Self Managed Super Funds

This document contains factual and general information only to assist you in understanding financial planning concepts. It is designed to be used in conjunction with a Statement of Advice.

A Self Managed Superannuation Fund (SMSF) is essentially a superannuation fund which is controlled by you.

The primary purpose of a SMSF is to provide for members in retirement.

As a fund trustee, you make all decisions relating to the operation of the SMSF, including how the SMSF's assets are invested. However, there are strict rules in place for the operation of a SMSF.

It is the responsibility of the trustees to ensure the SMSF is run in accordance with these rules.

You must have a trust deed in place to establish a SMSF. A trust deed is commonly referred to as 'the governing rules of the fund'. A trust deed is a legal document drafted by a lawyer that establishes the existence of the fund and rules regarding its operation when it is properly executed.

The trustees of the SMSF must document a written Investment Strategy for the fund which provides a framework or parameters for investment decisions of the fund. It must be in writing so that you have evidence that your investment decisions comply with the Superannuation Act. An investment strategy can be structured and reviewed by your financial adviser. Ask your financial adviser how to do this efficiently.

Failure to comply with all the necessary regulatory measures can result in fines, loss of concessional tax treatment and even criminal charges. In order to discharge the obligations of a trustee diligently, you may need to employ skilled professionals such as solicitors, insurance/risk advisers, auditors, accountants and investment advisers. Please note: employing these service providers still does not absolve the trustee of their ultimate responsibilities.

Definition

A SMSF is defined as follows:

- Fewer than 5 members
- All members are trustees and all trustees are members (except for single member funds)
- If the trustee is a company, all members must be directors of the trustee company
- No member is allowed to be an employee of another member unless they are related
- Trustees cannot receive any remuneration for their services as the trustees of the fund.

Differences between superannuation funds and SMSF

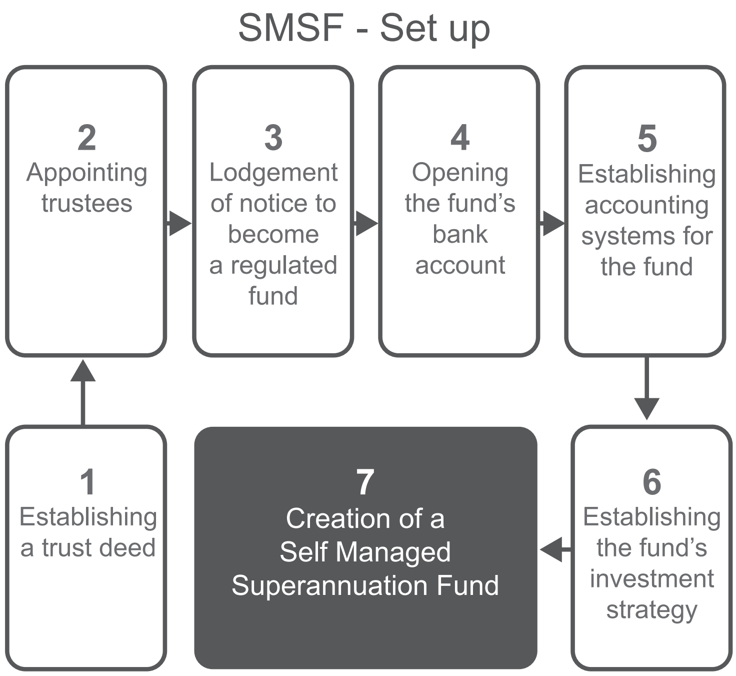
	Mainstream Funds (Retail, Industry, Public Offer)	SMSF
Available investment options	• Determined by the Fund • Can include shares, term deposits, Managed Funds and Managed Accounts. • Limited by the individual investment options the fund approves.	• Determined by the members. • Includes all of the options in mainstream funds and additional options like direct property and other assets like art. • There is no restriction for shares, managed funds etc. provided the investment options comply with the SMSF's Investment Strategy
Number of members	• Unlimited	• Up to 4 members
Management of fund	• The mainstream fund takes care of administration, compliance with the law and tax administration.	• Members of the fund as trustees are responsible for administration, compliance with the law and tax administration. • Although some tasks can be outsourced to professionals such as your accountant and financial adviser.
Control	• Retail fund makes the decisions on administration and investments decisions.	• You have greater control over the management of your superannuation benefits.
Licensing	• Mainstream funds are supervised by the Australian Prudential Regulation Authority (APRA) to ensure that they comply with the law. APRA funds are subject to a substantial prudential regime.	• SMSF's are subject to less onerous prudential requirements. SMSF's are subject to compliance-based regulation by the Australian Tax Office. • You will have obligations and responsibilities as a trustee. The Superannuation Act imposes administrative and compliance tasks on the trustees of SMSF's. If a SMSF does not meet the Superannuation Act requirements, the trustees may be exposed to penalties such as disqualification as a trustee or the SMSF may be taxed as a non-complying superannuation fund. The tax rate for a non-complying superannuation fund is 45% on the income and certain assets of the fund.
Insurance	• Mainstream funds can generally obtain large scale 'group' cover at significantly lower premiums and often without the need for underwriting. • Many funds will offer default levels of cover.	• SMSF Funds can only access retail insurance owned by the trustees. • You must document that you have considered the insurance needs of the members and if applicable, detail the reasons why personal insurance was considered not suitable.
Investment strategy	• You can choose your investment strategy from the available investment options but the fund does not have to document your overall strategy.	• You must review your fund's written investment and insurance strategy on a regular basis, at least annually.
Costs	• Costs are determined by the retail funds. They are often a combination of fixed costs and percentage based fees. • Generally you pay the trustee a fee to manage the fund. This may be bundled with administration and other investment costs.	• Most of the costs of running a SMSF are fixed (e.g. accounting costs, other compliance costs) regardless of the level of assets within the fund. This allows you to achieve economies of scale where you have sufficiently large assets within the fund. Generally you need $300,000 of investable funds for economies of scale to be seen.

	Mainstream Funds (Retail, Industry, Public Offer)	SMSF
Time	• Most tasks are done for you and involvement is usually limited to filling out forms and reading fund statements.	• Being a Trustee can be time consuming as decisions need to be made, meetings conducted and minutes taken.
Estate planning	• Many mainstream superannuation funds allow you to nominate who you would like to receive your accumulated superannuation benefit on your death, but the ultimate decision is made by the trustee.	• Trustees of a SMSF can control the distribution of superannuation benefits on the death of a member.
Winding up/Exit	• Mainstream superannuation funds allow you to roll out easily. The costs of exiting a fund will vary. Some funds do not charge for rollovers. From 1 July 2019, exit fees will not be charged.	• SMSFs are complex and costly to close and may include brokerage, agents' fees, final audit and administrative costs.
Compensation	• Mainstream funds are eligible for compensation where they suffer loss as a result of fraud or theft.	• SMSFs are not eligible for compensation if they suffer loss as a result of fraud or theft.
Complaints	• APRA regulated funds must address member complaints. Where complaints are not resolved members must be offered access to a free and independent complaints service which is generally the Australian Financial Complaints Authority (AFCA).	• SMSF trustees/ members must resolve their own complaints. This may require legal assistance and they do not have access to the Australian Financial Complaints Authority (AFCA).

Establishing a Self Managed Superannuation Fund

You need to set up a trust, and a trust deed which outlines the rules of operation of the fund. For example, you will need to address:

- Appointment of the trustee(s) of the fund (individual or corporate)
- Admission of members to the fund
- Appointment of professional advisers (e.g. administrator, auditor)
- Establishment of Trustee meetings, voting guidelines, minutes and how the meetings are to be run
- Setting an investment objective and written investment strategy
- Assessing the insurance needs of members
- Establishment of member accounts
- Establishment of reserves
- Establish a routine for regular reviews.



Ongoing costs of running an SMSF

Annual costs	Other costs
The annual ATO supervisory levy	Investment management fees (these fees may be unavoidable depending on the type of investments made)
The costs of annual financial statement and tax return	Accounting and book-keeping fees Professional investment advice fees
Annual independent audit fees SMSF establishment costs such as Trust Deed	If applicable, the set-up of a corporate trustee, including ASIC fees to establish a corporate entity and the annual corporate trustee fee
Fee for annual actuarial certification (when required).	Ongoing SMSF administration costs including the cost of amending the trust deed of the SMSF (Some of these costs may be unavoidable depending on legislative and investment changes.)

Investment Strategy for the Fund

The trustees of SMSF's are required to formulate and implement a written investment strategy that sets out the fund's objectives and investment parameters for the fund. In doing so, the trustees must have regard to:

- Appropriate diversification of the fund's assets
- The risk and return characteristics of the investments
- The fund's cash flow requirements including paying out benefits to the members as they fall due and any liabilities or meet fund expenses
- Whether the fund holds personal insurance for members
- Members' needs and circumstances

There should be an active review program for the investment strategy, and it should be updated as needed to reflect the needs of members. Ask your financial adviser how to do this efficiently.

Insurance Strategy for Members

The trustees must consider whether personal insurance cover is appropriate for the fund's members, taking into account each member's personal circumstances. Consideration should be given to the type and amount of cover required as part of the overall investment strategy of the fund.

Sole Purpose Test

SMSF's must be established for one of the following purposes:

- Provision of benefits for members upon retirement
- Provision of death or ancillary benefits to the dependants upon the death of the member prior to retirement.

This is known as the 'sole purpose test'. It is important that trustees understand that the assets of a SMSF can only be used for these purposes.

Related Party Transactions.

There are restrictions on the type of investments SMSF's are allowed to purchase from the members or an associate of a member. SMSF's can only purchase the following investments from a member:

- Listed securities
- Units in a widely held unit trust
- Business real property that is used to conduct business.

There are other investment restrictions such as lending to members or relatives, borrowing to invest, in-house assets limit (5% of current fund's assets) and arm's length transactions.

'In Specie' Transfers

Where an in-specie transfer is made from personal ownership to a superannuation fund, it is subject to the current concessional and non-concessional contribution caps and must comply with Superannuation (SIS) Act s66 which prohibits the purchase of an asset from a related party (some exemptions apply).

Conditions associated with In Specie Transfers:

- Asset values are at market value and market valuations must be performed by qualified valuers based on reasonably objective and supportive data
- In specie transfers must not breach SISA s66 as outlined above
- They must be in accordance with the fund's investment strategy, including the fund's trust deed
- Residential properties are not allowed as 'in specie' transfers into superannuation
- Some smaller property syndicates are not included and you should check with your managed fund if applicable.

Individual to SMSF Transfer

Trustees are generally prohibited from intentionally acquiring assets from related parties of the fund. However, there are exceptions to this rule including:

- All securities (such as shares, warrants etc) listed on an approved exchange (e.g. ASX) at market value
- Business real property, which must be acquired at arm's length and at market value
- Units in widely held unit trusts (like managed funds) at market value
- Term and other deposits with an approved deposit institution such as a bank

- Assets classed as "in-house assets" which would not result in the level of in-house assets exceeding 5% of the fund's asset value.
- You need to consider that you cannot personally borrow against the asset any more or use it for a personal guarantee. Only the superannuation fund can use it for superannuation purposes and in accordance with the trust deed and Superannuation (SIS) Act.

Gearing (Borrowing to Invest) within Self Managed Superannuation Funds

SMSF's can borrow money under a Limited Recourse Borrowing Arrangement (LRBA) to invest in eligible assets such as Australian direct property (residential or commercial) or listed shares or Exchange Traded Funds, provided the fund follows certain rules:

- The SMSF retains beneficial ownership of the asset.
- The asset is an asset the SMSF could otherwise legally acquire (if it had the funds).
- The investment is held in a third party trust which retains legal ownership of the investment until the loan is fully repaid.
- The borrowing is limited recourse i.e. the lender can only acquire the security or the asset purchased with this borrowed money and cannot claim other assets of the fund in the event of a default.

Gearing provides the benefits of possible further wealth accumulation for retirement; concessional tax on the investment income; capital gains of the asset; tax deductibility for the interest expenses and the ability to invest in the assets in which the SMSF previously could not invest in due to the lack of funds.

Ownership of Assets in a Limited Recourse Borrowing Arrangement

As the SMSF has the beneficial ownership of the investment, it is entitled to receive income e.g. rent and dividends (i.e. share dividend payments). The ownership will be transferred to the SMSF when the last loan repayment and any related outstanding costs are paid. The structure of the loan must be such that the lender's security is limited to the investment purchased only.

Important Considerations

The Trustees of the SMSF must consider the following before implementing gearing:

- Whether the trust deed allows borrowing to invest.
- Whether the fund has sufficient cash flow to service the loan and other related costs associated with the borrowing
- Whether the investment supports the sole purpose test of SMSF
- Whether the loan complies with the Superannuation Industry Supervision Act 1993 and ATO requirements
- Whether the contribution caps are exceeded if considering business real property or in-specie transfers as a personal contribution
- Whether the insurance needs of all members of the SMSF need adjustment due to the increased risks associated with borrowing to invest.
- Whether the investment can be signed off by the SMSF auditor as compliant with the legislation.
- Taxation issues such as capital gains tax and stamp duty.
- Costs associated with advice such as legal fees, establishment fees, etc.
- Restrictions on acquiring assets from related parties and in-house assets.
- Restrictions on the use of investment property assets.
- Members of the SMSF are unable to reside in an investment property that is owned by the SMSF – however they can do so after retirement, providing the property is withdrawn from the SMSF beforehand.
- Lending conditions - Due to the limited recourse nature of the loan the lenders bear more risk than standard loans so interest rates are typically higher. A lower loan-to-value ratio may also apply. Some lenders may seek personal guarantees from the SMSF members for a default scenario.
- Default - If the SMSF defaults on the loan, the lender may repossess or dispose of the asset.
- Compliance - If the required conditions are not strictly satisfied, borrowing money under a limited recourse loan will result in a breach of one or more of the superannuation laws. Such a breach may have civil or criminal consequences.
- Use of equity in property investments - Any equity that builds up in the property that is owned under this type of structure cannot be drawn down and used as the deposit for other properties. The property will need to be sold to realise the built up equity with the proceeds used for further SMSF property purchases.

You need to consider the following steps to implement the strategy:

- Speak with a solicitor to ensure an appropriate trust structure and declaration is established and trustees appointed correctly.
- Arrange the trust structure to ensure it meets all requirements. It is essential to seek professional legal advice on establishing an appropriate trust and company structure (if applicable) for this purpose.
- Review your SMSF Trust Deed to ensure it allows the fund to use borrowings to invest, and review/update as necessary.
- Review the investment strategy of the fund to ensure it allows for borrowing to purchase a direct property asset, and update if necessary.
- Minute your Trustee decisions that direct property investment and borrowing strategy is suitable for the Investment Profile of the SMSF members.

- Set up the declaration of trust. This is absolutely essential to ensure that a Capital Gains Tax event does not occur on transfer of the legal title to the SMSF and does not trigger stamp duty again.
- Maintain the sole purpose test by ensuring that the SMSF is invested for the sole purpose of providing retirement benefits to the members and dependants.
- Arrange a limited recourse borrowing arrangement by contacting a lender. The loan to valuation ratio should be no more than 66% which is around the limit allowable for these types of loans generally. The loan arrangement must be properly documented for the purposes of this strategy. You need to get professional legal advice for this. This will be an additional cost.

Publications for SMSF trustees and members

- Introduction for SMSF trustees: running a self-managed super fund (NAT 11032)
- Paying benefits from a self-managed super fund (NAT 74124)
- Introduction for SMSF trustees: Winding up a self managed super fund (NAT 8107)

In addition, the ATO has a step by step guide for every stage of an SMSF in information videos:
https://www.ato.gov.au/Super/Self-managed-super-funds/