Valuations and your SMSF

The days of a lax approach to valuations are over.

While there is not always the need to employ a qualified independent valuer for each valuation, there are important circumstances where it is mandated, and others where it is recommended. Where one is not used then appropriate documentation needs to be kept of how valuations were determined. Back-of-the-envelope or simply made-up valuations will not suffice.

Whilst in the old days the ATO had little it could do against SMSF trustees, the current penalty rules provide the ATO with much greater firepower. In particular, be careful in the valuation of assets for determination of whether a member is or is close to being in excess of the contribution rules. The ATO has signalled this is an area they will police in 2017-18.

When must a valuation occur?

A valuation is required in each of these situations:

- Valuation of all assets in an SMSF must be undertaken to reflect the value of assets held as of 30 June of every year. This is to ensure that the financial statements and accounts of the fund can be prepared and are accurate.
- Valuations are also required when acquiring assets from a related party to ensure that a proper price is paid and to ensure the asset is not under- or over-valued.
- When you sell a collectable or personal use asset (i.e. jewellery, art works), the asset must be valued by a qualified independent valuer. The valuer must also be an expert in that type of asset.
- Most importantly when you are setting up a pension, the assets that underpin the pension must be properly valued at the time that the pension is established. It also needs to be valued every year as at 1 July of the year the pension is paid.
- Valuation is also required if you have in-house assets to ensure that the assets do not exceed the 5% threshold.
- If you intend to use the CGT relief, then the value of the assets will also need to be determined.
- Valuation will also be required to determine if a member is in breach of the new contribution cap rules.

How is a valuation undertaken?

In circumstances where a qualified independent valuer is not needed, there are a variety of ways that assets can be valued. The valuation though needs to be genuine and based on acceptable methods for valuing. There should always be records kept of how any valuation is done.

For a lot of SMSF assets such as shares and bank accounts, the means of valuation is easy. It will be the value of the bank account at the time of valuation or the price of share/unit at the time of valuation, which is publicly available.

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Valuations and your SMSF *continued*

When valuing a property, there are a number of ways that property could be valued such as:

- getting a valuation by a qualified independent valuer, this is generally not required, however, if the property is a commercial property leased to a related party then it will need to be valued by a qualified independent valuer
- real estate agent – many real estate agents are willing to provide valuations, though this will generally be a range of valuations that may cover a wide range of prices
- Online valuation tools – a number of real estate websites can provide general valuations for property for free; and
- The trustees can value the property themselves, though they must use reasonable methods and document how this was done. Two popular methods are looking at the sale price of similar homes in the suburb and taking an average or by using a previous valuation and increasing (or decreasing it) by the average price increase (or decrease) in the suburb.

Where a significant change has been made to the property, it is probably best to get a proper new valuation (eg renovations to the property that increase its value).

What happens if I get valuations wrong or don't do a valuation?

The old days of the ATO not having power to take action against trustees for issues with validation are over. The penalty regime provides specific penalties in relation to valuations.

For the trustee (or directors of a corporate trustee) they face a fine of 10 penalty units (about $2100) for each trustee for any failure to value an asset as required by the law.

Furthermore, s 103 of SIS provides an offence of strict liability for failing to keep proper accounting records, which includes the need to have a valuation for assets as at 30 June each year. The fine here is 50 penalty units (about $10,500) per trustee.

Furthermore, if the ATO determines that assets are undervalued for the purpose of the contribution cap rules, then it can take further action against the trustees as well as determine that they are in excess of the contribution caps with all that entails. ■

Investing: Growth vs income

Every investor goes in with dreams of a pot of gold, but there is a fundamental difference between investor types – one looks to line their pockets with investment returns along the way, and the other has the patience to wait until the end of the rainbow to reap the rewards.

The distinction between investing for growth or investing for income should not be seen as a "them or us" battle. Rather, investing for growth or investing for income will depend on the personal circumstances of the individual.

The needs of each person naturally differ, and the type of investment they prefer will depend on these needs. Many investors simply need capital growth, and are looking to grow their portfolio for later use, say with the aim of securing a more comfortable retirement. Others, for example people already retired, will be looking to receive earnings from their investments, perhaps to replace income from employment.

Naturally, as needs and priorities change, the approach to investing may change as well – such as shifting a portfolio's emphasis from growth to income as one's longer-term goals are achieved.

Investing for growth will tend to require a longer time commitment, as assets such as shares or property will be anticipated to increase in capital value over time rather than provide a quick return. Investors wanting to build wealth over the long term will want to put more money into assets that should increase in value. Having a longer time horizon will also allow some shock-proofing for the inevitable ups and downs of markets.

Investing for income will have more appeal for people who are counting on some cash to meet living expenses or meet some short-term goal. While the aim should include keeping the principal base stable, the idea is to have a predictable income stream from interest payments or dividends that are earned on the value of that principal amount.

Of course there is also the idea that a healthy investment portfolio will have a balance of both growth and income assets, with part of the portfolio geared for growth while another part is tailored towards income producing investments.

Many investment assets will have elements of both growth and income, and the sharemarket abounds with examples of stocks that will offer both capital growth and dividend generation. The likely difference between different shares will be the emphasis given to delivering returns – of either the growth or the income variety.

One company, for example, might review profit more regularly and distribute it via dividend payments. Making a return on an investment will therefore not rest entirely on selling the shares, and if the company pays regular dividends the investor can continue earning over a prolonged period. The negative here however is that dividends can always diminish or even dry up.

A company that emphasises growth will more likely re-invest profits back into the company, and so not allocate the same amount of earnings for dividend payments to shareholders. However it is that re-investment that should see increased company value (and share price), which will translate into cash for the investor when the stock is eventually offloaded.

The risk of course is always that the share price could head south, and fall below the price that an investor paid for it, resulting in a capital loss rather than a capital gain.

The tax consequences of each differ too, with interest earnings counted towards assessable income (although share dividends can be treated differently due to the imputation system, which sees tax paid in the hands of the issuing company). Earnings from growth (capital gains) will come under the CGT rules.

See this office for more detailed guidance on your best investment options. ■