SELF MANAGED SUPER FUNDS

The purpose of article is to attempt to 'demystify' the process of setting up a SMSF by outlining the characteristics of SMSF's and the benefits of setting them up. We will also focus on some of the practical issues related to establishing and managing a SMSF.

We trust that the information provided here will be of benefit to you as you decide whether going the `SMSF route' is the right thing to do in your circumstances.

WHAT IS A SMSF

A SMSF is a superannuation fund set up for the benefit of 1-4 members* who are also the trustees' of the fund. To be recognised and regulated by the Australian Taxation Office (ATO) a SMSF must comply with the *Superannuation Industry Supervision Act 1993* (SISA) and other rules and regulations governing SMSF's. If the fund complies, and remains compliant, it will enjoy significant reduced tax rates (when compared to 'regular' investments) namely:

- 15% on the income of the fund
- 10% on capital gains on investments held for more than 12 months.

In order to continue to enjoy concessionary tax rates, compliance with SISA and ATO standards should be investigated and confirmed on a regular basis.

The fund should also meet the so-called 'Sole *Purpose Test.* This states that all the investment activity of the fund should be aimed at securing and providing retirement benefits for the members (or their dependants if a member dies before retirement).

** There are some exceptions to this e.g. if a member is a minor or is legally disqualified. In such cases the member must be represented by another trustee.*

THE ADVANTAGES & DISADVANTAGES OF SMSF'S

One of the big questions surrounding SMSF's is: *"Why should anyone bother to set up his/her own super fund if there are so many 'professional' products available on the market?"* The short answer to this question is that, if managed well and prudently, a SMSF can be one of the best ways to maximise your retirement income as it allows you to reduce costs and to benefit from highly advantageous tax rates.

Consider the following benefits:

- **Increased Control:** With most commercially available super products you simply send off your contributions and hope for the best! SMSF's allows you to take active control of your retirement funds as all the assets of the fund are under the control of the trustee/s who also take responsibility for all investment decisions.
- **'Keeping it in the Family':** A SMSF is an ideal vehicle for a family to 'save together' as it allows up to four trustees to actively participate in the fund and benefit from it.
- **Choice and Flexibility:** The trustees have a great deal of leeway to make independent decisions on the types of investments that are made (subject to the *'Sole Purpose Rule'* of course). This allows them the flexibility to respond to changing market conditions and to design 'tailor made' retirement income streams.
- **Cost Savings:** If a fund is well set up, and costs are managed carefully, a SMSF can represent a significant cost saving when compared to the fee structure of commercially available superannuation funds.

It should be clear from the above that there are several distinct benefits in using a SMSF to save for your retirement.

However, in the interest of full disclosure, it should also be noted that there are certain features of an SMSF which mean it is not the ideal option for everyone.

Some of the disadvantages include:

- **Increased Time Commitment:** The very nature of a SMSF requires all trustees to take an active interest in the management of the fund. It is therefore certainly not a kind of 'set and forget' investment and will require a certain time commitment from you. It should be noted, however, that this commitment can be reduced by making use of a specialist SMSF administration service.
- **Risk of non-compliance:** The ATO takes compliance issues surrounding SMSF's very seriously and the penalties for non-compliance are severe (up to a 45% tax penalty and the risk of prosecutions). Trustees must therefore keep a very close eye on their fund. This is, again, a burden that can be reduced by making use of professional services.
- **Costs:** Cost savings can be one of the greatest benefits of making use of a SMSF. However, the opposite can also be true. Investors with very minimal funds to invest, and those who are not careful to minimise costs as much as possible, may find managing a SMSF prohibitively expensive.

Three things should be clear from the information presented above:

- Setting up a SMSF could be one of the best possible financial decisions that you will ever make. This is, however, not 'automatically' the case. You will first have to investigate whether it is the right thing to do given your specific circumstances.
- There are so many different routes that you can take with a SMSF that it is imperative that you speak to an independent and professional financial adviser to discuss your options before you take any steps.
- Compliance is extremely important. It will therefore be necessary to surround the trustees with the best possible 'team' (i.e. an accountant, legal professional, investment adviser) in order to help you set up and manage the fund.

SETTING UP A SMSF

The process of setting up a SMSF is fairly straightforward. The most important thing is to ensure that each of the prescribed steps is completed before you move to the next one. The steps recommended by the ATO are:

Step 1: Obtain a Trust Deed

A 'Trust Deed' is a legal document that will govern every aspect of the setting-up and management of your SMSF. Since it is a legal document, it should be drawn up by a qualified legal professional. He/she should be able to advise you about the items that should be included in the deed. As a general rule of thumb, the deed should spell out the membership of the fund (i.e. the trustees and their responsibilities), the aims of the fund, the management and payment of benefits and procedures for the appointment of professional advisers. The trust deed should be reviewed regularly to ensure that it continues to comply with current legislation.

Step 2: Appoint Trustees:

After obtaining your trust deed you can formally appoint the trustees of your fund. There are several options available to you, including:

- Appointing yourself as a sole trustee
- Appointing up to four individual members
- Appointing a corporate trustee. (This is where you set up a company to act as the trustee of the fund. Every member of the fund will also have to be a director of the company)

The following persons may not serve as trustees:

- Undischarged bankrupts
- Anyone convicted of a serious offence involving dishonesty
- Anyone who has committed a serious breach of the SISA act
- Mentally impaired individuals
- Minors under 18 years of age

The latter two groups may be recognised as members of a SMSF but cannot be trustees. In practice this means that they will be represented by another trustee (usually a parent or other relative).

In addition to the above exclusions it should also be noted that no trustee may be employed by another trustee (unless they are related) and that no trustee may receive compensation for his/her activities as a trustee of the fund.

If you make use of a **corporate trustee** all of the above provisions apply, and you will also have to pay attention to the following in setting up your company:

- Every member of the fund will also have to be a director of the company.
- The corporate trustee (company) may not be paid for its services as a trustee
- The directors of the corporate trustee may not be paid for duties and services in direct relation to the fund.

Step 3: Sign a trustee declaration

The trustee declaration is a document that should be signed by all trustees to confirm that they understand their duties and responsibilities as trustees (or as directors of the corporate trustee). This declaration should always be easily accessible in case it is requested during an audit or review. Non compliance with this could attract severe penalties.

Step 4: Elect to be regulated by the ATO

As soon as your fund is legally set up you should register it with the ATO and elect for the fund to be regulated by them. This election must be registered within 60 days of establishing the SMSF otherwise the ATO may not accept your registration.

Election to be regulated is an absolutely vital step, as funds that are not regulated cannot claim the tax concessions associated with SMSF's. Members will also not be able to claim deductions for contributions that they have made to the fund. Once you have made the election it is irreversible and the fund will remain regulated until it is wound up.

Once you are officially registered with the ATO your fund will be allocated a *Tax File Number* (TFN) and an *Australian Business Number* (ABN). This will allow you to open a bank account and to carry out normal business functions. The ATO will also place details of your fund on the *Australian Business Register* and on the *'Super Fund Look-up'* website at http://www.abn.business.gov.au. These entries will allow other super funds to ascertain whether you are operating a compliant fund for the purpose of transferring superannuation benefits.

OPERATING & MANAGING A SMSF

You've gone to all the trouble to set up SMSF. Now what!? The short answer is that it should be operated and managed to maximise the retirement income of its members. It should also comply with SISA and all relevant ATO requirements in the process. Here are some suggestions for making this happen:

Always keep the 'Sole Purpose Test' and investment restrictions in mind

The *'Sole Purpose Test'* states that all the investment activity of the fund should be aimed at securing and providing retirement benefits for the members (or for dependants if a member dies before retirement). This provides a general framework for the activities of the fund and forms an important part of compliance testing.

In addition to the *'Sole Purpose Test'* you should also be aware of the following general restrictions on the investment activities of an SMSF:

- No money may be loaned to members or their relatives
- Assets, other than business properties or stock exchange listed securities, may not be acquired from members
- The fund may not borrow money unless it is for short term loans to cover certain approved expenses (e.g. paying a benefit to a member or for bridging finance for an investment)
- An SMSF may not have 'in house assets' of more than 5 % (in house assets' are investments that are linked directly with a member's company).

Work out an investment strategy

Having access to a powerful investment vehicle, like a SMSF, is of little use if you do not operate according to a clear investment strategy designed to deliver on the retirement goals of the members. Therefore it is very important that you regularly spend time as members to chart the course of your fund with a view to maximise returns.

A professional financial adviser will prove invaluable in helping you achieve this. He/she can assist with the following:

- Drawing up a risk and investor profile to assist you in choosing the kinds of investments that you would be 'comfortable' with.
- Suggest strategies for maximising returns within the parameters of acceptable risk.
- Suggest ways in which you can diversify the fund's investment portfolio across different types of assets (e.g. securities, property, fixed interest accounts, etc.)
- Help you to factor the requirement to pay benefits, taxes and costs into your calculations.

Once drawn up, your investment strategy should never be seen as a 'static' document. Instead it should be reviewed regularly to conform with the needs of fund members and with market conditions.

Get the best possible 'team' around you

Someone once said: *"If you think education is expensive, try ignorance!"* The same principle applies to 'buying in' knowledge to help you run your fund to maximum benefit. Yes it does cost some money to get experts involved, but it should pay handsome dividends over the long run. We suggest that you seriously consider getting the following people on your 'team':

- A legal professional
- A qualified accountant
- A tax advisor
- A financial planner/adviser

Some people also find it beneficial to `outsource' some of the administrative and compliance tasks to companies that can handle it on their behalf. This is not an absolute requirement since you should be able to complete most of these tasks yourself. It would however make sense to pay someone to do it on your behalf if you think that it will save you a lot of time and hassle.

Maintain compliance at all times

We have already emphasised the importance of compliance when operating a SMFS. In general, this means that your fund should always be operated in accordance with relevant legislation (particularly SISA), directives and ATO guidelines. It is a good idea to conduct regular compliance audits to ensure that you are not caught on the wrong side of the law. You can do so by consulting ATO compliance guidelines (referenced below) or by paying someone to do the audit on your behalf.

Some of the issues that such an audit should assess are whether:

- Correct procedures were followed in setting up the SMSF
- All trustees meet the requirements for trusteeship
- The *'Sole Purpose Test'* is applied
- All fund investments are within the ATO's stated guidelines
- Proper records are kept and safely stored (for at least ten years)
- All taxes and fees are paid
- Regular reports are submitted to relevant bodies as required

The importance of maintaining compliance cannot be emphasised enough. It is the one area that requires special attention and where you should get outside help if necessary.

PAYMENT OF BENEFITS

A member cannot receive his/her preserved benefits unless one of the following criteria is met:

- Retirement as SMSF members may make use of the 'Transition of Retirement'
- death (in which case the benefit will be paid to a nominated beneficiary)
- permanent incapacity
- permanent departure from Australia (only in the case of temporary residents)
- severe financial hardship
- compassionate grounds

It is a very good idea to maintain a register of when members are likely to require the payment of their benefits. This will provide you with some handy reference points to work toward in the management of the fund.

MORE INFORMATION ABOUT SMSF

We highly recommend that you study the ATO's own publications on SMSF as a source of first hand information to complement the advice that you receive from other sources www.ato.gov.au

WHAT NEXT

Building and maintaining wealth is an ongoing journey. Stay proactive and keep looking for ways to make the most of what you have.

In planning your way to wealth you should take a holistic approach, looking at your debts and assets, present and future needs, and considering tax implications and how decisions could impact on entitlement to government benefits.

If you would like further information on this wealth building strategy, please contact **Tony Rimac from PT Wealth Solutions on 9891 1544 or tony@ptws.com.au** who can assist by providing you with the correct tax and investment advice on Self Managed Super Funds.