procedures and protocols and help improve the management of superannuation administrative issues. The group includes representation from several professional accounting, tax and financial planning associations, as well as the superannuation industry.

The group works closely with other established Tax Office consultative forums such as the Business Systems Working Group and the various legislative discussion groups sponsored by the Tax Office that involve lawyers, retirement product providers and intermediaries.

ADDITIONAL REFERENCES

You may find the following self managed superannuation products helpful.

To order any of these products phone our Publications Ordering Distribution Service on **1300 720 092**.

Self managed superannuation funds – fact sheets		Description
NAT no.	Product name	
2057	<i>Introduction to superannuation – for self managed superannuation funds</i>	Describes how superannuation is a long-term savings arrangement that operates primarily to provide income for retirement.
2058	<i>What is a self managed superannuation fund?</i>	Defines what a self managed superannuation fund is.
2059	<i>Setting up a self managed superannuation fund</i>	Provides a guide to the steps involved in setting up a fund. Topics covered include: <ul style="list-style-type: none"> ■ obtaining a trust deed ■ appointing trustees ■ electing to become a regulated fund, and ■ obtaining a tax file number and Australian business number.
2060	<i>Duties of trustees</i>	Explains that trustees of self managed super funds are ultimately responsible for the running of their fund. It is imperative that each trustee understands the duties, responsibilities and obligations of being a trustee.
2061	<i>Sole purpose test</i>	Explains that the object of the sole purpose test is to ensure that self managed super funds are maintained for the purpose of providing benefits to members upon their retirement.
2062	<i>Acceptance of contributions</i>	Explains to trustees of self managed super funds the minimum standards relating to the acceptance of contributions prescribed under the <i>Superannuation Industry (Supervision) Act 1993</i> (SIS Act).
2063	<i>Investment strategy and investment restrictions</i>	Explains that investment management is a key area of responsibility for trustees of self managed super funds.
2064	<i>Administrative obligations</i>	Explains the range of administrative obligations imposed on self managed super funds under the law.
2065	<i>Our compliance approach</i>	Explains that self managed super funds with fewer than five members must comply with the rules and are encouraged to self regulate.
2067	<i>Election and return lodgment – APRA or the Tax Office (self managed superannuation funds)</i>	Explains the process for election and annual return lodgments and whether the Tax Office or APRA regulates and manages the process.
2069	<i>Checklist for self managed superannuation funds (long version)</i>	Highlights some of the more important rules under the SIS Act that a trustee must comply with.
2070	<i>Preservation rules</i>	Explains that trustees of self managed super funds are required to comply with the preservation rules set out in the SIS Act.
2071	<i>Payment of benefits</i>	Explains that trustees of self managed super funds need to know the requirements of the SIS Act when paying benefits from their fund.

4591	<i>Actuarial certificates</i>	Outlines the two distinct purposes for which a self managed super fund may need to obtain an actuarial certificate in relation to pensions.
6854	<i>Checklist for self managed superannuation funds (short version)</i>	Designed to draw attention to details that a trustee of a self managed super fund must be aware of in operating a fund.
6733	<i>Allocated pension payments</i>	Explains allocated pension payments for self managed super funds. The Superannuation Industry (Supervision) Regulations 1994 require a pension payment at least annually.
6732	<i>Allocated pension deductions and rebates</i>	Explains whether a recipient receives a deductible amount and a tax offset (rebate) on an allocated pension/annuity.
6730	<i>Tax implications for allocated pensions</i>	Explains that if your fund pays a pension there are two methods it can use under the <i>Income Tax Assessment Act 1936</i> to exempt from tax that 'proportion' of the fund's income earned in respect of its current pension liabilities.
6731	<i>Payment for allocated pensions</i>	Explains that a self managed super fund can pay for an allocated pension provided the trust deed allows for the payment of benefits as an income stream.
6734	<i>What is an allocated pension?</i>	Explains that an allocated product can be treated as a pension by meeting specific conditions under the Superannuation Industry (Supervision) Regulations 1994. An allocated pension can be set up within a superannuation fund to pay a benefit as income.
7236	<i>Penalties</i>	Discusses penalties that may apply to self managed super funds that contravene the SIS Act.
10417	<i>Illegal arrangements to withdraw your superannuation</i>	Explains our concerns that schemes involving self managed super funds are being used to gain improper early access to preserved superannuation, and the consequences of being involved in such schemes.

Self managed superannuation funds – circulars

NAT no.	Product name	
8311	<i>Australian Taxation Office Superannuation Circular 2003/1 – valuation of assets</i>	We intend that self managed super funds should use market values for all valuation purposes. This includes valuations for determining the purchase price of a pension and the use of market value accounting for all financial statements. This circular provides the basis for conducting these valuations.

Self managed superannuation funds – publications

NAT no.	Product name	
11032	<i>Self managed superannuation funds – role and responsibilities of trustees</i>	This guide has been written for trustees of self managed super funds as an introduction to the rules governing the operation of these funds as set out in the SIS Act. The decision to become a trustee of a self managed fund should not be taken lightly. Trustees are responsible for ensuring their fund complies with the SIS Act, as well as with many other legislative and administrative requirements.
11375	<i>Self managed superannuation funds – role and responsibilities of approved auditors</i>	This guide outlines the responsibilities of approved auditors of self managed super funds under the SIS Act and the Superannuation Industry (Supervision) Regulations 1994. It also explains what we expect of auditors when conducting audits.
3683	<i>Guide to the ABN, GST and PAYG for the superannuation industry</i>	This provides an outline of elements of The New Tax System. In particular it explains how the Australian business number (ABN), goods and services tax (GST) and the pay as you go tax system apply to the superannuation industry.

General publication

7769	<i>Compliance program</i>	Our Compliance Program details the many compliance issues the Tax Office faces in managing Australia's revenue systems. It also details our responses to managing those issues.
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MORE INFORMATION

If you need more information on self managed superannuation funds, you can:

- visit our website at www.ato.gov.au/super
- phone **13 10 20**
- obtain a fax by phoning **13 28 60**, or
- write to
Superannuation Business Line
Australian Taxation Office
PO Box 277
WTC VIC 8005

If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.

If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

IF YOU WANT TO PROVIDE INFORMATION ABOUT TAX EVASION OR EARLY ACCESS TO SUPERANNUATION SCHEMES

We have set up a tax evasion referral centre to collect information from the community. This information is a valuable part of our compliance program. It is used with other intelligence to help our investigations.

Our website has a link that allows you to report tax evasion and avoidance. The website explains what tax evasion is and provides details about other questions you might have.

To report information about tax evasion to us confidentially you can:

- phone **1800 060 062**
- fax **1800 804 544**
- visit www.ato.gov.au
- write to:

Australian Taxation Office
Tax Evasion Referral Centre
Locked Bag 6050
Dandenong VIC 3175

If you contact us your confidentiality is assured, and you can choose to remain anonymous.

