Understanding Self Managed Superannuation Funds

Version 5.0

This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to **Self Managed Superannuation Funds**.

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HOW TO READ THIS DOCUMENT

Managing your finances to meet your day to day requirements as well as your long-term goals can be a complex task. There are all sorts of issues you need to consider such as taxation, legislation, protecting your wealth and assets, associated costs and the inherent risks of investment. When undertaking a financial plan it is important you understand how these issues will impact you and what you should expect over time.

Your financial adviser will provide you with a Statement of Advice (SOA) which sets out the details of the advice and how it will meet your goals and objectives.

This document provides some additional information to help you understand the financial planning concepts discussed in the SOA in relation to **Self Managed Superannuation Funds**.

It is very important you read this document to help you understand the benefits of the strategies recommended to you and the associated costs and risks.

Please contact your adviser if you do not understand anything, or need further information or clarification.

Self Managed Superannuation Funds

For individuals seeking to own direct investments within superannuation or gain greater control of their superannuation portfolio, Self Managed Superannuation Funds (SMSFs) can be an attractive alternative.

SMSFs can facilitate all major superannuation functions including:

- accepting new superannuation contributions
- housing superannuation funds received from a change in employment, and
- paying a retirement income.

Considerations in establishing SMSFs

Members

A SMSF must have between one and four members. No member is allowed to be an 'employee' of another member unless related.

The sole purpose test

To meet the sole purpose test, SMSFs must be established for:

- benefits to members upon retirement; or
- death or ancillary benefits to members.

The trustee of a regulated superannuation fund must comply with the sole purpose test to be eligible for the taxation concessions available to a complying superannuation fund.

Investment guidelines

Legislation requires the trustees of SMSFs prepare and implement an investment strategy that includes the:

- risk/return profile of selected investments in light of the investment horizon
- diversification of fund assets
- liquidity of fund assets,
- ability of the fund to attain life insurance for members and
- ability of the fund to meet current and prospective liabilities.

This strategy must be documented, monitored regularly and updated where required.

In addition, a SMSF may only purchase certain types of investments from you or an associate. A fund can only acquire the following assets from a member:

- shares listed in Australia or an approved overseas stock exchange
- units in widely held unit trusts, and
- business real property used wholly for any business purpose.

The transfer of any other assets may attract a penalty of imprisonment.

Cost considerations

The costs associated with establishing a SMSF may include:

- the preparation of a trust deed including updates following legislative changes
- in the event of a corporate trustee, the costs of establishing and using this framework
- the costs of using and establishing the administrative framework and,
- the accounting, audit and ongoing administration of the fund.

Establishing the trustee/s

The trustee is responsible for compliance with a range of investment related requirements including:

- the investment strategy covenant
- various restrictions on investments and benefits including those related to:
  - lending to members or their relatives
  - acquiring assets from members or their relatives
  - in-house assets
  - arms-length transactions
  - borrowing by the fund
  - member reporting obligations
  - contribution standards, and
  - benefit payments standards.

While trustees may outsource certain functions to external service providers such as a fund administrator or an accountant, the ultimate responsibility and accountability for the fund always lies with the trustees.

The trustee of a SMSF can be a corporate trustee (ie: a private company) or individuals who are members of the fund.

Where the trustees are individuals, the trustee arrangements must be (subject to limited exceptions):

- all members must be trustees, and
- each individual trustee must be a member.

This arrangement promotes true self management of the fund by ensuring all the members have the opportunity to be involved in making decisions that directly affect their superannuation.

A SMSF may have a corporate trustee providing:

- each director of the company is a member of the fund, and
- each member of the fund is a director of the company.

Single member funds

Where a SMSF has only one member, that person may elect to have a corporate trustee. In this case, the member must:

- be the sole director of the trustee company or;
- there can only be two directors of the trustee company, however the single member:
  - must not be an employee of the other director of the trustee company, or
  - must be related to the other director of the trustee company.

Alternatively if the single member fund does not wish to have a corporate trustee, the fund must have two individuals as trustees. One of the individual trustees must be the member along with:

- any other person provided the member is not an employee of that person selected to be the other individual trustee, or
- any other person who is a relative of the member.

Establishing a trust deed

A trust deed is commonly referred to as 'the governing rules of the fund'. A trust deed is a legal document that establishes the existence of the fund and rules regarding its operation when it is properly executed.

Trust deeds are available from:

- a solicitor
- an accountant, or
- a specialised SMSF service provider

The major clauses of a trust deed will normally address:

- the establishment of the fund
- the structure and purpose of the fund
- details of who can be a trustee
- how to appoint and remove trustees
- the decision making powers of the trustee
- who can be a fund member
- who can make contributions
- when to pay benefits to members
- ability for the fund to take insurance on the lives of members
- members' benefit entitlements
- what investments the fund can make
- fund records, audit requirements, disclosure and reporting requirements
- the appointment of actuary, auditor and managers.

Advantages of SMSFs

Direct investment choice

You can invest directly in your own chosen combination of investments, for example, shares, property, fixed interest investments, managed funds and cash. You may also include business real property (commercial property).

Access to wholesale managed funds

You may gain the benefit of access to wholesale managed funds where the investment charges are lower than retail managed funds.

Consolidation

You have the ability to have up to four members in a SMSF. You are therefore able to combine your superannuation benefits into one strategy to reduce ongoing costs and increase the potential for compounding capital growth.

Tax planning

You have the ability to reduce taxation liabilities within the fund by selecting a tax effective mix of investments, including franked dividends. Investment earnings are subject to tax at a maximum rate of 15%.

Estate planning

SMSFs provide estate planning opportunities where there is more than one member in the fund.

A member of a SMSF is able to a have a non-lapsing binding nomination which allows them to specify how their benefits are to be distributed on their death.

Disadvantages of SMSFs

Cost barriers

A typical SMSF is expected to have ongoing costs in a range of $2,000 to $6,000 pa. The cost varies depending on the complexity of investments and level of outsourcing.

Upfront costs in establishing the fund are estimated to be between $1,000 and $5,000.

Additional costs may also be incurred upon winding up a SMSF.

Legal and compliance obligations

Although as a member/ trustee, many responsibilities can be outsourced, the ultimate responsibility remains with the trustee. Non compliance can result in fines and /or imprisonment.

Expertise and performance

A high level of flexibility in investment choice requires sound knowledge and experience on behalf of the members/ trustees.

Time consuming

It is reasonable to expect a SMSF will take up a considerable more amount of time for the member than alternative superannuation fund offers.

When are SMSFs appropriate?

A SMSF is most appropriate for investors who:

- prefer to have direct control over their retirement funds
- wish to be involved in investment decisions, and
- wish to gain from the flexibility and estate planning benefits associated with SMSFs.

SMSF members must be prepared for the responsibilities associated with being a trustee of a regulated superannuation fund. Members who are prepared to pay for outsourcing much of the administration and investment management of the fund will not need to commit as much of their own time to the fund but will need to be prepared to pay the associated fees for these services.

What level of support is appropriate?

While all SMSFs feature direct investment discretion you can choose the extent of administration support, investment reporting and compliance.

Broadly speaking you may choose from:

- a professional administration service for all services required in conjunction with the use of a financial adviser for investment decisions and other key decisions such as commencing a pension, contributions to and withdrawals from the fund, and
- an accounting firm for compliance and tax returns in conjunction with the use of a financial adviser for investment decisions and other key decisions such as commencing a pension, contribution to and withdrawals from the fund and then completing the trustee responsibilities yourself.

From your perspective, the major difference between the these options is who is responsible for the prudent management of the fund.

The Superannuation and Insurance Supervision (SIS) legislation codifies some of the most important fiduciary duties of trustees in formal covenants. The codified duties exist alongside trustee duties under common law. For trustees, SIS means their basic duties are clearly spelt out. For members, SIS establishes statutory rights to civil action for loss or damage due to breach of covenants.

ADDITIONAL INFORMATION

For information regarding obtaining personal insurance within a SMSF, refer to our **Understanding insurance** document.

For information regarding borrowing by a SMSF for investment purposes, refer to our **Understanding gearing** document.

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