Nexia Australia

Superannuation Solutions

Welcome

Welcome to the latest edition of our Superannuation Solution Newsletter.

With the Federal Budget for 2020-21 having recently been announced, we have included an article in this month's Newsletter which will hopefully explain in simple language the changes which were and were not announced on budget night

We have also included an article on the effect JobKeeper has on the work test as well as the ATO's new approach to administrative penalties.

We hope you find this newsletter informative. Should you have any questions in relation to how these changes may impact you, please contact one of our SMSF Specialists.

Important Dates

28 November 2020
September Quarter Superannuation Guarantee Charge lodgement and payment if not made before 28 October 2020.

1 December 2020
2020 Tax payment due for medium/large Super Funds

15 January 2021
2020 Tax Returns due for lodgement for medium/large Super Funds

28 January 2021
December Quarter Superannuation Guarantee Charge Contributions due for employers

Federal Budget 2020-21

What Was Announced on Budget Night

The 2020 Federal Budget was presented by The Federal Treasurer Josh Frydenberg on 6 October. Fortunately there were no major changes to the taxation of super funds. The Government outlined the major superannuation developments in a separate document, "Your Future Your Super", which outlines how the Government intends to address a number of structural problems in the superannuation system that have been pointed out by the Productivity Commission inquiry into super and the Hayne Royal Commission. The proposed changes do not directly affect SMSFs but clients using corporate, industry or retail funds should be aware of the changes.

Compulsory occupational superannuation contributions were first introduced into industrial awards in the 1980s under the Hawke Government. Since then, the value of assets under management in Australia's super system has grown to almost $3 trillion, and with Australia's population ageing, governments depend on the super system to relieve pressure on the budget by providing retirement incomes independent of the age pension.

The Productivity Commission and the Hayne Royal Commission have demonstrated that many Australians are being let down by the super system. Treasury estimates that 3 million super accounts worth $100 billion are underperforming, and the ATO estimates there are 6 million unintended multiple super accounts (mainly opened when a person changes jobs).

The Federal Government has announced four major steps to counter these problems:

1. a person's superannuation account will follow them when they change jobs;
2. an on-line comparison tool will be developed to allow MySuper products to be compared;
3. an annual performance test will be developed to identify funds which perform poorly, with consequences for repeated poor performance;
4. steps will be taken to increase the transparency and accountability of super trustees.

1. Your superannuation will follow you

Under the compulsory superannuation system an employer is required to make contributions to a super fund for employees. In most cases employees are able to choose which super fund receives the contributions, but many (and perhaps most) employees do not nominate a fund, so the employer contributes to its default super fund. As people change jobs, they can end up with multiple low-balance accounts all charging fees and insurance premiums. If the employee moves to another job, the super provider will often lose contact with the member, and these accounts become lost super balances. Using data submitted by super funds, the ATO has estimated that around 6 million multiple accounts are held by 4.4 million people, and over one third of multiple accounts are held by people aged 35 or younger.

The Government intends that when a person changes jobs, their super account will be "stapled" to them, so their super account will follow them from job to job. This will be achieved in two phases.

With effect from 1 July 2021, employers will no longer automatically create a new superannuation account in their default fund for new employees if an employee does not choose a fund themselves. Instead, employers will obtain information about the employee's existing fund from the ATO if this is not provided by the employee. Initially this will involve the employer obtaining the employee's fund details from the ATO on-line services. From 1 July 2022, digital software providers will be able to automate the communications between the employer's payroll system and the ATO, so the employee's super account information can be downloaded directly into the employer's payroll system.

If an employer does not have an existing super account and does not choose a super account, the employer will follow the current practice of contributing to its default super fund.

2. On-line comparison tool for MySuper products

One of the major problems with our superannuation system is that many people are disengaged from the system because they feel it is complex and confusing, and they lack the ability to compare rival super products. This in turn reduces the effectiveness of competition between funds which would reduce fees. From 1 July 2021 the Federal Government will deliver an interactive on-line comparison tool administered by the ATO that will gather information in one place on the current performance of all MySuper products.

The concept of MySuper accounts was introduced by the Federal Government in 2014. MySuper accounts are low cost simple super solutions with only basic features. Employers must choose a MySuper product for their default employer contributions.

The aim is to enable super members to choose a well-performing product by making comparisons between MySuper products easier. The Productivity Commission has noted that super fees charged in Australia are high by world standards. The ability to compare and choose between products should force fees down as funds vie to remain competitive with each other.

The comparison tool will display a table of MySuper products ranked by fees and investment returns, updated each quarter, together with the person's current super accounts and tools to facilitate consolidating accounts if they have more than one account.

3. Holding funds to account for underperformance

Sub-standard Investment returns have a large negative effect on super balances upon retirement. Analysis of data from the Australian Prudential Regulatory Authority (APRA) shows that many funds are consistently poor performers, assessed against a performance benchmark developed by the Productivity Commission. This includes 21 of the 77 MySuper products.

Under the Government's proposal, as of 1 July 2021 MySuper products will be subject to an annual performance test. Each year APRA will construct an individual benchmark for each MySuper product based on the individual product's portfolio asset allocation, and each product will then be compared annually against this benchmark. Products that underperform their net investment return benchmark for 0.5 percentage points pre year over an eight-year period will be classified as underperforming.

A product that is judged as underperforming will be required to notify its members in writing by the following 31 October, and also draw their members' attention to the MySuper comparison tool. Products that fail the test two years running will not be permitted to accept new members until their performance improves. As the test is carried out each year, presumably new members will be locked out for a full 12 months. Such funds will also attract the attention of APRA in terms of their obligations to existing members.

From1 July 2022 the system will be expanded to include "trustee-directed products" outside MySuper. These are super products regulated by APRA where the trustee has control over the design and implementation of the investment strategy and the investment strategy covers more than one asset class. This would include, for example, "conservative", "balanced" or "growth" portfolios in retail and industry super funds, but not portfolios that include only one asset class, such as cash, property or infrastructure assets.

4. Increasing transparency and accountability of super funds

In the course of its inquiry the Productivity Commission noted that super funds do not always act in their members' best interests. The Government intends to amend the law to impose an obligation on the trustees of APRA-regulated super funds to act in the best financial interests of their members. This will be backed up with penalties for beaches which apply to both corporate trustees and individual directors. Further, the usual onus of proof is to be reversed, so that the onus of demonstrating compliance with the new duty will lie with trustees.

Clients may be aware of the recent controversy between industry super funds and the Federal Government over the funds' advertising campaign to draw attention to the upcoming increase in the compulsory super rate from 9.5% to 10% which is due to take effect from 1 July 2022. The campaign happened to coincide with rumours that the Federal Government was considering deferring the increase, and no doubt the campaign caused some embarrassment. Members of the Federal Government expressed the view that the campaign might have been more political than member-focussed. It will be interesting to see what effect the new obligation imposed on super trustees will have on such advertising.

In addition, some aspects of corporate regulation are to be applied to super funds. The law was amended last year to require super funds to hold annual members' meetings once a year, to allow the trustee to explain how the fund has performed during the year and answer questions from members. Funds will now be required to include with the notice meeting a range of information similar to that required in company law but tailored to the fiduciary obligations of super funds. Funds must provide the annual report of the fund; the annual outcomes assessment of the fund; as well as information on the remuneration of key executives, marketing expenditures related to promoting the fund, political donations, sponsorships, payments to industry bodies or trade associations, and related party transactions.

What Wasn't Announced on Budget Night

There are some changes which many would have liked to see announced.

1. Transfer balance cap relief

The transfer balance cap (currently $1.6m) sets a lifetime upper limit on the amount that a member can transfer into retirement phase as a pension. When a member opens a super account in retirement phase, the value of the account at that time is applied to reduce the available $1.6m cap. Later fluctuations in the value of the account do not increase or reduce the amount of cap available.

When the transfer balance cap was introduced in 2017, many asked: What if we have another disaster like the global financial crisis? If a member has used up their full $1.6m cap, they won't be able to counter their investment losses by topping up their pension balance. With the COVID19 pandemic, we are seeing exactly this situation. So far there has been no indication that the Federal Government intends to provide for any special relief from the transfer balance cap in this situation.

2. Legacy pensions

A small number of older SMSF members are stuck in defined benefit or market linked pensions which were set up in the late 1990s and early 2000s for good reasons at the time, but the super law currently does not permit these pensions to be converted into modern account based pensions. The SMSF Association, the Actuaries Institute and others have made submissions to the Federal Government concerning the necessity and potential simplicity of this change, but so far the only response from the Minister has been that the legislative agenda is currently full.

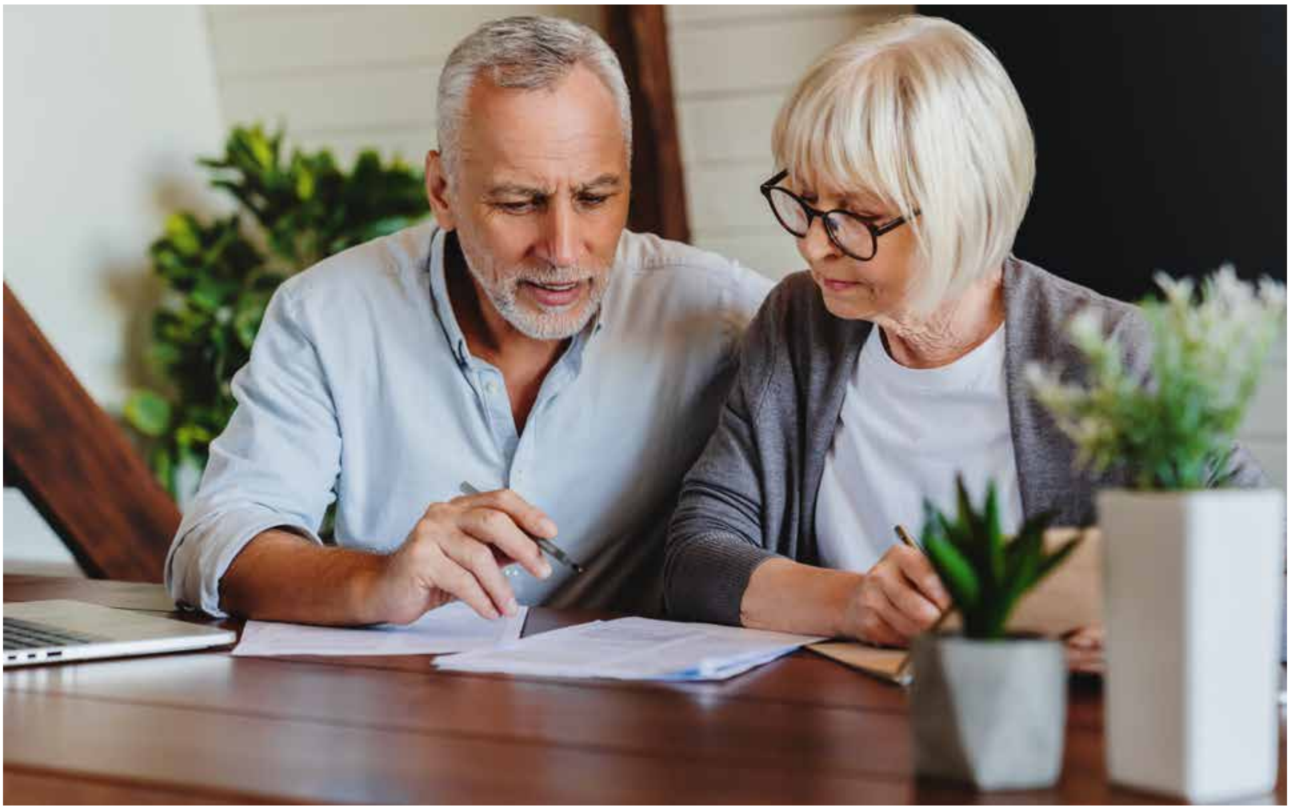
3. Non-arm's length general expenses

There has been a provision in the tax law for many years which taxed the non-arm's length income (NALI) of super funds at 45% instead of the usual 15%. With effect from 1 July 2018, NALI has included income or capital gains where in deriving the income or gain the fund has incurred expenses or losses that were less than arm's length amounts. The problem is that there are some classes of expenses (such as administration or audit fees) which are of such a general nature that they can be considered to be related to the earning of all the income and gains of the fund, with the result that a non-arm's length audit fee could taint all the income and gains of the fund as NALI, and subject to tax at 45%.

The ATO has attempted a number of administrative fixes for this. In Draft Practical Compliance Guideline PCG 2019/D6 the ATO advised that it would not apply resources to examine the situation of general expenses until 30 June 2020. This deadline was extended to 20 June 2021 under PCG 2020/5.

In view of the serious potential consequences, a proper legislative fix is needed, perhaps in the form of a de minimis provision which would exclude expenses of under a certain dollar amount from the NALI rules.

If you have any questions in relation to changes to superannuation post-budget please reach out to a Nexia Adviser for further information.



The Effect of JobKeeper on the Work Test

Generally, a person over the age of 67 (until 1 July 2020 the cut-off was 65) must satisfy the "work test" before they can make personal contributions to a super fund. To satisfy the work test, a person must have been gainfully employed for at least 40 hours in a period of 30 consecutive days in the financial year in which the contribution is made. The ability to make personal contributions into a super fund ceases at age 75.

Does the receipt of JobKeeper by a super fund member constitute gainful employment, even if the member has been fully stood down by their employer and is not actually performing work?

The Australian Prudential Regulatory Authority, which is the prudential regulator of most super funds other than SMSFs, has recently answered in the affirmative. In an update to its FAQ for COVID-19s, APRA says "In APRA's view, it is appropriate for an RSE licensee [trustees of corporate, public offer and industry super funds] to take this approach because the individual is still employed and is obtaining a valuable benefit from his or her employer". APRA stated it might be difficult for RSE licensees to differentiate between an individual member who is actually working and a member who is not working but still receiving the JobKeeper payment.

In some ways, this is a pragmatic response by APRA, but still very welcome. The ATO, which is the regulator of SMSFs, usually follows APRA's lead on issues like this, so we would expect the ATO to announce shortly that this approach will also apply to SMSFs.

If you have any questions about the effect of JobKepper in relation to superannuation please contact your Nexia Adviser.

New ATO Approach to Administrative Penalties

The ATO has a number of options available to encourage compliance by SMSFs and penalise trustees where appropriate. Since July 2014 the law has permitted the ATO to impose fines, called "administrative penalties", on SMSF trustees for breaches of various regulations without needing to go to court.

In the past these penalties have been rarely used, but the ATO has recently released Law Administration Practice Statement PSLA 2020/3, which indicates that we can expect to see penalties being imposed more frequently in the future. Strictly, the law automatically imposes a penalty when a breach occurs, and it is up to the ATO to decide whether to remit the penalty and by how much. In considering whether to remit in full or in part, the ATO will consider the scale and impact of the contravention on the SMSF. Trustees have the right to object against a decision by the ATO to not remit a penalty, but this does not stop the ATO from commencing action to collect the penalty in the meantime.

Where penalties apply, it is advantageous for a fund to have a corporate trustee. In the case of a corporate trustee, the penalty is imposed only once, on the corporate trustee, but the directors are jointly and severally liable to pay the penalty. Where the fund has individual trustees, separate penalties are imposed on each individual trustee. The penalty cannot be paid by the SMSF itself.

The dollar amount of the maximum penalty which can be imposed is expressed in terms of a number of penalty units. The dollar amount of a penalty unit is currently $222, and is adjusted periodically. Here is a list of the relevant breaches and the amount of the maximum penalty that can be imposed. As you will see, this can be substantial, and situations may arise where multiple penalties are payable.

60 penalty units (60 x $222 = $13,320)

- A fund must not lend to or provide financial assistance to a member of a fund or a relative of a member.
- A fund must not borrow, subject to specific exemptions (such as a limited recourse borrowing arrangement).
- Trustees must take all reasonable steps to ensure that the in-house asset rules are complied with.
- Trustees must notify the ATO of an event having a significant adverse effect on the financial position of the fund.

20 penalty units (20 x $222 = $4,440)

- Trustees must ensure that the prescribed operating standards applicable to the fund are complied with at all times.
- Trustees must notify the ATO of a fund becoming an SMSF or ceasing to be an SMSF.

10 penalty units (10 x $222 = $2,220)

- SMSFs must prepare annual financial reports signed by the trustees and retained for 5 years.
- SMSFs must keep minutes of trustee meetings and retain them for 10 years.
- SMSFs must keep records of all changes of trustee, changes of directors of any corporate trustee, and consents act as trustees or directors of a corporate trustee, and these must be retained for 10 years.

- All trustees of SMSFs appointed after 30 June 2007 must within 21 days of appointment sign a trustees declaration to the effect that they understand their duties as a trustee of an SMSF, and the declarations must be retained for 10 years.
- Copies of all member reports must be kept for 10 years.

5 penalty units (5 x $222 = $1,110)

- The appointment of an investment manager must be made in writing
- A trustee must comply with an education direction from the ATO to undertake a specified approved course of education.
- Trustees must provide required information to the ATO when an SMSF is established.
- Trustees must provide ATO with statistical information when required.

The ATO takes the view that SMSF trustees should know what is expected of them, and should seek professional advice if they are in doubt about any transaction they are considering. Please contact your Nexia Adviser if we can be of any assistance.

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