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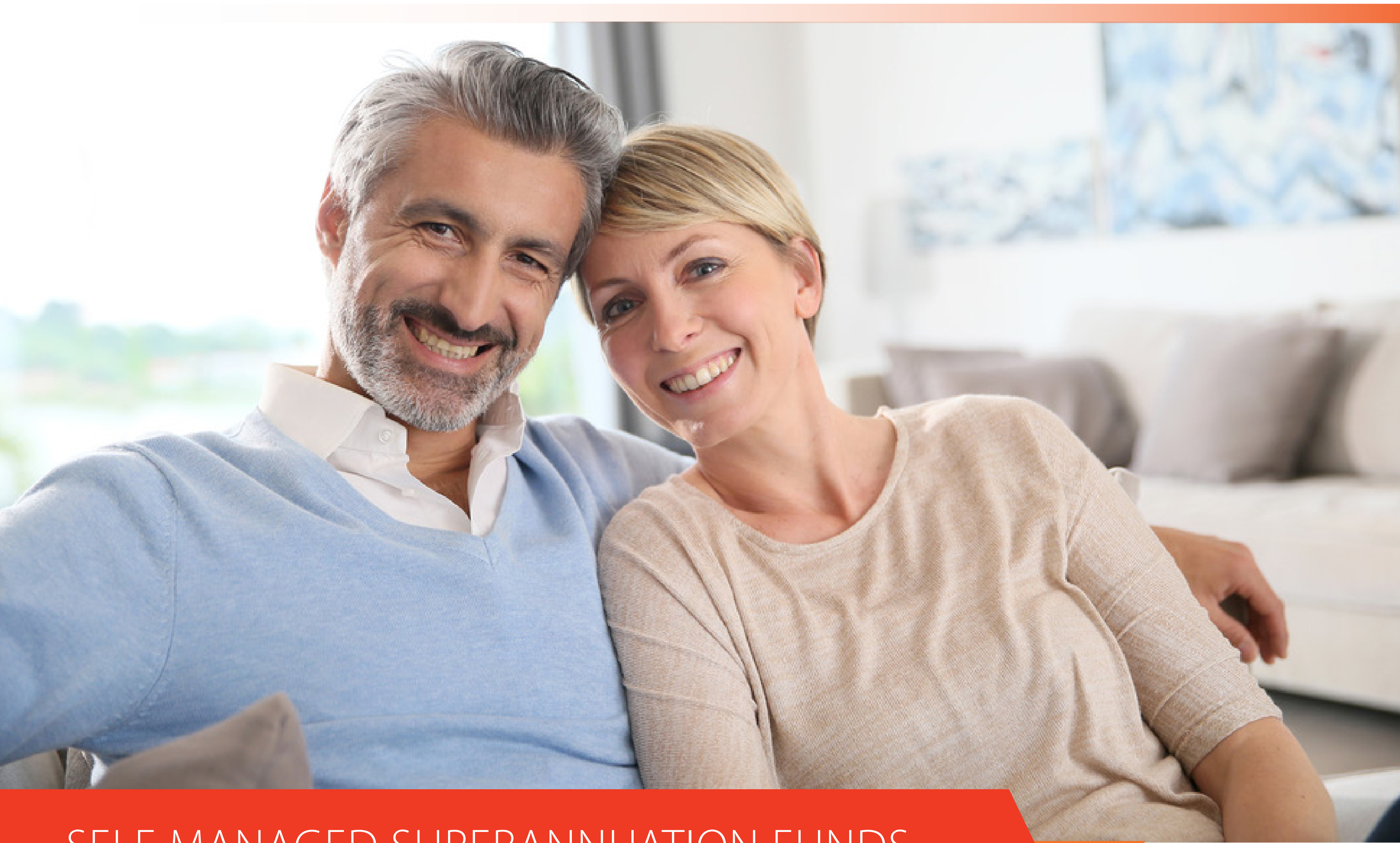

SELF MANAGED SUPERANNUATION FUNDS

IS AN SMSF RIGHT FOR YOU?

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Introduction

Self-managed superannuation funds (or SMSFs) are a way of saving for your retirement. The difference between an SMSF and other types of superannuation funds is that the members of an SMSF are usually the trustees. This means that the members of the SMSF run it for their own benefit and are responsible for complying with Australian superannuation and taxation laws.

Growth in SMSFs

The latest available ATO figures indicate there are close to 600,000 SMSFs in Australia as at June 2021. This resumed the steady growth of the sector after a brief dip in numbers during the early phase of market disruption due to COVID.

In the five years to 2020–21, the number of SMSFs grew by an annual average of 1.7%, with an average of 25,000 new funds established annually (around 2,100 per month).

30,000 SMSFs were established in 2016–17, dropping to 20,000 in 2018-19, then growing to 25,000 in 2020–21.

At 30 June 2020, SMSFs had assets of over $1.3 million on average, the same as the previous year and up 20% from 2015–16.

What is driving this growth?

SMSFs are widely recognised as offering greater control and flexibility over investment choice. Although traditional industry and retail funds offer a wide range of investment options, the ability to invest in direct property (residential and commercial) as well as collectibles, such as; antiques, artwork and jewellery, are features unique to SMSFs. For small business owners, the ability to purchase a commercial property through an SMSF can be particularly appealing.

* Australian Taxation Office. 2022

Benefits of an SMSF

SMSFs offer a number of advantages over traditional retail or industry super funds. These include:

Greater control over how your money is invested

The trustees decide on the investment strategy and choose what assets the SMSF will invest in as well as how and when those assets are invested. The SMSF (subject to certain restrictions) can access a range of investments that may not always be available through other types of superannuation funds, such as direct property investments, direct Australian and international shares, and direct fixed interest.

Flexibility

SMSFs offer greater flexibility in relation to transferring assets, as well as the timing of decisions that may have a bearing on taxation.

In-specie contributions

Subject to investment rules, it is possible for members of the SMSF to transfer assets (such as ASX listed securities, bonds, managed funds, or commercial property) directly into the SMSF instead of cash. These types of contributions are called "in specie" contributions.

Potential cost savings

Depending on your particular circumstances and the value of your investments, an SMSF may offer potential cost savings in comparison to other types of superannuation funds. As the fees associated with an SMSF are largely fixed, the more an SMSF grows, the more cost-effective it becomes. You can also pool your funds with other members allowing you the ability to share these fixed costs.

While these benefits appeal to many people saving for retirement, there are a number of issues and risks associated with SMSFs that you need to consider before deciding whether an SMSF is right for you. Remember that you can have investment choice within the relative 'safety' of a retail or industry superannuation fund, so it's worth considering whether this may be a better option before deciding to set up your own SMSF.

Like all super funds, SMSFs benefit from concessional tax rates. In the accumulation phase, tax on investment income is capped at 15 per cent, while in the pension phase there is no tax payable, not even capital gains tax.

Understanding your role as the trustee

If you're thinking about setting up an SMSF you need to familiarise yourself with the responsibilities and costs associated with running the fund.

Running an SMSF can be expensive and requires a considerable amount of time and effort for administration, record keeping, reporting, and researching investments. Unless you have a degree of financial acumen and are comfortable with managing money and investing concepts, you should think carefully about whether an SMSF is right for you.

The primary responsibility of the trustee is the management of the fund for the benefit of members for their retirement. As the trustee, you must ensure fund assets are held in trust and invested on behalf of the members. You are responsible for ensuring the fund is properly managed and complies with all rules (including super laws and the fund trust deed). You will also be required to make important decisions that may affect the retirement savings of fund members.

Your responsibilities as the trustee include:

- Making sure the purpose of the fund is to provide retirement benefits for members.
- Preparing an investment strategy and making investment decisions in accordance with that strategy.
- Accepting contributions and paying benefits (income streams and lump sums) in accordance with super laws and the fund trust deed.
- Advising the ATO of any changes in trustees, directors or members within 28 days of the change occurring.
- Ensuring an audit of the fund is conducted each year by an approved SMSF auditor.
- Undertaking administrative tasks such as lodging annual returns and record-keeping.

It is important to understand that as the trustee of the fund you are personally liable for all the decisions made by the fund even if you get help from a professional or another member makes the decision.

Understanding your role as the trustee

You must ensure the fund trust deed and investment strategy are regularly reviewed and updated in accordance with the law and the needs of the members.

Over time your circumstances may change, possibly in a way that affects your ability to effectively manage the fund and undertake your obligations as trustee. Accordingly, throughout the fund's life cycle, you must consider the individual circumstances of each member and the general condition of the fund. You need to continually assess whether an SMSF is still the appropriate option for your fund members.

Regardless of whether you choose to outsource some aspects of the administration of your SMSF to an accountant, financial adviser or solicitor, the ultimate responsibility of the SMSF rests with the trustees. Should you fail to meet the responsibilities of your role as the trustee there can be serious consequences including significant penalties for non-compliance.

Sole purpose test

SMSFs are subject to the Sole Purpose Test. The Sole Purpose Test refers to each trustee's responsibility to ensure the superannuation fund is only maintained for the purpose of providing benefits to the members upon their retirement (or their beneficiaries if a member dies). When making decisions you must always put your obligations and responsibilities as a trustee of the fund before your wishes as a member. Should a conflict arise between your wishes as a member and your legal responsibilities as a trustee, you must comply with your trustee obligations.

The trust deed

All SMSFs are required to have a trust deed. A trust deed is a legal document that sets out the rules for establishing and running the SMSF. It includes details such as:

- The objectives of the fund.
- Who can be a member or a trustee.
- What contributions can be accepted.
- What investments you can make.
- Whether benefits can be paid as a lump sum or income stream.

The trust deed and super laws together form the fund's governing rules.

The structure of an SMSF

An SMSF is essentially a trust. A trust is an arrangement where one party (either a person or a company) holds assets for the benefit of another party – referred to as a beneficiary, or in the case of an SMSF; a member. There are three parts to an SMSF:

The trustee(s)

The trustee is the individual, persons or company appointed under the trust deed to hold and invest the fund's assets for the benefit of fund members. The trustee is responsible for running the fund and for making decisions on behalf of members. You can choose to have individual trustees (in which case all members of the fund must generally be trustees), or a corporate trustee (ie a company), in which case, all members will generally be directors of the trustee company.

The fund

The SMSF itself is a type of trust established under the trust deed with the sole purpose of providing retirement benefits to the fund's members.

The Members

The members are the beneficiaries of the trust.

Are you eligible to be a trustee or a director?

Generally anyone 18 years of age or over can be a trustee of an SMSF, provided they are not subject to a legal disability (ie bankrupt or mentally impaired). An individual is also disqualified from being an SMSF trustee if they:

- Have ever been convicted of an offence involving dishonesty.
- Have ever been subject to a civil penalty order imposed by superannuation law.
- Are considered insolvent under administration.
- Are an undischarged bankrupt.
- Have been disqualified by a regulator (such as the ATO or APRA).

Is an SMSF right for you?

Before making a decision to set up an SMSF, ask yourself the following questions:

Have you considered other do-it-yourself (DIY) super options?

Many professionally managed super funds have DIY investment options which let you choose which assets that you would like your super invested in, such as shares, exchange traded funds, and term deposits. This gives you some control over your specific investments without the legal and administrative responsibilities of running an SMSF.

Have you considered other super funds or investment options?

If you're thinking about setting up an SMSF because you're not happy with your current fund or the way in which your money is invested, consider changing to another fund or investment option first.

Will your self-managed fund outperform your current fund?

Super funds use highly skilled professional managers to invest your super money. Can you do better than the professionals? Consider whether the investments you choose will perform as well as your professionally managed super fund. Are you confident you can accurately measure returns?

Have you considered the costs?

Like all super funds, your SMSF will have costs associated with running the fund. These include the cost of investing, accounting and auditing for your SMSF, which may be much higher than what you are currently paying.

Will you lose any benefits?

Super funds usually offer discounted life and disability insurance. If you set up an SMSF you will have to purchase your insurance separately. As the trustee of an SMSF, you are required to consider the insurance needs of the fund's members. Therefore, make sure you look into your insurance options before closing your current super account as age and health issues can limit your ability to buy a new policy and increase your premiums.

Do you know enough?

Are you aware of all your legal responsibilities? Do you understand the different investment markets? Can you construct and manage a diversified portfolio of investments? Do you know the tax implications?

SMSF prerequisites

If you're contemplating setting up and running an SMSF you typically need:

- A large amount of money in the fund to make the initial set up and annual running costs worthwhile.
- To budget for ongoing expenses such as professional accounting, tax, audit, legal and financial advice.
- The time and aptitude to research investments and manage the fund.
- The financial experience and skills to make sound investment decisions.
- To organise life insurance, including income protection and total and permanent disability cover for members.

How much money do you need to get started?

As a general guide you will need a minimum of $500,000 in existing super savings for an SMSF to be cost-effective. This is due to the fact that for balances of less $500,000 fees on a typical retail, industry, or corporate super fund are generally lower. A minimum of $500,000 also ensures that you will have sufficient funds to allow for some diversification in your investments.

Setting up an SMSF

If you decide that an SMSF is right for you, it's important to remember that you are taking on the legal responsibility of a trustee. This means that you are responsible for ensuring that the fund operates in accordance with the rules of the Superannuation Industry Supervision Act (SIS Act), and adheres to the rules of the fund's trust deed. Should you wish to proceed, the steps involved in setting up an SMSF include:

- Select the structure of the fund. You can either choose an individual trustee structure where each trustee is also a member of the fund, or a corporate trustee structure where a company is created to be the trustee, with each member of the SMSF appointed as a director of the company.
- Appoint the trustees. An SMSF can have a maximum of four members. All trustees and directors must consent in writing to their appointment, sign a trustee declaration and keep these documents on file.
- Establish the trust deed. The trust deed outlines the rules for the SMSF. The trust deed is typically prepared by a solicitor.
- Register the fund. You will need to register the fund with the ATO. This includes obtaining a Tax File Number (TFN) and Australian Business Number (ABN), electing your fund to be regulated and registering for GST (where applicable).
- Set up a bank account. You will need to open a bank account in your fund's name to manage the fund's operations and accept cash contributions, rollovers of super, and income from investments. This account is also used to pay the fund's expenses and liabilities.
- Develop and implement an investment strategy. You will need to formulate an investment strategy that accommodates the needs of all the fund's members. You must also consider any insurance requirements. Your financial adviser can provide you with professional advice and guidance in the development of the investment strategy.
- Appoint an auditor. You must appoint an approved SMSF auditor to audit your fund each year. The auditor examines your fund's financial statements and assesses your fund's compliance with super law.

Fees and charges

There are a number of fees and charges associated with establishing and running an SMSF. Typically these include, but are not necessarily limited to:

- Initial and ongoing professional advice fees (such as financial adviser, solicitor and accountant).
- Fund establishment fees (including preparation of the trust deed, ATO registration fees, and any establishment fees associated with investing).
- Ongoing auditing fees.
- Fees for establishing a bare trust (if you intend to borrow in the fund).
- Loan application fees (if you intend to borrow in the fund).
- Investment costs, such as; brokerage fees, or any fees associated with buying property in the fund (if applicable) such as stamp duty, property inspection fees and legal fees.

Depending on your circumstances and requirements, initial establishment fees can range from $2,500 to $4,000 with additional ongoing annual fees generally within the range of $2,700 to $5,500.

Remember your obligations

While SMSFs offer considerable flexibility compared to other super fund structures, the rules they operate within are subject to change. As the trustee, you are responsible and liable if you breach these rules. Your financial adviser and accountant can provide you with advice and guidance, however the ultimate responsibility rests with you.

Making an informed decision

Although SMSFs offer a greater degree of control and flexibility in comparison to other super fund structures, they require considerable time and effort to manage. To operate your SMSF effectively you will need the commitment and discipline to research investments, maintain records and prepare reports.

While they offer a number of benefits that can enhance your overall financial position, there may be other more suitable investment structures that can help you get to where you want to be. At the end of the day, whether an SMSF is the right solution for you will ultimately depend upon your needs, your circumstances, and your goals and objectives.

To discuss your particular circumstances in further detail and to explore whether an SMSF may be the right option for you, please contact us.

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