



## CGT Relief

From 1 July 2017 a cap of \$1.6m will be introduced on the amount a person can transfer into the tax free retirement phase. Anyone with a total retirement phase balance in excess of \$1.6m will generally be required to either commute the excess amount back to accumulation phase or withdraw the excess from superannuation altogether. Further, transition to retirement (TRIS) pensions will not be treated as retirement phase income streams from 1 July 2017.

### Overview

Earnings on assets supporting retirement phase income streams are eligible for an exemption from income tax. To compensate those who will need to transfer assets out of retirement phase in order to comply with the new rules will have access to Capital Gains Tax (CGT) relief on the impacted assets. This CGT relief will allow the Trustee to elect to reset an asset's cost base in 2016-17. This effectively locks in the capital gains tax treatment of the assets up to 30 June 2017 prior to the new rules applying from 1 July 2017. How this relief applies is different depending on several factors.

While beneficial for many Funds the decision to apply the CGT relief is not entirely straight-forward. In this article we highlight two key strategies to consider before making any decisions on applying CGT relief

### Moving to the proportionate method on 30 June 2017 may provide the best outcome for segregated assets

Trustees currently employing a tax strategy, which segregate pension and accumulation accounts, should carefully consider how their asset segregation will impact on applying CGT relief. Assets which were attached to pension assets at 9 Nov 2016 must use the

tax segregation method to claim CGT relief however they have two options for how the relief is applied. An asset can apply the CGT relief if it ceases to be a segregated pension asset in order to comply with the new transfer balance rules.

### Option 1:

If specific segregated pension assets are commuted to reduce the retirement phase balance to below \$1.6m and the assets remain as segregated accumulation assets then only these particular assets are affected by the requirement to comply with the transfer balance cap. This will mean that only the specific assets chosen are eligible to apply CGT relief. Remaining Fund assets, both those in pension and accumulation, will not be affected and as such would not be eligible for the CGT relief.

### Option 2:

The Trustee may decide to unsegregate all segregated pension assets where they do not wish to select specific assets to commute to accumulation (or in fact if they can't because assets are greater in value than the excess required to be commuted). The Fund could cease to treat assets as segregated current pension assets and use the proportionate method from 30 June 2017 in order to comply with the transfer balance cap. This will allow the Fund to apply the CGT relief to all segregated current pension assets on 30 June when assets cease to be segregated current pension assets.

The ATO's Law Companion Guide on applying the CGT relief suggests that Funds that are 100% in pension phase on 9 November 2016 are automatically deemed to be using the segregated method and would therefore need to use this approach to applying the relief. We do not believe this is in line with standard industry practice or our interpretation of the legislation.



Our understanding has always been that a Fund can adopt the proportionate method for the entire financial year where it has both accumulation and pension interests during the year, even if at some points during the year all the assets are supporting pension interests. The SMSF Association will be consulting with the ATO on this as we foresee a number of issues if this approach is pursued.

#### **Are you fully retired? Those who aren't might be better off NOT applying the CGT relief**

For Funds that were using the proportionate method as at 9 November 2016, the CGT relief provisions allow the Trustee to elect for unsegregated assets to lock in the 2016-17 financial years' tax exempt percentage on their unrealised capital gains or losses. While for many this will be advantageous there are certain situations where it may actually be better to retain the existing cost base and not lock in the current tax position on capital gains until the year in which the asset is actually sold. The main argument for not applying the CGT relief and resetting the cost base is where the Fund's tax exempt percentage is expected to increase in the future. This may occur when a Fund member is not yet in retirement phase but is expected to satisfy a condition of release and convert their balance to retirement phase prior to the sale of the asset.

An example of this may be a Fund that over the next three financial years from 2017 to 2019 will experience tax exempt percentages of 60%, 40% and then 80%. One member is in pension and one member is in accumulation in 2017. The change in the tax exempt percentage is caused by the pension member commuting part of their pension back to accumulation

at 30 June 2017 in order to comply with the incoming transfer balance cap, resulting in a lower tax exempt percentage for 2018. At this point it does look like resetting the cost base in 2017 would be a good idea. However let's assume in the 2019 financial year the accumulation member has now satisfied a condition of release and converts their balance to retirement phase. The Fund will have a better tax exempt percentage in 2019 than in 2017.

Based on this example we can see that the decision on whether to apply the CGT relief per asset depends on the timing of future capital gains tax events.

We will consider this decision on a per asset basis. If an asset is expected to be sold in a period where the tax exempt percentage under the unsegregated method is likely to be the same or lower than it is in the 2017 financial year then applying the CGT relief may provide the Fund with a better tax outcome. This may be the case where the trustee does not expect any further movement of member balances into retirement phase and pension assets are expected to reduce over time compared to accumulation balances.

Alternatively, if members are expected to move into retirement phase, or members intend to draw down their new accumulation balances, prior to when the trustee expects to sell an asset then it may be better to NOT apply the CGT relief to that asset.

The CGT relief provides a great opportunity for SMSFs to reset the cost base of Fund assets and lock in capital gains which would currently be tax free or based on a tax exempt percentage that is better than that expected in future income years because of the transfer balance cap. However, while beneficial at first glance there are some scenarios which require further consideration.

**We will be reviewing this, for you, on a one-on-one basis and if we have not already discussed with you, we will be in touch, if your Fund is eligible, to discuss your options.**

## Always Keep Your Investment Strategy in Your Mind

You have made it through the financial year and navigated the new superannuation laws that took effect on 1 July 2017 but there is one thing you should always think about and that is your investment strategy. Additionally, there is no better time than right after a financial year end where you can review your SMSF investment strategy and its performance.

As a trustee you are required to review your investment strategy regularly to ensure it continues to reflect the purpose and circumstances of your fund and its members. An SMSF investment strategy must take into account the following:

- The risks involved in making, holding and realising the SMSF investments, their expected return and cash flow requirements of your SMSF.
- The diversification and composition of your SMSF investments.
- The liquidity of your SMSF investments, having regard to expected cash flow requirements.
- The SMSF's ability to pay current and future benefits to the members.
- Whether to hold insurance cover for each member of your SMSF.

An important requirement for you as trustee of your SMSF is to have an investment objective and a strategy to achieve that objective before you start to make decisions about how you want to invest your SMSF's funds?

Whatever assets you choose for your SMSF to invest in, there must be a clear and obvious retirement purpose in the choices you make. Of equal importance is that the investment objective and strategy is not set in

stone. Trustees can choose to change the investment objectives they have set for their SMSF at any time.



So as an SMSF trustee, your best defence against this uncertainty is to have a clearly defined, well-rounded and long term investment strategy. Not only is your SMSF legally required to have an investment strategy, it is key to guiding you and your fund through uncertain times.

A key aspect of an investment strategy is to consider the diversification of your SMSF's assets. Diversification of your retirement savings across different assets and regions is key to protecting your fund from volatility in financial markets over the long-term.

While it is important to keep track of events that affect financial markets and your superannuation savings, it is important to remember that superannuation is for the long-term and that sometimes, short-term decisions can do more harm than good. A good investment strategy that keeps members disciplined and focused on the long-term is essential.

With any decisions you make as a trustee in relation to your fund's investments strategy and asset allocation, the important things to keep in mind are:

- Try to avoid taking undue risks with your underlying investments, which increases the likelihood of short-term losses. For example, think twice before moving from relatively stable shares to speculative shares even if you think a short-term win will come to your SMSF.

- If the fund is considering payment of an income stream, ensure the cash flow from the asset allocation is sufficient to pay the required amount.
- If there is a relatively long timeframe before benefits become payable from the fund, the potential capital growth of the investment is an important consideration.
- Consider the effects of inflation and protect against the reduction in the real value of the fund's investments.
- All trustees and members of SMSFs have a range of attitudes towards risk and how they see their funds' investments performing over time. When it comes to the fund's investment strategy and asset allocation it is important to carefully consider its overall risk profile or tolerance, including the impact of asset allocations on the overall investment portfolio.

Your investment strategy does need to be reviewed at least once a year and this will be evidenced by your approved auditor. It is also important to review your strategy whenever the circumstances of any of the members change or as often as you feel it is necessary. The following practical tips will help you keep on top of your obligations:

- Put your investment objective and strategy in writing.
- Set an investment objective that you can achieve with the underlying investments you are comfortable to invest in.
- There is no template for an investment objective and strategy, but make sure they reflect how you intend to invest your SMSF's money.
- The investments you actually make must be contemplated by the investment strategy you have set.
- Additionally, document your actions and decisions, as well as your reasons, and keep them as a record in order to demonstrate that you have indeed satisfied your obligations as a trustee in this important area.

### How we help?

As SMSF Specialist Advisors we review your investment strategy each year to ensure that it is in line with your current situation, and if it is not we will help you formulate, execute and review an updated strategy as well as answering any questions or concerns you may have.



## Review your Mortgages

According to Galaxy research, that iSelect arranged, one third of mortgagors have not reviewed their mortgage options in the last five years and over 80% of Australians do not know their mortgage rate.

If you could pay less in interest rates, grow your superannuation benefits faster or just pay less in fees is it not worth knowing about?

There is a misconception that moving lenders is costly and a hassling event, this is not always the case. The potential saving gains that can occur, when switching a loan to one with a lower interest rate, can sometimes be underestimated.

This year we will be encouraging our clients to do an annual home loan check, both outside of their SMSF and within for the Limited Recourse Borrowing Arrangement (LRBA's) in place.

## **\*BEWARE\***

### **Low Cost Providers**

We have had several discussions with clients, and other professionals within the self-managed superannuation fund (SMSF) industry, about low cost providers of accounting and audit work. The ATO have commenced targeting low cost auditors and suppliers.

Kasey Macfarlane, the ATO SMSF Segment Assistant Commissioner said during the interview with the SMSF Association that low-cost audit problems discovered included the failure to confirm fund assets and not reviewing the terms and structures of Limited Recourse Borrowing Arrangements. Kasey continues “In another case, there was an auditor who failed to retain documentation in accordance with the auditing standards and had failed to identify and report two material real contraventions that the ATO had required.<sup>1</sup>”

The ATO are also using various ways to gain additional information on these providers, such as social media, websites, suggestions from individuals and even information supplied in your annual fund tax return. Kasey advised that it was likely more low quality; low cost and non-independent SMSF auditors will be reviewed and forwarded to the Australian Securities and Investments Commission (ASIC)<sup>2</sup>.

One, but not exclusively, of the ATOs concerns are that low cost providers are turning out these audits, or accounts, in a ‘one size fits all’ approach and that your Fund’s individual circumstances are not being actively reviewed or considered, you are but a number. The ATO also now have monetary administrative penalties in place for each Trustee, if individuals, or for the Corporate Trustee, as a single entity. Since 1<sup>st</sup> July 2017 each penalty unit will be \$210, some of these include, but not limited to:

<b>Provision SISA*</b>	<b>Description</b>	<b>Administrative penalty</b>
Subsection 34(1)	Operating standards	20 penalty units at \$210: <ul style="list-style-type: none"> <li>• \$4,200 per individual trustee</li> <li>• \$4,200 per corporate trustee</li> </ul>
Subsection 35B(1)	Accounts and statements	10 penalty units at \$210: <ul style="list-style-type: none"> <li>• \$2,100 per individual trustee</li> <li>• \$2,100 per corporate trustee</li> </ul>
Subsection 65(1)	Lending to members and relatives	60 penalty units at \$210: <ul style="list-style-type: none"> <li>• \$12,600 per individual trustee</li> <li>• \$12,600 per corporate trustee</li> </ul>

<sup>1</sup> <http://www.smsmagazine.com.au/articles/problems-with-low-cost-audits-pinpointed-1>

<sup>2</sup> <http://www.smsmagazine.com.au/articles/problems-with-low-cost-audits-pinpointed-1>

Provision SISA*	Description	Administrative penalty
Subsection 67(1)	Borrowings	60 penalty units at \$210: <ul style="list-style-type: none"> <li>\$12,600 per individual trustee</li> <li>\$12,600 per corporate trustee</li> </ul>
Subsection 84(1)	In house assets	60 penalty units at \$210: <ul style="list-style-type: none"> <li>\$12,600 per individual trustee</li> <li>\$12,600 per corporate trustee</li> </ul>
Subsection 103(1)	Duty to keep minutes	10 penalty units at \$210: <ul style="list-style-type: none"> <li>\$2,100 per individual trustee</li> <li>\$2,100 per corporate trustee</li> </ul>
Subsection 103(2)	Duty to keep minutes of meetings	10 penalty units at \$210: <ul style="list-style-type: none"> <li>\$2,100 per individual trustee</li> <li>\$2,100 per corporate trustee</li> </ul>
Subsection 104(1)	Duty to keep records of changes of trustees	10 penalty units at \$210: <ul style="list-style-type: none"> <li>\$2,100 per individual trustee</li> <li>\$2,100 per corporate trustee</li> </ul>
Subsection 104A(2)	Declaration of recognition of obligations and responsibilities	10 penalty units at \$210: <ul style="list-style-type: none"> <li>\$2,100 per individual trustee</li> <li>\$2,100 per corporate trustee</li> </ul>
Subsection 105(1)	Duty to keep and retain member or beneficiary reports	10 penalty units at \$210: <ul style="list-style-type: none"> <li>\$2,100 per individual trustee</li> <li>\$2,100 per corporate trustee</li> </ul>
Subsection 106(1)	Duty to notify of significant adverse events	60 penalty units at \$210: <ul style="list-style-type: none"> <li>\$12,600 per individual trustee</li> <li>\$12,600 per corporate trustee</li> </ul>
Subsection 254(1)	Information to be given to the Regulator	5 penalty units at \$210: <ul style="list-style-type: none"> <li>\$1,050 per individual trustee</li> <li>\$1,050 per corporate trustee</li> </ul>

\* SISA – Superannuation Industry (Supervision) Act 1993

There are also companies that outsource both the accounting and the audits overseas. They can keep their charges low as they are paying considerable less hourly rates overseas, to their employees/contractors. The work can be done by employees that are unaware of our complex rules. There are also potential issues with auditor independence and audit quality.



## Finalist Announcements

Stellar Super Pty Ltd is in the running to take out several of Australia's most coveted SMSF awards.

We have been shortlisted as finalists in the following awards:

### SMSF and Accounting Awards 2017 – NSW/ACT

- SMSF Firm of the Year
- SMSF Adviser of the Year
- SMSF and Accounting Professional of the Year – Metropolitan
- SMSF Specialist Accountant of the Year

### Women In Finance 2017 - Nationwide

- SMSF Adviser of The Year

We are humbled by this recognition and it is wonderful to be eligible for this accolade.

The winners will be announced on the 21<sup>st</sup> September and the 2<sup>nd</sup> November, in Sydney.

