Self-Managed Superannuation Funds

Self-managed super funds (SMSFs) are managed by the members. Each member is a trustee or director of a trustee company. The trustees act on behalf of the members (including themselves) and must act in each member's best interest.

In a SMSF, you can consolidate your existing super arrangements into one flexible super fund, that is purpose-built for its members. It offers the opportunity for as much control and flexibility as you want or need. As the trustee of your SMSF, you have control over fund assets, investments, tax strategies and estate planning. If you want assistance in the ongoing management and administration of the fund, you can utilise the services of specialists to do the administration, accounting and compliance work.

While all investments must be made in accordance with super law, the fund's trust deed and written investment strategy, SMSFs offer a greater breadth of investment choices when compared to typical retail or public offer fund.

There are several steps to set up a SMSF:

- Arrange for a trust deed - preferably drafted to address the current legislative requirements;
- Appoint the trustee/s – the trust deed will set out the appointment process. To be classified as a SMSF, all members must be trustees, and all trustees must be members or directors of the trustee company. You should seek legal advice about what type of trustee will best suit your circumstances. Special rules apply to single member SMSFs;
- Elect to become a regulated super fund – by completing and lodging the appropriate Australian Taxation Office (ATO) form within 60 days of the fund's establishment to receive concessional tax treatment;
- Obtain an Australian business number (ABN) - by completing and lodging the appropriate ATO form;
- Obtain a taxation file number (TFN) - by completing and lodging the appropriate ATO form;
- Admit members and establish member records;
- Open up a cash management trust (CMT) or bank account in the name of the SMSF and ensure the SMSF assets are maintained separately from personal assets;
- To comply with SuperStream and be able to receive contributions and rollovers for members, apply for an Electronic Service Address from a SMSF messaging provider:
- Formulate a written investment strategy;
- Review insurance cover for members of the fund;
- Review trustee duties and responsibilities; and
- Make investments in accordance with the investment strategy and the provisions of the trust deed.

The trustee must also meet ongoing administrative and compliance obligations such as lodging an annual statutory return which includes the SMSFs income tax return.

How a SMSF can work for you

SMSFs are for family members or close business associates looking to take control of the selection and management of their retirement assets. SMSFs can also facilitate the ownership of property, including business real property and in some circumstances, borrowings against these properties.

Characteristics of a SMSF

- They have six members or less.
- All members must be trustees, and all trustees must be members (except for single-member funds).
- Where the trustee is a company, all members must be directors of the trustee company.

- There must be a family relationship between members where a member of the fund is an employee of another member.
- The trustees cannot be paid for carrying out their duties as a trustee.
- The SMSF is regulated by the ATO rather than the Australian Prudential Regulation Authority (APRA).

Setting up a trust deed

A trust deed outlines the rules of operation for the fund. Things to include are:

- Corporate trustee - the establishment of a company to act as a corporate trustee;
- Appointments of the trustee(s) of the fund (individual or corporate);
- Admission of members to the fund;
- Appointment of professional advisers (e.g. administrator or auditor);
- Trustee meeting, voting guidelines, minutes and how the meetings are to be run;
- Setting an investment objective and investment strategy;
- Types of investments the trustee(s) can invest in;
- Borrowing to invest;
- Establishment of member accounts;
- Establishment of reserves; and
- Making non-lapsing binding nominations.

Corporate trustee

A corporate trustee can offer you the following long-term benefits which individual trustees cannot provide.

Liability issues

Companies have the benefit of limited liability. Therefore, if a corporate trustee suffers any liability, the individual directors will not suffer personal liability (other than in exceptional circumstances). On the other hand, an individual who acts as a trustee exposes their personal assets in certain circumstances, to liabilities of the trust.

Simpler succession and control of a trust on the death of an individual

A company continues to function even after the death of one of its directors; therefore, the control of a SMSF can continue even after the death of an individual SMSF member or director.

Assets are kept separate

It is easier for a corporate trustee to ensure that trust assets are kept separate from the personal assets of SMSF members.

Administrative efficiency for SMSFs

If a new member is introduced to a SMSF, then, generally they must become a trustee of the fund.

If the relevant SMSF has a corporate trustee, then a new director needs to be appointed a director of the company and notified to ASIC. If it has an individual trustee, a deed of appointment needs to be executed and, in most cases, all trust assets need to be transferred into the new trustee's name or jointly with other trustees. This can cause administrative hassles if the trust assets consist of real estate and shares. This does not apply to a corporate trustee as the SMSF assets are usually held in the company name, and the company remains the trustee. In most instances, bank lenders will insist upon the SMSF having a corporate trustee.

A corporate Trustee can be exposed to the following disadvantages and risks:

- Costs associated with establishing and maintaining a corporate trustee;
- ASIC reporting requirements of the trustee; and
- Procedural issues for holding meetings.

Advantages of setting up a SMSF

The advantages of having a SMSF are based on four main elements:

- Investment choice and control;
- Investment flexibility;
- Estate planning; and
- Creditor protection.

Investment choice and control:

The primary reason for establishing a SMSF is the control the trustees and members have over investment decisions. Many trustees of SMSFs prefer to invest directly by purchasing shares, interest-bearing securities and real estate as they consider whether their decisions can produce better returns than professional super fund managers.

SMSFs are in a unique position as they can acquire certain investments from members that are not available to funds with seven or more members. For example, super funds with less than seven members can purchase business real (commercial) property from members and other related parties. Before the transfer, the trustees would need to ensure the other investment standards in the Superannuation Industry Supervision Act (SISA) are satisfied, for example, that the property is not subject to a mortgage or charge.

In addition to the SMSF investing directly, the fund can purchase an asset via a limited recourse borrowing arrangement. This permits the fund to borrow to purchase an asset, providing it is one that the fund could acquire, and it is held on trust until the loan has been extinguished.

Investment flexibility

Any investment can be purchased within a SMSF as long as it meets the super legislative requirements and the trust deed of the fund. This gives trustees the flexibility to invest in line with the personal preferences of its members. They can also manage tax and estate planning directly by choosing how and when they acquire and sell investments of the SMSF.

In some circumstances the fund can purchase assets from members of the fund, allowing consolidation of investment assets.

Estate planning

SMSFs can provide an effective estate planning vehicle retaining investments for the benefit of future generations. By introducing younger generations as members of a SMSF and with prudent contribution strategies, they can build up the fund to provide cash benefits to older generations, preserving assets such as those used in the family business and/or real estate.

A SMSF can be tailored to meet your circumstances concerning estate planning. You can include family members as long as there are no more than six members in the fund at any given time.

Creditor protection

SMSFs can provide protection from creditors for those assets which may be leased to related parties of the fund. This would apply to business real property or certain in-house assets, that can be owned by the fund and, as a general rule, cannot be accessed by creditors of the fund members.

This contrasts with larger funds that usually do not permit the lease of fund property to members or related parties. There is no limit to the amount that can be held in the fund and protected from creditors.

As a consequence, the bankruptcy legislation has been strengthened to ensure that amounts transferred into super to avoid creditors can now be accessed.

Trustee obligations

The SMSF trustees are responsible for:

- Maintaining the fund for the sole purpose of providing retirement benefits to SMSF members, or their dependants if a member dies before retirement;
- Accepting contributions and paying benefits (pension or lump sums) to members and their beneficiaries in accordance with super and taxation laws, as well as the SMSF trust deed;
- Investment of funds and valuing the fund's assets at market value for the preparation of financial accounts and statements; and
- Having the financial accounts and statements for the SMSF audited each year by an approved SMSF auditor meeting the reporting and administration obligations imposed by the ATO.

Risks and disadvantages

The specific risk associated with having a SMSF is if the SMSF does not meet the SISA requirements, the trustees may be exposed to a range of penalties, disqualification as a trustee of any fund or the fund may be taxed as a non-complying super fund.

There are numerous requirements set out in SISA that the SMSF must meet to be a regulated super fund and receive the tax concessions of a complying super fund. One of the most important is the sole purpose test, which has traditionally been difficult to define and apply. What is certain though is that if a transaction is entered in to by the SMSF with the motivating force not being the provision of retirement benefits for members, the trustee risks breaching the sole purpose test.

The tax rate for a non-complying super fund is 45% on the income and certain assets of the fund from the financial year in which the fund is made non-complying.

The risk of this strategy is that, as directors of the corporate trustee, you are ultimately responsible in making sure the SMSF remains complying.

Even if one trustee is less actively involved, all trustees are equally required to comply with these trustee responsibilities and obligations and are liable for the actions of other trustees.

Super legislation imposes significant administrative and compliance obligations on the trustees of SMSFs, and non-compliance carries severe penalties.

The management of SMSFs can be very costly. You will need a combined balance of over $300,000 to make the cost viable compared to a traditional accumulation fund. If the SMSF's assets are invested in managed funds or via platforms, there can be increased costs, as the management fees are in addition to accountant, audit and advice fees for the SMSF.

The Australian Financial Complaints Authority (AFCA) can consider complaints about a range of different types of superannuation products including self-managed superannuation funds, however the AFCA cannot accept complaints from members of self-managed superannuation funds about the decision and related conduct of their trustees.

SMSFs are not subject to the same government protections that are available in APRA regulated funds, such as statutory compensation in the event of theft or fraud.

Unavoidable costs of having a SMSF

SMSFs have many ongoing costs to ensure compliance with superannuation and taxation legislation. These include:

- The annual SMSF supervisory levy (collected by the ATO);
- The costs to produce an annual financial statement and tax return;
- Annual independent audit fees;
- Costs relating to the establishment of the SMSF, including costs for a trust deed; and
- The fee for annual actuarial certification (when required).

Limited recourse borrowing arrangement (LRBA)

SMSFs are able to borrow to purchase assets in certain circumstances. One of the limitations is that the asset needs to be held in trust, and the loan is to have limited recourse to the asset held as security only. This is to protect the remaining balance of the SMSF.

Establishing a LRBA through a bare trust

You will require the services of legal and accounting professionals for the establishment of an LRBA:

- Bare trust establishment and preparation of appropriate documentation;
- Establishment of a corporate trustee to act as the trustee of the bare trust which will hold title to the property; and
- Appointment of directors to the corporate trustee.

The bare trust will hold the asset and borrow the funds for the purchase of the asset. The SMSF will not have legal ownership of the asset until the loan is repaid.

The SMSF trust deed should allow the trustee the power to borrow, grant security and allow assets to be held by custodians/nominees on their behalf. If not, the trust deed may be amended.

The SMSF's investment strategy also needs to allow for the acquisition of property and permit borrowing for that purpose. If not, the investment strategy may be amended.

How does this work?

This arrangement enables the SMSF to acquire an asset, in this case, direct property. This is achieved through the SMSF paying an initial instalment together with a borrowing of money to fund the remaining amount required to acquire the asset. The borrowing is repaid by the investor making further instalment payments.

The SMSF obtains an interest in the underlying asset that provides an entitlement to the income from the asset (e.g. rent in the case of property). The SMSF's interest in the asset is provided as security for the borrowing the SMSF has made. If the SMSF defaults on the borrowing, the lender may have recourse to the asset acquired. The lender has no recourse to any other asset of the SMSF.

To comply with legislation, strict conditions must be met to ensure borrowings do not breach the general prohibition that applies to the SMSFs borrowing money.

The arrangement must meet the following conditions:

- The borrowed money is applied to the purchase of an asset;
- The borrowings must be used to acquire assets that the trustees of the fund are not otherwise prohibited from acquiring;
- The asset acquired must be held in trust for the SMSF so that the fund receives a beneficial interest in the asset;
- The trustees of the SMSF must have a right to acquire legal ownership of the asset once one or more instalment payments have been made; and

- The lender's recourse must be limited to the asset to which the borrowings are attached. That is, even in the event of default, the lender cannot have the right to recover monies through recourse to the fund's other assets. However, the whole of the asset (direct property) is at risk.

Advantages

- The interest expense is deductible to the SMSF. If the property is negatively geared, the excess deductions can be used to reduce any contributions tax liability of the fund.
- As the rental payments will not be super contributions, they are not subject to contribution caps that apply to concessional and non-concessional contributions. They will be regarded as investment income.
- If you were to sell the property in the future, any capital gains arising would be capped at a maximum of 10% (assuming the property is held for over 12 months). This could potentially reduce to zero if the building is disposed of after commencing an income stream or pension.

Risks and disadvantages

- If the required conditions are not satisfied, borrowing money under an LRBA will result in a breach of one or more of the super laws. Such a breach may have civil or criminal consequences, and this could result in the SMSF becoming non-compliant.
- When borrowing to invest under the instalment warrant exception, the impact of State and Commonwealth taxes must not be overlooked. Of particular importance is the impact of capital gains and property transfer (stamp duty) taxes at the time the final instalment is made and the title to the asset passes to the trustees of the super fund.
- In certain circumstances tax concessions may apply where the transfer of title does not involve a change of beneficial ownership, however as laws differ from state to state, professional taxation or legal opinion should be sought before entering any arrangements involving the borrowings under the instalment warrant exception.
- In the event of a falling market, the SMSF may not have sufficient money to maintain the property.
- A disadvantage of this strategy is that the bare trust, loan agreements and a corporate trustee could cost approximately $3,000 to establish.
- If you borrow to invest within your SMSF and you purchase direct property, your SMSF portfolio could be lacking diversification which can carry significant risks when the property market underperforms other asset classes.

In-specie transfer to SMSF

An in-specie or off-market transfer is the transfer of an asset in its current form into super. E.g. listed securities, business real property or managed funds.

As the in-specie transfer is seen as a contribution into super, it is subject to:

- The current non-concessional contribution cap of $110,000 per annum or $330,000 over three years by choosing to bring forward the next three years limit (from 1 July 2021);
- The concessional caps of $27,500 per annum for all ages; and
- Must comply with SISA s 66.

Advantages

- Making an in-specie transfer into your SMSF will allow the asset to be transferred into your SMSF without the need to sell it. You will not experience time out of the market, and the value of the investment is the market value at the time of the transfer.
- It has the potential to increase your retirement benefits, increasing income to the fund, as well as decrease income tax payable by you.
- You can transfer business real property into a SMSF.

Risks and disadvantages

- You will not be able to access your super monies until you meet your preservation age and trigger a condition of release, which can include:
    - Between preservation age and 60 – cease employment with no intention of working either part-time or full-time again;
    - Having attained age 60 and ceased employment; or
    - Attained age 65.
- The market valuation of the asset. A market valuation may be undertaken by either a qualified person or a person without formal qualifications. However, the person who conducts the valuation must base their valuation on reasonably objective and supportable data.
- Capital gains tax consequences. Although the asset has not been sold, with the transfer into super, beneficial ownership of the asset will change; therefore, you may either trigger a capital gain or crystallise a capital loss.

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.

If being transferred into a SMSF, they must be in accordance with the fund's investment strategy.

This document contains general information about the benefits, costs and risks associated with certain product classes and strategies. It is designed for use in conjunction with a Statement of Advice that takes into account the circumstances and objectives of an individual. Before making a commitment to purchase or sell a financial product, you should ensure that you have obtained an individual Statement of Advice. As legislation may change, you should ensure you have the most recent version of this document.

Winding-Up Process

It is expected that you will operate your SMSF for many years however you should be aware of some of the common reasons why a SMSF is wound up:

- divorce of members
- death of a member
- loss or lack of capacity of a member
- SMSF is no longer a suitable investment vehicle (e.g., trustee / director no longer has the time or ability to operate the SMSF)
- member becomes a non-resident.
- member becomes a disqualified person e.g., bankruptcy.

The ATO provides some information on the processes involved in winding up a fund.

https://www.ato.gov.au/Super/Self-managed-super-funds/Winding-up/

Other Information

The ATO website has a lot of further information on the establishment and operation of a SMSF and we suggest you refer to the following short videos that they provide:

https://www.ato.gov.au/Super/Self-managed-super-funds/Thinking-about-self-managed-super/
https://www.ato.gov.au/Super/Self-managed-super-funds/Setting-up/
https://www.ato.gov.au/Super/Self-managed-super-funds/Contributions-and-rollovers/
https://www.ato.gov.au/Super/Self-managed-super-funds/Investing/
https://www.ato.gov.au/Super/Self-managed-super-funds/Paying-benefits/
https://www.ato.gov.au/Super/Self-managed-super-funds/Administering-and-reporting/

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