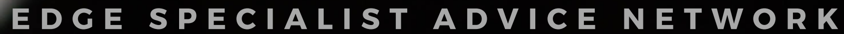

EDGE SPECIALIST ADVICE NETWORK

Self managed Superannuation

HAVING AN SMSF MEANS SIMPLY HAVING CONTROL OF HOW YOUR SUPER IS BEING INVESTED, AND IT HAS RECENTLY BECOME A POPULAR METHOD OF SAVING FOR RETIREMENT.

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Self Managed Superannuation

The term self-managed superannuation fund – otherwise known as an SMSF – basically refers to do-it-yourself super. Having an SMSF means simply having control of how your super is being invested, and it has recently become a popular method of saving for retirement.

If you choose to go down this path, it's essential that you are aware of the administrative and compliance requirements of SMSFs. The information below should answer many of the questions and obligations specific to managing your own SMSF.

Before you consider leaving your current superannuation fund to establish an SMSF, you should discuss your options in detail with a financial advise

Self Managed Superannuation

WHAT IS AN SMSF?

An SMSF is a trust where funds or assets are held and managed on behalf of a maximum of four individuals , to provide future retirement benefits. Subject to certain exceptions, all members of an SMSF must be trustees of the fund or directors of the fund's corporate trustee.

WHAT ARE THE BENEFITS?

The main rationale for establishing your own SMSF is the increased level of control you have, as well as the investment choice and flexibility. You become the trustee of your fund and therefore make decisions on your fund's investment strategy and the type of assets that are held within your fund.

Your SMSF can also invest in almost anything, including investments not usually available in a public super fund (please note, however, that these investments are subject to certain limitations and legal restrictions). This will allow your fund's investments to be customised to suit the precise requirements of members, before and after retirement.

Furthermore, similar to all complying super funds, an SMSF is taxed at a concessional rate. The top tax rate for investment earnings from your SMSF is 15 per cent. This tax concession, however, is only available for complying funds – which are SMSFs that fulfil all the rules set out by the ATO, the Superannuation Industry (Supervision) (SIS) Act 1993 and the SIS Regulations.

THINGS TO CONSIDER

Who are the governing bodies?

The Australian Taxation Office (ATO) is responsible for overseeing the regulation of SMSFs. While the ATO's regulatory approach to SMSFs has been focused mainly on education and information, it is fast becoming more aggressive in its stance on fund compliance.

Understanding the obligations and rules associated with an SMSF

As an SMSF investor, you need to consider your fund's investment philosophy – like any other super investment, you will need to establish what the acceptable rate of return is and how much risk you are willing to take with your retirement savings. These are areas where professional management can be a good idea. As an SMSF trustee, you are required to regularly review the investment strategy of your fund and consider insurance for the members of your fund.

Many investors who open an SMSF employ the services of specialist administrators to take on the difficult compliance activities on behalf of their fund. This is beneficial as they can still enjoy the investment control and flexibility without the added burden of administration.

Your fund's compliance with superannuation law is vital and you are legally accountable for ensuring your fund complies with all the rules – even if you pay for professional management.

Self Managed Superannuation

The main components of compliance for an SMSF relate to:

- how and when an SMSF is permitted to borrow
- in-house asset rules
- acquisition of assets from related parties, and
- conducting all dealings at arm's length.

Sole purpose test

The foundation of the SMSF regulatory system is the 'sole purpose test' – the sole purpose of your fund should be to provide retirement benefits to fund members.

Separation of assets

The assets of the fund must be separate to those of a business where one or more of the trustees are involved. For instance, if the trustee is declared bankrupt or if their business is placed in receivership and the assets are held in the name of that trustee, rather than being clearly held as a part of the fund, the fund risks the loss of the asset. The failure to separate assets is a clear contravention of SIS.

SMSF investments

To assist in making sure the assets in an SMSF are available to produce retirement funds, SMSFs are limited in the investments they can make. However, one of the concessions that the SMSFs can enjoy, is the ability to invest up to 100 per cent of the funds' assets in an investment property. The disadvantage of this, however, is the lack of investment diversification and liquidity. More restrictive rules apply to investments in personal use assets and collectables, that are in addition to the sole purpose test. Under the latter members cannot enjoy the benefit from the investment prior to reaching their retirement age.

This means that unless strict conditions are met and must be removed from the fund – like in the case of leasing the art to a member or related party, in line with
the 'in-house asset' and 'arm's-length' rules – the art cannot be displayed in the trustee's home or office.

The in-house asset rules suggest that the particular investment can make up a maximum of 5 per cent of the fund's entire assets and the arm's-length requirement means that it should be leased to the related party at commercial rates.

SMSF and Property

Using your SMSF to buy property is becoming increasingly popular but the decision to acquire property through your SMSF is one that requires careful consideration and should be discussed with your Financial Planner prior to proceeding. You will need to ensure that holding property within your portfolio supports your overall investment strategy and avoids any unnecessary risk. Your dedicated Financial Planner can assist you not only in making the most appropriate investment decisions based on your
current circumstances, but also ensuring your fund does not breach any current legislation and become uncompliant.
Any property that you purchase through your SMSF must meet the sole purpose test, and must not be purchased from, lived in or rented by any fund member or a relative of any member of the fund.

Limited Recourse Borrowing Arrangements

A limited recourse borrowing arrangement (LRBA) can be used to borrow money to purchase a single asset, for example a residential or commercial property.

Self Managed Superannuation

Borrowing to invest in super was introduced in 2007. Until then this strategy was generally not available to super funds because the superannuation law prohibited borrowing except in limited circumstances. The law was amended from September 2007 to allow super funds to borrow more broadly, and subsequent amendments in 2010 have further clarified the capacity of super funds to borrow to invest.

LRBA's must be set up to comply with all superannuation legislation and lenders requirements. The lender e.g. a bank, has recourse to the asset and no other asset of the trust. This is referred to as "limited recourse".

The asset must be held in a bare trust to ensure the loan remains limited recourse, and once the asset has been acquired, it can only be improved if it does not change the nature of the asset.

Fiduciary responsibilities

It is essential that all fiduciary responsibilities of the fund are met, especially in regards to the SMSF holding its own bank account (and no other personal accounts), and ensuring that this account is not overdrawn.

SMSFs that comply with all regulations are demonstrating to the ATO that they are appropriately managed. It is also important to note that the costs associated with the management of the SMSF, including ensuring compliance with all regulations, generally means that fund member collectively need between $150,000 and $200,000 to make the exercise of establishing an SMSF worthwhile.

SMSF TERMINOLOGY

- A trustee is a person or a company that holds and invests a fund's assets for the benefit of the members retirement.
- A member is a person who has contribution made for them
or receives benefits from the fund.
- A trust deed is a legal document that sets out the rules for
establishing and operating your fund.
- A bare trust, also known as a holding trust is where a trustee simply holds a property on behalf of a beneficiary.
- A related party of your fund includes all members of you fund, associates of the fund members, relatives of members, business partners and or any spouse or children
of those business partner.
- A lender is someone who lends the SMSF/bare trust monies to invest in a single asset e.g. a bank.
- A beneficiary of a bare trust is generally the SMSF as the trust is holding the asset for the SMSF.
- Diversification is a means to reducing non-systematic risk by investing in a variety of assets.
- Liquidity is the ability to convert an asset into cash e.g. a property is harder to convert than shares.
- Limited recourse means that a lender has limited claims on the loan in an event of default e.g. unable to pay any repayments requested by the lender.
- Fiduciary Responsibilities is the legal obligation for one party to act in best interest of another.

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