



Self managed superannuation funds

A Financial Planning Technical Guide

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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 the key things you need to know about SMSFs.

The following information is current as at June 2014.

What is a self managed superannuation fund (SMSF)?

A 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. A rapidly growing number of people, however, have decided to manage their own super funds. In many cases they are people who own a business or are self-employed. Following the introduction of Super Choice rules in 2005, many employees are also opting to manage their own super savings via a SMSF.

A SMSF provides retirement benefits for its members in the same way as any regular superannuation fund. A SMSF is free from some of the regulations imposed on regular superannuation funds, but there are a whole set of special SMSF rules that must be adhered to. The key ones are listed below:

- The SMSF must have no more than four members.
- The trustees of a SMSF can be either individuals or a corporate trustee.
- As a general principle, each member must be a trustee (or director of the corporate trustee) and each trustee/director must be a member of the SMSF.
- No member of the SMSF can be an employee of another member, unless they are also related.
- Trustees cannot be paid for carrying out their trustee duties.

A trustee cannot be a 'disqualified person' meaning they:

- Have never been convicted of an offence involving dishonest conduct.
- Have never been subject to a civil penalty under the superannuation legislation.
- Are not insolvent or under administration (an undischarged bankrupt).
- Have never been disqualified from acting as a trustee of a superannuation fund by the Regulator.

A company cannot act as a trustee if:

- A responsible officer of the body corporate is a disqualified person,
- A receiver, official manager or provisional liquidator has been appointed, or
- The company has been wound up.

What are the benefits?

SMSFs have continued to grow in numbers at a solid rate. Common reasons for their continuing popularity include:

- More control – over the investment strategy and the way it is implemented.
- Greater investment choice – although there are some limitations imposed by law and the trust deed.
- Costs – because you control the investment management you may have the ability to minimise the fees incurred by the investment portfolio and the degree of trading within the portfolio.
- More opportunities for tax effective investments.
- Potentially higher net returns – due to lower costs, less tax and a more effective investment strategy.

What are the risks?

The main issues and risks to be aware of when establishing a SMSF include:

- Obligations of the trustee – as a trustee of the SMSF you are bound by law to responsibly manage the Fund and are personally liable for any actions of the Fund. You can delegate the tasks associated with administering your SMSF but not the legal responsibility.
- Costs – costs associated with a SMSF are potentially greater for account balances less than \$200,000 as compared to other funds.
- Time – as trustees you will be required to set aside your time for the ongoing management of the SMSF. Alternatively you can seek, at a cost, professional assistance from your financial adviser or accountant, although this will not remove all time commitments.
- No recourse – a trustee of a SMSF does not have access to the Superannuation Complaints Tribunal should something go wrong.

Establishing a SMSF

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

1. Establish a trust

Before you can register a 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; and
- 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.

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 a 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 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 a 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 a 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 a 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.

4. Lodge an election with the regulator

Within 60 days of the establishment of a 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 of 45%.

5. Open a bank account

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

Stages of the SMSF

Accumulation Phase

The accumulation phase of a 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:

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

Core purpose

A 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; or
- 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 a 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; or
- Another ancillary purpose approved in writing by the regulator.

This allows a 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 (CCs) 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 payments 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 CCs above the CC cap.

Whilst there is no limitation on the amount of CCs or NCCs that a member can make in a particular year, members will be subject to penalties if the total contributions exceed certain contribution cap limitations. Whilst the penalties apply to members personally, they have the ability to access their super to fund payment of these penalties.

Investment restrictions

There are various restrictions and requirements placed on how a SMSF may invest its assets. These are designed to protect members' 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 a SMSF

It is the trustee's responsibility to ensure that the ongoing administration and compliance tasks of a 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, regulatory return and 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; and
- Holding the assets of the SMSF separately from the trustee's personal assets

Managing the SMSF

Investment strategy

As a trustee of a 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); and
- Whether the trustees of the fund should hold insurance for one or more members of the fund.

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

- The asset classes the SMSF will invest in; and
- 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 (eg 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 a SMSF. The premiums for these policies are generally tax deductible (in full or part) to the SMSF as long as the Fund is a complying superannuation fund. Whilst there is nothing to stop the Fund holding a Trauma or Living policy, it is possible that a condition of release may not be met by the member to access these Funds. Also, a Trauma or Living policy is not a superannuation death benefit or disability superannuation benefit as defined by the Income Tax Assessment Act 1997 (Cth), because:

- The payment of a trauma or living benefit is not conditional on the death of a member.
- Permanent disability is not part of the criteria under which the policy can pay a benefit.
- A Trauma or Living policy does not provide a benefit by way of income.

Due to this, a SMSF cannot claim a tax deduction for any premium payment relating to a trauma policy.

Beneficiary nominations

The benefit clauses in a 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; or
- 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 to who they would like the trustee as 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) (eg 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 Fund's assessable income. Where the Fund 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 Fund's assessable income.

Imputation credits

Where a 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 a 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 a SMSF is that a SAF must have an authorised trustee, whereas the trustees of a 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.

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