Fact Sheet - Self Managed Superannuation Funds

This document provides some additional information to help you understand the financial planning concepts in relation to self managed superannuation funds.

For more information, please contact the DPM Private Wealth team on (03) 9621 7000 or email info@dpmfs.com.au.

For individuals seeking to own direct investments within superannuation or gain greater control of their superannuation portfolio, Self Managed Superannuation Funds (SMSFs) can be an attractive alternative.

SMSFs can facilitate all major superannuation functions including:

- Accepting new superannuation contributions.
- Housing superannuation funds received from a change in employment.
- Paying a retirement income.

Considerations in Establishing Self Managed Superannuation Funds

Members

A SMSF must have between one and four members. No member is allowed to be an 'employee' of another member unless related.

The Sole Purpose Test

To meet the Sole Purpose Test, SMSFs must be established for one of the following purposes:

- The provision of benefits to members upon retirement or
- The provision of death or ancillary benefits to members.

The trustee of a regulated superannuation fund must comply with the Sole Purpose Test to be eligible for the taxation concessions available to a complying superannuation fund.

Investment Guidelines

Legislation requires that the trustees of SMSFs prepare and implement an investment strategy having regard to:

- The Risk/Return profile of selected investments in light of the investment horizon.
- The diversification of fund assets.
- The liquidity of fund assets.
- The ability of the fund to meet current and prospective liabilities.

This strategy must be documented and continually monitored and updated.

In addition, a SMSF may only purchase certain types of investments from you or an associate. A fund can only acquire the following assets from a member:

- Shares listed in Australia or on an approved overseas stock exchange.
- Units in widely held unit trusts.
- Business real property used wholly for any business purpose.

The transfer of any other assets may attract a penalty of imprisonment.

Cost Considerations

The costs associated with establishing a SMSF fund may include the following:

- Preparation of a trust deed including updates following legislative changes
- In the event of a corporate trustee, costs of establishing and using this framework
- Costs of using and establishing the administrative framework and,
- Accounting, audit and ongoing administration of the fund.

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Establishing the Trustee/s

The trustee is responsible for compliance with a range of investment related requirements including:

- The investment strategy covenant
- Various restrictions on investments and benefits including those related to:
    - lending to members or their relatives
    - acquiring assets from members or their relatives
    - in-house assets
    - arms-length transactions
    - borrowing by the fund
    - member reporting obligations
    - contribution standards
    - benefit payments standards.

While trustees may outsource certain functions to external service providers such as a fund administrator or an accountant, the ultimate responsibility and accountability for the fund always lies with the trustees.

The trustee of a SMSF can be a corporate trustee (i.e.: a private company) or individuals who are members of the fund.

Where the trustees are individuals, the trustee arrangements must be as follows:

- All members must be trustees
- Each individual trustee must be a member

This arrangement promotes true self management of the fund by ensuring that all the members have the opportunity to be involved in making decisions that directly affect their superannuation.

A SMSF may have a corporate trustee providing that:

- Each director of the company is a member of the fund
- Each member of the fund is a director of the company

Single Member Funds

Where a SMSF has only one member, that person may elect to have a corporate trustee. In this case, the member must:

- Be the sole director of the trustee company or;
- There can only be two directors of the trustee company, however the single member:
    - Must not be an employee of the other director of the trustee company, or
    - Must be related to the other director of the trustee company

Alternatively if the single member fund does not wish to have a corporate trustee, then the fund must have two individuals as trustees. One of the individual trustees must be the member, along with:

- Any other person provided the member is not an employee of that person selected to be the other individual trustee, or;
- Any other person who is a relative of the member

Corporate Trustees

Advantages of a Corporate Trustee

Administrative Efficiency - under a corporate trustee structure, when a member joins or leaves an SMSF all that is required is that the person becomes or ceases to be a director of the corporate trustee. The corporate trustee does not change and therefore the assets remain in the name of the corporate trustee. To introduce a new member to an SMSF with individual trustees, that person must also become a new trustee of the fund. As a result, all assets must be transferred into the name of the trust trustees, which requires the title to all assets being transferred to the new trustees and may involve stamp duty and related costs.

Continuous Succession - a company has an indefinite life span and therefore a corporate trustee can make control of an SMSF more certain in the circumstances of the death or incapacity of a member. If an SMSF has individual trustees, timely action must be taken on the death of a member to ensure that the trustee rules are satisfied. If one trustee passes away, a new trustee needs to be appointed to the fund.

Greater Asset Protection - as companies are subject to limited liability, a corporate trustee will provide greater protection where a party sues the trustee for damages. If an individual trustee suffers any liability, the trustee's personal assets may be exposed.

Estate Planning Flexibility - a corporate trustee ensures greater flexibility for estate planning because the trustee does not change as a consequence of the death of a member. The death of a member for an SMSF with individual trustees requires there to be a change of trustee, and gives rise to considerable administrative work and costs at an inopportune time.

Disadvantages of a Corporate Trustee

Establishment & ongoing costs - a disadvantage of a corporate trustee is the up-front cost of establishing the company, although this cost is amortised over the life of the fund. As far as ongoing costs are concerned, ASIC charge an ongoing annual review fee for all Australian companies, while Doquile Perrett Meade SMSF service also charge an ongoing annual fee for the preparation of minutes of meetings, attention to ASIC annual company statement and maintenance of Company Secretarial Register.

Establishing a Trust Deed

A trust deed is commonly referred to as 'the governing rules of the fund'. A trust deed is a legal document that establishes the existence of the fund and rules regarding its operation when it is properly executed.

Trust deeds are available from:

- A solicitor
- An accountant or;
- A specialised SMSF service provider

The major clauses of a trust deed will normally address the following:

- Establishment of the fund
- Structure and purpose of the fund
- Details of who can be a trustee
- How to appoint and remove trustees
- Decision making powers of the trustee
- Who can be a fund member
- Who can make contributions
- When to pay benefits to members
- Determining members' benefit entitlements
- What investments the fund can make
- Fund records, audit requirements, disclosure and reporting requirements
- Appointment of actuary, auditor and managers

Advantages of Self Managed Superannuation Funds

Direct Investment Choice - You can invest directly in your own chosen combination of investments, for example, shares, property, fixed interest investments, managed funds and cash. You may also include business real property (commercial property).

Access to Wholesale Managed Funds - You may gain the benefit of access to wholesale managed funds where the investment charges are lower than retail managed funds.

Consolidation - You have the ability to have up to four members in a SMSF. You are therefore able to combine your superannuation benefits into one strategy to reduce ongoing costs and increase the potential for compounding capital growth.

Tax Planning - You have the ability to reduce taxation liabilities within the fund by selecting a tax effective mix of investments, including franked dividends. Investment earnings are subject to tax at a maximum rate of 15%.

Estate Planning - SMSFs provide estate planning opportunities where there is more than one member in the fund. A member of a self managed super fund is able to a have a Non-lapsing Binding Nomination which allows them to specify how their benefits are to be distributed on their death.

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Disadvantages of Self Managed Superannuation Funds

Cost – The cost of running an SMSF can be expensive where the fund size has not reached critical mass. A retail fund may be cheaper below a certain level. The Australian Taxation Office suggests an initial superannuation balance of $200,000 for a SMSF to be cost effective.

Obligations of trustees – Trustees are bound by law to responsibly manage the super fund for the benefit of the members. The level of effort required to do this can be considerable. Non-compliance can result in severe penalties, increased taxes or in some cases, if severe enough, imprisonment.

Significant administrative and compliance tasks – There are significant administrative and compliance tasks that must be undertaken by the trustees which can often be difficult and time consuming. Trustees also need to keep up to date with the relevant legislation to ensure that the fund does not breach any legal or regulatory requirement.

Fund Performance – There is a danger that trustees will not give due consideration to an appropriate investment strategy and, accordingly, medium to long term returns may be lower than those achieved from a retail fund.

Trustees must consider all of the fund members and the dates at which they will retire, and then structure the fund portfolio to help meet the required retirement benefits on these dates. This skill, as well as being able to watch markets, is generally not acquired easily.

When are Self Managed Super Funds Appropriate?

A SMSF is most appropriate for investors who:

- Prefer to have direct control over their retirement funds.
- Wish to be involved in investment decisions.
- Wish to gain from the flexibility and estate planning benefits associated with SMSFs.

SMSF members must be prepared for the responsibilities that are associated with being a trustee of a regulated superannuation fund. Members who are prepared to pay for outsourcing much of the administration and investment management of the fund will not need to commit as much of their own time to the fund but will need to be prepared to pay the associated fees for these services.

What Level of Support is Appropriate?

While all SMSFs feature direct investment discretion, you can choose the extent of administration support, investment reporting and compliance. Broadly speaking you may choose from:

- A professional administration service for all services required in conjunction with the use of a financial adviser for investment decisions and other key decisions such as commencing a pension, contributions to and withdrawals from the fund.
- An accounting firm for compliance and tax returns, in conjunction with the use of a financial adviser for investment decisions and other key decisions such as commencing a pension, contribution to and withdrawals from the fund and then completing the trustee responsibilities yourself.

From your perspective, the major difference between the three options is who is responsible for the prudent management of the fund.

The Superannuation and Insurance Supervision (SIS) legislation codifies some of the most important fiduciary duties of trustees in formal covenants. The codified duties exist alongside trustee duties under common law. For trustees, SIS means their basic duties are clearly spelt out. For members, SIS establishes statutory rights to civil action for loss or damage due to breach of covenants.

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