



Entrusting the trustees: the regulation of self-managed superannuation funds in Australia

by
Josephine Castillo
Faculty of Law

Submitted in fulfillment of the requirements for the Doctor of Philosophy
University of Tasmania, August 2012

Declaration of Originality

This thesis contains no material which has been accepted for a degree or diploma by the University or any other institution, except by way of background information and duly acknowledged in the thesis, and to the best of the my knowledge and belief no material previously published or written by another person except where due acknowledgement is made in the text of the thesis, nor does the thesis contain any material that infringes copyright.

Statement regarding published work contained in thesis

The publisher of the paper comprising Chapter 3, Thomson Reuters, holds the copyright for that content, and access to the material should be sought from the *Australian Business Law Review*. The remaining non published content of the thesis may be made available for loan and limited copying and communication in accordance with the Copyright Act 1968.

Acknowledgements and thanks

Heartfelt thanks to my primary supervisor Professor Gino Dal Pont for his support and encouragement, efficiency and timeliness in the review of drafts and absolute attention to detail.

Many, many thanks to Dr Anthony Abraham, my PhD mentor, who gave me many good ideas and spent so much time talking me through what he had learnt during his own tortuous doctoral candidature.

Thank you also for the support and assistance provided to me by Dr Lisa Butler Beatty and Professor Donald Chalmers, my consultant supervisors.

Finally, thank you to my family and friends for their support, patience and encouragement.

Abstract

Self-managed superannuation funds (SMSFs) are a uniquely Australian retirement savings vehicle which are constituted as trusts with one to four members, each of which must be a trustee of the fund unless under a legal disability. SMSFs have become so popular in recent years that as a sector they are now the largest in terms of number of funds and assets under management, yet very little academic study has been directed at this important sector to date.

The intent of this thesis is to evaluate the regulation - both statutory and supervisory - of the SMSF sector, which has, since 1999, been subject to the supervisory regulation of the Australian Taxation Office. As a starting point, the regulation of SMSFs can be characterised as extremely difficult because of their private nature and sheer numbers.

An examination of the demographic characteristics and motivations of the SMSF trustees forms part of this evaluation, as does an international comparison with selected western countries where self-directed superannuation is permitted. What is apparent is that the Australian SMSF enjoys a freedom unparalleled elsewhere and under that regime appears to be performing very well in enhancing its members' retirement savings.

CHAPTER 1	
INTRODUCTION	
1.1. Background to the study	9
1.1.1. The importance of superannuation	9
1.1.2. What is superannuation?	11
1.1.3. What is regulation?	12
1.2. Aim and overview of the thesis	14
1.3. Parameters of thesis	15
1.4. Methodology	15
CHAPTER 2	
THE HISTORY OF SELF-MANAGED SUPERANNUATION IN AUSTRALIA	
2.1 Introduction	18
2.2 Excluded funds	21
2.3 Excluded funds become SMSFs/SAFs	24
2.4 Subsequent events affecting SMSFs	27
2.4.1 Disqualification of trustees by the ATO	27
2.4.2 Auditor contravention reports	28
2.4.3 Supervisory levy increase	28
2.4.4 Fund choice	28
2.4.5 'Simplified Super'	29
2.4.6 Instalment warrants	29
2.4.7 The Super System Review and government response	30
2.5 Characteristics of SMSFs	30
2.6 Future growth in SMSF numbers	31
2.6.1 General outlook for the sector	32
2.6.2 Establishment statistics	34
2.6.3 Fees statistics	35
2.6.4 Performance statistics	36
2.6.5 Regulatory and legislative risk	37
2.7 Conclusion	38
CHAPTER 3	
THE SMSF TRUSTEE-MEMBERS	
3.1 Introduction	40
3.2 Demographic characteristics of SMSF members	41
3.2.1 Geographic location	41
3.2.2 Business owners	42
3.2.3 Gender	42
3.2.4 Age	43
3.2.5 Phase in accounts	43
3.2.6 Education	44
3.2.7 Health	44
3.2.8 Wealth	45
3.2.8.3 <i>Low SMSF asset balance SMSFs</i>	46
3.2.9 Risk takers?	47

3.3	Familial characteristics	50
3.3.1	Corporate trustees	50
3.3.2	Families	51
3.3.3	Superannuation and divorce	51
3.4	Compliance and demographic characteristics	52
3.5	Reasons for establishing an SMSF	53
3.5.1	Surveys	53
3.6	SMSF advantages	57
3.6.1	Control	58
3.6.2	Transparency	59
3.6.4	Tax advantage(s)	61
3.6.6	Estate planning	62
3.6.7	Sense of self-worth	65
3.7	Knowledge and understanding of obligations as trustee	66
3.8	Outsourcing of management by trustees	69
3.9	Trustee Education	70
3.9.1	Compulsory education	70
3.9.2	ATO educative material	70
3.10	Disqualification of trustees	73
3.11	Conclusion	76
CHAPTER 4		
REGULATION		
4.1	Introduction	79
4.2	'Regulation' in the SMSF environment	80
4.3	Rules	82
4.3.1	Legislation	82
4.3.2	Regulations	86
4.3.3	Common law and governing documents	87
4.4	Regulation by the ATO	88
4.4.1	Communication of rules	88
4.4.2	Monitoring	88
4.4.3	Enforcement	90
4.4.4	Sanctions	91
4.5	Regulatory oversight – Adjudication and Evaluation	93
4.5.1	Court and tribunal oversight	93
4.5.2	Statutory offices	94
4.5.3	Overview role of taxpayer and professional associations	95
4.5.4	Overview role of industry bodies	96
4.5.6	Taxpayer Charter	98
4.6	Conclusion	98
CHAPTER 5		
IS SMSF REGULATION APPROPRIATE AND EFFECTIVE?		
5.1	Introduction	101
5.2	What is good regulation?	101

5.3 Appropriateness of regulation	104
5.3.1 Department of Human Services	104
5.3.2 ASIC.....	105
5.3.3 APRA	106
5.3.4 ATO.....	108
5.3.4 Prudential regulation	110
5.3.5 Portfolio regulation.....	113
5.3.6 SMSF performance, prudential regulation and portfolio controls.....	116
5.3.7 The appropriate regulator	117
5.3.8 Conflict between roles of revenue protection and protection of retirement income	119
5.4 Effectiveness of regulation.....	127
5.4.1 Resourcing of the ATO	128
5.4.3 Skill levels of ATO staff	130
5.4.4 Support by ATO to SMSF professionals	131
5.4.5 Gaps in regulatory reach	132
5.4.6 Issues with the registration process.....	136
5.4.7 Resourcing of the ATO - conclusion	139
5.4.8 Fraudulent use of SMSFs.....	140
5.4.9 Delegation to approved auditors	148
5.4.10 Possibility of incentive for compliance by SMSFs	160
5.4.11 Capture of the regulator.....	160
5.4.12 Degree of compliance by SMSFs	162
5.5 Conclusion.....	166
CHAPTER 6	
IS THE SMSF LEGISLATIVE REGIME APPROPRIATE?	
6.1 Trust law	168
6.2 Trust deeds	171
6.3 Corporations Act and ITAA.....	172
6.3.1 Corporate trustees	173
6.4 The SIS Regime	173
6.4.1 General observations on the SIS Regime	174
6.4.2 Specific deficiencies in the SIS Regime.....	180
6.5 SMSF Investments.....	183
6.5.1 Investment Strategies	185
6.5.2 Peculiarities of SMSF investing	187
6.6 Member number limit.....	192
6.7 Does the legislation sufficiently empower the regulator?	193
6.8 Penalties	194
6.8.1 Strict liability, civil and criminal liability	194
6.8.2 SMSF: Non-complying	196
6.8.3 Locus of liability	197
6.8.4 Trends in non-compliance	198
6.8.5 Crudeness of current penalty regime	199

6.8.6 Inability of ATO to issue directions.....	199
6.8.7 Lack of mechanism to prosecute promoters	200
6.9 Separate SIS Scheme for SMSFs.....	201
6.10 Should the statutory regime governing SMSFs include a model trust deed?	204
6.11 Investment rules as black letter law	206
6.12 Conclusion	206
CHAPTER 7	
INTERNATIONAL COMPARISON OF SELF-MANAGED SUPERANNUATION REGULATION	
7.1 Introduction.....	209
7.1.1 Pillars of the retirement income system	210
7.1.2 Self-managed voluntary personal pension plans.....	213
7.2 Allowable investments.....	217
7.2.1 Asset categories	217
7.2.2 Related party transactions.....	221
7.2.3 Loans by the fund	224
7.2.4 Borrowing by the fund	228
7.2.5 <i>In specie</i> contributions	230
7.3 Asset title and custody arrangements	231
7.3.1 United Kingdom.....	231
7.3.2 Canada	232
7.3.3 United States	233
7.4 Taxation treatment.....	234
7.4.1 Taxation treatment of contributions	235
7.4.2 Taxation treatment of plan/fund earnings	239
7.4.3 Taxation treatment of benefits	240
7.4.4 Early Access to benefits	243
7.5 Challenges for overseas regulators	244
7.5.1 Resourcing.....	244
7.5.2 Legislative delay	244
7.5.3 Lack of graduated penalty powers.....	245
7.5.4 Fiduciary duties.....	245
7.6 Major differences between other jurisdictions and Australia.....	246
7.6.1 Third party custodian.....	247
7.6.2 Allowable loans to account holders	249
7.6.3 <i>In specie</i> contributions	251
7.6.4 Collectables	254
7.6.5 Taxation treatment.....	255
7.7 Other legislative features of overseas jurisdictions	256
7.7.1 Ability to carry over unused contribution allowance, calculation of unused contribution allowance by tax authority: CANADA	256
7.7.2 Incentives for annuitisation.....	258

7.7.3 Charitable donations count towards minimum pension payments: USA	261
7.8 Supervisory features of overseas jurisdictions	262
7.8.1 Resolution of non-compliance	262
7.8.2 Publicised outcomes of compliance projects	264
7.8.3 Model plan documents	265
7.8.4 Regulator with financial literacy mandate	265
7.8.5 Supervisory levy on a cost-recovery basis	267
7.8.6 Advisory committees	268
7.8.7 IRS webinars	269
7.9 Conclusions	270
CHAPTER 8	
CONCLUSIONS	
8.1 Recommendations:	273
8.1.1 Supervision	273
8.1.2 Statutory	275
8.1.3 More generally	277
8.2 Scope for future research	279
8.3 Evaluation	280
APPENDIX 1 - KEY TO INTERVIEWS	
APPENDIX 2 - SIGNIFICANT LEGISLATIVE EVENTS AFFECTING SMSFs	
APPENDIX 3 - BIBLIOGRAPHY	