Self managed superannuation funds

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If you want greater control over your super and more flexibility than you would get with a conventional super fund, then a Self Managed Superannuation Fund (SMSF) could be an attractive option. However they are more complex and also strictly regulated. This guide outlines some of the ways you might benefit from an SMSF but also some of the key things you need to consider before establishing one and moving your benefits over to it.

The following information is current as at 9 November 2015.

What is a self managed superannuation fund (SMSF)?

An SMSF is a superannuation fund that you manage yourself.

Most people have their super with a fund that is managed by a third party – a fund manager, a large corporation or an industry body. However, a rapidly growing number of people have decided to manage their own super funds which are known as SMSFs.

An SMSF provides retirement benefits for its members in the same way as any larger regular superannuation fund but there are some differences in how they are regulated by the government and how they are administered. One key difference between SMSFs and larger funds is that they must have no more than four members. In addition, the fund is run by all the members collectively.

What are the Benefits?

Investment control

Most superannuation funds will allow you to invest into shares, fixed interest and property via managed funds, but often with strict restrictions. SMSFs however, offer a large range of additional investment options including direct property, physical gold and other commodities, derivatives, and subject to strict requirements, collectables such as art work. SMSFs also offer the flexibility of borrowing within your fund for investment.

In particular, many small business owners hold their business premises within their SMSFs for a variety of reasons including asset-protection, succession planning and security of tenancy.

Greater investment flexibility

SMSF members also have greater flexibility on when they acquire and sell their investments and this hands-on approach can mean, for example, as market conditions change you can quickly respond by adjusting your investment portfolio.

Capacity to pool your super with up to three other individuals

SMSFs provide you the ability to pool your resources with up to three other members. This increased pool may allow you to access investment opportunities that may not be available otherwise. The available investments further increases when gearing using this increased investment pool is considered.

Estate planning

SMSFs offer great flexibility with your estate planning needs. SMSF members can make binding death benefit nominations that do not lapse, unlike many public offer super funds which tend to require binding death benefit nominations to be updated every 3 years. In addition, SMSF members have greater flexibility in specifying how death benefits are to be paid.

Effective tax management

Control and flexibility over your SMSF investment decisions affords you the ability and means to consider tax when managing your fund's investments such as the effect imputation credits will have on the after-tax earnings of the fund.

The current tax rate on earnings within a superannuation fund is 15% however, where the income is produced by assets supporting an income stream such as a pension, there is no tax payable within the fund on that income.

This difference in tax rates means that by having control over the disposal of assets, you can minimise, or potentially eliminate a capital gains tax liability.

What are the Risks?

Time required to manage your own SMSF

Running your own SMSF can be time consuming and even though you can appoint an SMSF administration service, which most trustees do, there is a significant amount of activities which need to be completed throughout the year.

Skills required to manage your own SMSF

All super members should have an understanding of the investment markets and classes in which their super benefits are and could be invested. However, this is more important for members of an SMSF who have to make and implement the investment decisions of the fund.

In addition, when running your own SMSF you are required to form and regularly review an investment strategy which considers the risk, diversification, liquidity, solvency and insurance requirements of the fund.

Penalties for non-compliance

Being a member of an SMSF means that you are running your own super fund and as such, you have an obligation to comply with the super rules. Where you fail to comply, the ATO can levy a range of penalties which vary depending on the severity of the breach and can include compulsory education and/ or fines. The penalties can be quite harsh for serious misconduct.

Lack of statutory compensation

Unlike members of conventional funds, members of SMSFs will not be eligible for compensation under superannuation laws if the SMSF suffers loss as a result of theft or fraud in the underlying investment assets.

Access to complaints mechanisms

SMSF members do not have access to certain dispute resolution mechanisms, such as the Superannuation Complaints Tribunal (SCT) for their SMSF benefits. Disagreements can be resolved through alternative dispute resolution techniques or in court which will be at the members' own expense.

Impact on insurance

Life and disability insurance can be more expensive and harder to obtain for SMSFs than for larger superannuation funds which can often also offer default levels of cover without a medical assessment.

When establishing an SMSF it is important to consider keeping the account in your large super fund open with a sufficient balance to maintain your insurance.

Exit strategy

In addition, there are a number of trigger events that may lead to needing to exit an SMSF in the future. These include a trustee becoming a disqualified person; non-residency; loss of capacity; lack of interest; relationship breakdown of fund members; death of a member or special estate planning needs. In addition, when you draw down on your benefits, the balance of the fund may reduce below the point where the fund continues to be cost competitive.

Where one of these events occurs and the SMSF is to be wound up, there are generally three options available. These include rolling over the superannuation benefits to a public offer fund, converting the SMSF to a small APRA fund (SAF), or meeting a condition of release. There are costs involved in winding up an SMSF, however it is important to have an exit plan.

Anti-Detriment

The anti-detriment payment, which is a refund of the tax paid from the deceased's account on certain death benefit payments, is generally not paid from SMSFs.

This may result in your beneficiaries receiving less than they would have if your benefits had been in a larger fund.

How much does an SMSF cost?

It is important to consider the costs associated with an SMSF and to compare those costs with what you would incur by keeping your benefits in a large super fund. The difference in costs can be considerable because of the way they are charged. The various costs related to SMSFs are more likely to be fixed and therefore, the overall cost is generally less affected by changes in the level of benefits within the fund. On the other hand, the fees charged in large super funds are generally percentage based and as such, increase in-line with the level of benefits.

Where the combined benefits within an SMSF are less than $200,000, the SMSF is unlikely to be cost competitive compared to a large super fund.

Examples of SMSF costs		
Cost Type	Examples	
Costs associated with setting up an SMSF	Unavoidable	Costs for a trust deed
	Optional	Costs for establishing a corporate trustee, including the ASIC fee for establishing a corporate entity.
Ongoing costs associated with operating an SMSF	Unavoidable	The annual SMSF supervisory levy (collected by the ATO), the annual independent audit fee, costs to produce an annual financial statement and tax return, and (when required) the fee for annual actuarial certification
	Optional	Costs for amending the trust deed of the SMSF, professional investment advice fees, accounting and book-keeping fees, and investment management fees.
Costs associated with winding up an SMSF		Costs will include both compliance costs and costs related to realising assets. The nature of some of these costs will depend on the assets the SMSF invests in, but might include brokerage or agent fees.
Investment costs		There will be costs associated with making investments through the SMSF. These costs will vary depending on the nature of the asset and also the frequency with which assets are bought and sold within the SMSF.

Further, there is a cost associated with the time you spend on running your own fund which will depend on how much you do yourself and how much you outsource to a professional.

Who can be a member and who can be a trustee?

An SMSF can have no more than 4 members at any one time and are generally, though not always, members of the same family. A member cannot be an employee of another member unless they are related.

An SMSF is in essence just a trust and like any trust is run by the trustees. There are two SMSF trustee structures, one where the trustees work in their individual capacity and another where a company is appointed as the trustee. In both cases, it is the members who run the fund and as a general rule, all members are either trustees themselves or directors of the corporate trustee. Also, it is only the members who run the SMSF and as such, all individual trustees or directors of the corporate trustee must generally be members of the fund.

Trustees cannot be paid for carrying out their trustee duties.

Certain people cannot act as an individual trustee or a director of a corporate trustee of a super fund including someone who:

- has been convicted of an offence involving dishonest conduct.
- has been subject to a civil penalty under the superannuation legislation.
- is insolvent or under administration (an undischarged bankrupt).
- who has been disqualified from acting as a trustee of a superannuation fund by the ATO.

The appropriateness of the different SMSF trustee structures

There are a number of differences between the two SMSF trustee structures and it is important to choose the one most appropriate during the establishment of the SMSF as it can be quite difficult to change later on. A corporate trustee structure is the most appropriate for the majority of SMSFs though the table below should assist you in determining which is the most appropriate in your circumstances.

Area	Comparison
Change of members or trustees	Where a new member is admitted to a fund or a member departs including through death, there can be significantly more administration involved where there are individual trustees. This is due to the requirement that all trustees are members and where there are individual trustees, all assets should be in the name of all trustees. For corporate trustees, the assets are held in the name of the company and no change in ownership occurs when a member joins or leaves.
Single member funds	With individual trustees, a single member fund is only allowed where there is a second trustee who is not a member. However with a corporate trustee it is not necessary to involve a second person, though it is permitted.
Costs	There are slightly increased establishment costs with a corporate trustee due to the additional requirement to register a company. In addition, the company incurs an annual fee payable to ASIC though this fee is quite low when the company only acts as trustee of the SMSF.
Ownership of assets	As the assets are held in the name of the company when using a corporate trustee, there can be no mistake or dispute over whether an asset belongs to the fund or to the individual. However, where the company is used for other purposes there can be confusion over which assets belong to the SMSF and therefore, it is generally better to establish a new company solely to operate as the SMSF Trustee.
Trustee obligations	All trustees are obligated to abide by the fund’s trust deed and the superannuation laws. However, directors of corporate trustees will also have to comply with the company’s constitution and the laws applying to companies.

Establishing an SMSF

Your Financial Planner can help you establish an SMSF, but it is important to understand the steps involved. These are outlined below.

1. Establish a trust

Before you can register an SMSF with the Australian Tax Office (ATO), you need to establish a trust. A trust is required to have the following:

- Trustees
- Assets
- Identifiable beneficiaries
- Intention to create a trust.

2. Obtain trust deed

The trust deed sets out the rules and conditions under which the SMSF will operate, so it is vital to start with a well-drafted trust deed. It should be prepared by a qualified legal practitioner who understands superannuation law (and SMSFs in particular) and designed to give the trustees maximum control and flexibility. When the deed is found to be satisfactory, it should be executed by the trustee(s) according to the rules applying in their state.

The trust deed:

- Stipulates the regulations for the trustee to follow, however it is not permitted to contain clauses that would require the trustee or trustees to breach the SIS Act
- Should be drafted to allow the SMSF to target its objectives
- Can be amended, but only in accordance with the rules set out in the original trust deed
- Determines how member accounts will be calculated. In the accumulation phase, the trust deed will indicate how earnings will be credited to each member's account
- Stipulates whether the SMSF can pay pensions, and if so, how.

Provisions that could be contained within a trust deed

A trust deed for an SMSF could contain provisions that deal with the following:

- Who will be a trustee of the SMSF
- Who can be a member of the SMSF
- Trustee rights to amend the trust deed
- Who can make contributions
- Member investment choice availability
- When and how benefits can be paid
- Types of income streams the SMSF can pay
- Acceptance of binding death benefit nominations
- Who benefits can be paid to upon the death of a member
- Rules to establish and administer fund reserve accounts
- When and how the SMSF should be wound up.

3. Sign a declaration

Upon becoming a trustee or director of the corporate trustee of an SMSF, you are required to sign a declaration form stating that you understand your obligations, duties and responsibilities as a trustee or director of the corporate trustee of an SMSF. The declaration must be in the approved form (available from the ATO) and completed within 21 days of you becoming a trustee.

Your obligations and responsibilities as a trustee of an SMSF include:

- Acting honestly in all matters affecting the SMSF.
- Exercising the degree of care, skill and diligence of an ordinary prudent person.
- Acting in the best interest of the members.
- Keeping SMSF assets separate from your personal and business assets (and those of any other trustees of the fund).
- Not do anything that would impede trustees from performing their functions and powers.
- Formulating and implementing an investment strategy.
- Managing reserves responsibly.

Allowing the members access to certain information.

You must keep your completed declaration for at least 10 years and make it available to the ATO if requested.

4. Lodge an election with the regulator

Within 60 days of the establishment of an SMSF, the trustees must lodge an election to be regulated with the ATO. This election is irrevocable and advises the ATO that the SMSF will be subject to the requirements of the relevant superannuation legislation and therefore will be entitled to concessional taxation treatment at the rate of 15% as a complying fund.

If an election notice is not lodged, the SMSF will not be treated as a complying fund for taxation purposes and the SMSF will be taxed at the highest marginal tax rate.

5. Open a bank account

The trustee of an SMSF will generally need to set up a bank account so the SMSF can accept contributions, rollovers and earnings from investments. This account will also be required to pay expenses such as annual supervisory levy, accounting fees, taxation liabilities and importantly, member benefits.

Stages of the SMSF

Accumulation Phase

The accumulation phase of an SMSF is where the SMSF accumulates contributions and earnings. Each member has a specific balance in the SMSF and earnings are generally allocated in proportion to their interest in the SMSF.

Pension Phase

This is where the accumulated funds are used to provide an income stream for the member of the SMSF based on their individual balance in the SMSF.

Key rules and regulations

The rules and regulations that govern SMSFs are stringent.

The governing legislation for SMSFs is the Superannuation Industry (Supervision) Act 1993, commonly referred to as the SIS Act. Here are some key rules you should be aware of.

The sole purpose test

The sole purpose test requires that SMSFs are maintained for the purpose of providing benefits to members upon their retirement, or to their dependants if a member dies. As a trustee of a regulated superannuation fund, you must comply with the sole purpose test for the SMSF to be eligible for superannuation tax concessions. The sole purpose test is divided into core and ancillary purposes.

A regulated SMSF must be maintained solely for either:

- One or more core purposes, or
- One or more core purposes and one or more ancillary purposes.

Core purpose

An SMSF must be maintained to provide benefits for each member of the SMSF on or after at least one of the following:

- The member's retirement
- The member reaching an age not less than prescribed in regulations
- The member's death, if the death occurred before they retired, and the benefits are provided to their dependants or legal personal representative or both
- The member's death, if the death occurred before they attained an age not less than prescribed in regulations, and the benefits are provided to their dependants or legal personal representative or both.

Ancillary purpose

Ancillary purposes for maintaining an SMSF are to provide benefits for members in the following circumstances:

- Termination of a member's employment with an employer who made contributions to the SMSF for that member
- Physical or mental ill health
- Death of a member after retirement where the benefits are paid to their dependants or legal personal representative or both
- Death of a member after reaching an age not less than prescribed in regulations where the benefits are paid to their dependants or legal personal representative or both
- Another ancillary purpose approved in writing by the regulator.

This allows an SMSF to also provide benefits in situations of financial hardship and/or on compassionate grounds, subject to the SIS Act, the governing rules of the SMSF and the approval of the appropriate regulator.

Accepting contributions

As a trustee you must be aware of the minimum standards for accepting contributions under the SIS regulations. The rules become more complex from age 65 and generally require satisfaction of a work test. There are also limitations on how much can be accepted as a single contribution at any point in time.

Types of contributions

Concessional Contributions are contributions made for you or by you for which a tax deduction is claimed and are included in the assessable income of the SMSF.

They include:

- Superannuation Guarantee (SG) contributions
- Contributions made by employers over and above the SG or award obligations including salary sacrifice contributions
- Payments by the ATO of SG shortfall amounts
- Award/agreement certified by an industrial authority related contributions
- Personal contributions for which a tax deduction is claimed.

Non Concessional Contributions (NCCs) are contributions that are not assessable to the SMSF and include:

- Personal post tax contributions
- Spouse contributions
- Certain amounts of an overseas transfer
- Excess concessional contribuitons above the concessional contribuitons cap which are not refunded.

Investment restrictions

There are various restrictions and requirements placed on how an SMSF may invest its assets. These are designed to protect member benefits. The main ones are:

- Sole purpose test
- Trustee covenants concerning investment of member's money
- Regulations applying to investments in collectibles and personal use assets
- Borrowing restrictions
- Fund assets cannot be used as security for any borrowing
- Restrictions on loans to members
- Non arm's length investments
- Acquisition of assets from related parties
- In house asset provisions
- Written investment strategy.

Administering an SMSF

It is the trustee's responsibility to ensure that the ongoing administration and compliance tasks of an SMSF are carried out in accordance with the applicable regulatory requirements. Some of the ongoing responsibilities include:

- Arranging the annual return which includes the tax return, the regulatory return, a member contribution statement in respect of each member and audit reports
- Valuing the assets of the SMSF at market value
- Keeping all necessary records and documents
- Holding the assets for the SMSF separately from the trustees's personal assets.

Managing the SMSF

Investment strategy

As a trustee of an SMSF, one of your key areas of responsibility is to manage the SMSF's investments. The SIS Act places certain duties and responsibilities on trustees when making investment decisions. These are designed to protect and increase member benefits.

You are required to prepare and implement an investment strategy for the SMSF, and regularly review it. The strategy must reflect the purpose and circumstances of the SMSF and consider:

- Investing in such a way as to maximise member returns, taking into account the risk associated with the investment
- Appropriate diversification and the benefits of investing across a number of asset classes (for example shares, property, fixed interest) in a long term investment strategy
- The ability of the SMSF to pay benefits as members retire and pay other costs incurred by the SMSF
- The needs of members (for example, age, years to retirement and the type of benefit to be paid)
- Whether the trustees of the SMSF should hold insurance for one or more members of the SMSF.

The investment strategy outlines how the SMSF will aim to achieve its objectives and should include:

- The asset classes the SMSF will invest in
- The relative percentage weightings and benchmarks for each asset class.

The percentage weightings and benchmarks should take into consideration the risk profiles of the members as well as the SMSF's overall objectives.

Separate investment strategies can be formulated for each member of the SMSF. This can assist the trustee to deal with situations where different members of the SMSF have different risk profiles (e.g. someone who has just started working may have a higher growth asset allocation whilst someone near retirement age may be more conservative).

Review regularly

The investment strategy should be reviewed on a regular basis for several important reasons. These include:

- Whenever the membership of the SMSF changes or whenever the personal circumstances of a member change
- The death or departure of an existing member
- The addition of a new member
- The retirement of a member.

These reviews are in addition to the regular review of the investments held, which should be undertaken at least annually.

Failure to comply with investment rules carries significant penalties. These penalties can range from the freezing of SMSF assets through to trustee fines, disqualification, prosecution and criminal conviction.

Insurance via superannuation

Death, Total and Permanent Disablement (TPD) and Salary Continuance policies can be purchased by an SMSF. The premiums for these policies are generally tax deductible (in full or part) to the SMSF as long as the SMSF is a complying superannuation fund

Since 1 July 2014, it has not been possible to take out a new Trauma policy or a new TPD policy for own occupation with any superannuation funds including SMSFs.

Beneficiary nominations

The benefit clauses in an SMSF trust deed outline what benefits may be paid, to whom they can be paid and the procedure for nominating beneficiaries.

For example, the trust deed may:

- Require payment to certain beneficiaries
- Allow a member to make a non-binding death benefit nomination
- Allow a member to make a binding death benefit nomination.

Non-binding death benefit nomination

A non-binding (or discretionary) death benefit nomination involves the member advising the trustee as to who they would like the trustee to pay their accumulate benefits upon their death. However the trustee retains ultimate discretion as to who and how the death benefit is actually paid.

Binding death benefit nomination

A binding death benefit nomination involves the member making a nomination to the trustee in a way that binds the trustee to pay the member's death benefit in accordance with their nomination. A binding death benefit nomination should meet the following conditions:

- It must contain the name of each person(s) (e.g. spouse who is to be paid a benefit), and a clear instruction as to the amount of the death benefit
- Each death benefit nominee must be a legal personal representative or dependant of the member
- The nomination form must be dated and signed by the member in the presence of two witnesses aged 18 or over, neither of whom is a beneficiary named in the notice
- The nomination form must contain a declaration by the witness, stating that the member has signed and dated the nomination form in their presence.

A binding death benefit nomination may be amended or revoked at any time. Depending on the terms of the Trust Deed, a binding nomination may need to be renewed every three years.

Tax issues

Tax concessions for complying funds

The trustee of a complying fund is liable to pay tax on the taxable income of the SMSF for the year. The taxable income of a complying SMSF is calculated by adding total assessable investment income, concessional contributions and assessable gains, then offsetting for allowable deductions. A complying SMSF is taxed at the concessional rate of 15% on its taxable income in accumulation phase. However, income (including capital gains) earned in pension phase is tax exempt

Capital gains tax

Capital Gains Tax (CGT) provisions apply to complying SMSFs where the SMSF disposes of a CGT asset. Where the SMSF has held the asset for less than 12 months, the entire gain (after allowing for any capital losses) is included in the SMSF's assessable income. Where the SMSF has owned the asset for at least 12 months, only 2/3rds of the gain (after allowing for any capital losses) is included in the SMSF's assessable income.

Imputation credits

Where an SMSF has investments in Australian equities and managed funds carrying imputation credits, an opportunity exists to improve the tax efficiency of the SMSF. Excess imputation credits may be used to offset other tax payable in the SMSF, or otherwise refunded to the SMSF in cash.

Franked dividends are taxed in the same manner for a complying SMSF, as for an individual. The franked portion of the dividends are required to be "grossed up" and it is on the grossed up amount (dividends received plus imputation credits) that tax is assessed.

Small APRA funds (SAFs) – an alternative to SMSFs

A SAF may be used where the members want some control over their superannuation investments but do not wish to undertake the trustee requirements of an SMSF. A SAF may also be useful if a member of the fund is a disqualified person or is under a legal disability.

The main difference between a SAF and an SMSF is that a SAF must have an authorised trustee, whereas the trustees of an SMSF are the members. A SAF is regulated by APRA whereas SMSFs are regulated by the ATO.

To become a SAF a fund must have:

- A maximum of four members, and
- A trustee that is an approved trustee.