SELF-MANAGED SUPERANNUATION FUND (SMSF)

Introduction - General Information

Public offer and Industry Super are managed by paid Trustees. They act on behalf of all the members, which may be many tens of thousands of individuals, however Self-Managed Superannuation Funds (‘SMSF”) are managed by the members. Each member is a Trustee or director of a Trustee Company. The members act on behalf of themselves and their best interest.

In an SMSF, you can consolidate your existing super arrangements into one flexible super fund that is purpose built for you and your family, it offers the opportunity for as much control and flexibility as you want or need. As Trustee of your own SMSF, you have maximum flexibility in relation to fund assets, investments, tax strategies, and estate planning.

You can utilise the services of specialists to complete the administration, accounting and compliance work.

While all investments must be made in accordance with the fund’s Trust Deed and written investment strategy, SMSFs offer almost limitless investment choices when compared to your current “public offer” super fund.

How a Self-Managed Superannuation Fund can work for you

SMSF’s are for family members or close business associates looking to take tighter control of their retirement savings.

What are the Characteristics of a SMSF?

- They have 4 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 and
- The Trustees cannot receive any remuneration for his or her or their services as a Trustee.

A list of the steps involved in setting up a SMSF:

- Arrange for a trust deed - preferably drafted as broadly as possible to address the current legislative requirements
- Appoint 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, if a corporate Trustee is in place. You should seek legal advice about what type of Trustee will best suit your circumstances
- Elect to become a Regulated Superannuation Fund – by completing and lodging the appropriate ATO form within 60 days of the Fund's establishment (in order to receive concessional tax treatment)
- Obtain an Australian Business Number - by completing and lodging the appropriate ATO form
- Obtain a Taxation File Number - by completing and lodging the appropriate ATO form
- Admit members, and establish member records
- Open up a CMT/bank account in the name of the SMSF, and ensure that the SMSF assets are maintained separately from personal assets
- Formulate a written Investment Strategy
- Review Trustee duties and responsibilities
- Make investments in accordance with the investment strategy, and the provisions of the trust deed
- On-going administrative and compliance obligations must also be met by the Trustee, these include:
- Annual Taxation and Compliance returns.

Setting up a Trust Deed

A Trust Deed outlines the rules of operation of the fund. Things to include are:

- Appointments of the Trustee(s) of the fund (individual or corporate)
- Admission of members to the fund
- Appointment of professional advisers (e.g. administrator, auditor)
- Trustee meeting, voting guidelines, minutes and how the meetings are to be run
- Setting an investment objective and investment strategy, including types of investments the Trustee(s) can invest in
- Establishment of member accounts
- Establishment of reserves
- Making Death Benefit Nominations.

Appoint the Trustees

Either establish a corporate Trustee or appoint individual Trustees.

Establish the SMSF Bank Account

Apply to open up a Cash Management Account in the name of the SMSF to act as the central account for all superannuation income (rollovers, contributions, investment income) and expenses (tax, professional fees, insurance etc).

Corporate Trustee v Individual Trustees

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 Trustee exposes their personal assets if they incur any liability as Trustee of an SMSF or other trust: if the individual's right of indemnity against the SMSF is not sufficient to discharge the liability, then the individual is still liable for the shortfall. Corporate Trustees a liable 'once', individual Trustees are separately liable.

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

A company continues to function even after the death of one of its directors, therefore, the control of a SMSF or other trust can continue even after the death of an individual SMSF member/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 an 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 to the company and notified to ASIC; or
- An individual Trustee, a deed of appointment needs to 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 major administrative hassles if the

trust assets consist of real estate and shares. The hassles do not apply to a corporate Trustee as the SMSF assets are usually held in the company name, and the company remains as Trustee.

Bank lenders generally insist upon (or at least prefer) the SMSF having a corporate Trustee.

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

- There will be costs associated with establishing a Corporate Trustee
- ASIC reporting requirements of the Trustee
- Procedural issues for holding meetings.

Advantages of Setting up a SMSF

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

- Control
- Flexibility
- Estate Planning
- Creditor Protection

Investment Choice and Control:

The major 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 superannuation fund managers.

SMSF's are in a unique position as they are able to acquire certain investments from members which are not available to funds with five or more members. For example an SMSF can acquire business real (commercial) property from members and other related parties. This can provide a number of taxation advantages for a client who is able to transfer commercial property they own to the SMSF. Prior to the transfer, the Trustees would need to ensure the other investment standards in the SISA are satisfied, for example that the property is not subject to a mortgage or charge.

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

Investment Flexibility

A SMSF has the flexibility to buy direct property which cannot be done via a retail or industry superannuation fund.

Estate Planning

SMSFs can provide an effective estate planning vehicle which retains investment that may be used for the benefit of future generations. By introducing younger generations as members of a SMSF and with prudent contribution strategies, it may be possible to build up the fund to provide cash benefits to older generations and preserve assets used in the family business, such as real estate.

Creditor Protection

SMSFs are able to provide protection from creditors for those assets which may be leased to related parties of the fund. This would apply to business property or certain in-house assets which 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 superannuation with the aim to defeat creditors can be accessed.

Having control over the fund, including the investments within the fund. This allows you to tailor an investment strategy that suits your circumstances. Advice should be sought if required.

Having a wide range of investment options, including direct shares and direct property. In some circumstances the fund can purchase assets from members of the fund, allowing better consolidation of investment assets.

More flexible strategies are available within a SMSF to manage these issues than those which exists with retail super funds.

A SMSF can be tailored to meet your own personal circumstances in relation to estate planning. You can include family members as long as there are no more than 4 members in the fund at any given time.

A SMSF can be used as a vehicle to accumulate superannuation benefit whilst employed and can be maintained well into retirement and beyond, particularly where there are other family members in the fund.

There are a number of requirements set out in legislation that a SMSF must meet in order to be a "regulated superannuation 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. With guidance you can take advantage of these requirements.

Trustee Obligations

- Maintaining the fund for the sole purpose of providing retirement benefits to SMSF members, or to 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 superannuation and taxation laws and the SMSF trust deed.
- Valuing the fund's assets at market value for the preparation of financial accounts and statements.
- 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 Australian Taxation Office (ATO).

Risks and Disadvantages

The specific risk associated with having a SMSF is if a 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 superannuation fund.

The tax rate for a non-complying superannuation fund is 45% on the income and certain assets of the fund in the financial year in which the fund is made non-complying. In subsequent years in which the fund remains non-complying, the income and capital gains are taxed at 45%.

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

Failure to comply with obligations under superannuation and taxation laws can have significant consequences (e.g. the loss of tax concessions). 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.

Superannuation legislation imposes significant administrative and compliance tasks on the Trustees of SMSFs, and non-compliance carries severe penalties.

You may incur extra costs depending on the asset level of the SMSF and the investments chosen. If the SMSFs assets are invested in managed funds, there can be an increase in costs, because in addition to accountant and financial planner fees for the administration of the SMSF, fund managers charge ongoing fees.

SMSFs have no access to the Superannuation Complaints Tribunal. This means that conflicts between Trustees will need to be resolved privately.

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.

Superannuation Complaints Tribunal

As Trustees of your own self-managed super fund it is important to know that you don't have access to the Superannuation Complaints Tribunal and as such have no access for compensation arrangements under Pt 23 of the Superannuation Industry (Supervision) Act 1993 (SIS Act) in the event of fraud or theft. This is generally because it is understood that the Trustees are the members and not likely to defraud themselves.

Costs of having an SMSF

There are many administrative functions that must be satisfied in the smooth running of a self-managed superannuation fund (SMSF). Although you may use a service to assist with the administration of the SMSF, as Trustee you are still ultimately responsible for all decisions and actions.

Other features of this ongoing management service include the ability to manage your tasks and activities online, regular contact from a client service representative, technical support, as well as access to specialist third party service providers.

The costs for the administration services are independent of the ongoing management/advice service offered by Twilight Financial Planning.

SMSF Costs

- The annual SMSF supervisory levy (collected by the Australian Taxation Office)
- 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 updating Deeds where required
- The fee for annual actuarial certification (when required)
- The cost of establishing and running a SMSF includes investment cost, brokerage, accounting and adviser fees.

Commencing an SMSF pension

If you operate a SMSF you can commence an account-based pension once you satisfy a condition of release. It is important that the pension is set up properly in line with legislative requirements to avoid taxation penalties. Following is a summary of the steps that need to be taken.

1. Member requests pension and Trustee acknowledges

The member provides the Trustee with a written request confirming that a condition of release has been met and their intention to access benefits as an account-based pension. The Trustee acknowledges the request by preparing a Trustee minute and retains on file evidence that the member has met a condition of release and interim details about the pension, including the intended commencement date, capital sum, required pension and frequency, estate planning preferences (e.g. reversionary beneficiary, death benefit nominations) and member bank account number.

2. Review trust deed

The Trustee should check the fund's trust deed to determine if there are any restrictions. In particular, the Trustee should check that the member's benefits can be released, that the fund is able to pay an account-based pension, and whether or not the fund can cater for the estate planning needs of the member.

3. Provide confirmation to member
The Trustee should provide the member with a written confirmation that the fund can pay the requested pension and is able to satisfy estate planning requirements.

4. Determine the member’s entitlement
Trustees should verify the value of the member’s superannuation account and the underlying tax components. This will require obtaining a current valuation of assets.

5. Review investment strategy
The Trustees should review the fund’s investment strategy to determine if changes are necessary to facilitate the payment of the pension or whether the member’s risk profile has changed. Strategies for liquidating investments to enable payment of the pension may need to be considered. The Trustee should document the outcomes of this review by preparing a Trustee minute and make any necessary changes to investments.

6. Set up pension and review death benefit nominations
The fund accounts should be adjusted to record the commencement of the pension and appropriate mechanisms put in place to make the regular pension payments.

7. Prepare tax documents
If the member is under age 60, the fund will need to register as a PAYG payer and deduct tax (as applicable) from each payment. The member should provide the Trustee with a TFN declaration form.

8. Calculate and pay pension payments to member
The Trustee must ensure pension payments are paid at the requested frequency into the member’s nominated bank account. The Trustee should also ensure that at least the required minimum is paid each year.

9. Ongoing review and maintenance
In addition to the usual Trustee obligations, commencing a pension increases the fund’s annual obligations, which may include arranging actuarial certificates, reviewing minimum pension payments, and issuing pension members with payment summaries (if appropriate) and Centrelink schedules.

SMSF Investment Strategy

Self-managed superannuation fund (SMSF) Trustees are required to prepare and implement an investment strategy, which sets out the fund's investment objectives and the methods that will be used to achieve those objectives. All investment decisions for the fund must be made in accordance with the investment strategy.

The investment strategy should be in writing, must be reviewed at least annually and whenever there is a change to the fund, such as if a new member joins or if an existing member commences a pension.

Following is a summary of some of the important features of an investment strategy.

Objective

The investment strategy should set out the fund's investment objectives and the methods that will be used to achieve those objectives. In setting the objective, Trustees should consider the needs of each member, such as their time to retirement, risk profile and growth targets. Consideration will also include whether the member is in accumulation or pension phase.

If the risk levels of members are different, Trustees can consider segregating member accounts and having different investment strategies for the members.

Risk and return

Risk includes the possibility of loss on an investment. There is a strong correlation between risk and return. Trustees need to determine an acceptable level of risk and volatility of returns according to the fund's circumstances. Risks may include market volatility, liquidity risk, credit risk, operational risk and legislative risk. The investment strategy must include procedures to identify, monitor and manage these risks.

Diversification

A simple risk management strategy is diversification which helps to disperse and manage risk, and reduces the volatility of returns on investments. Diversification can be achieved through:

- investing across a range of asset classes
- investing in a number of assets within a single asset class
- investing in Australia and overseas

- investing in several funds with different management styles.

In some situations an SMSF may have very little diversification, for example if the majority of funds were invested in a single property. In this case the investment strategy should identify the lack of diversification and explain how the Trustees will manage this risk.

Liquidity and cashflow

The fund must have sufficient liquidity to ensure that liabilities can be paid as they arise. Liabilities include tax payments, pension payments, administration expenses and any other fund expenses.

One strategy to assist a fund's liquidity is to hold a cash reserve or investments that can be sold quickly.

The investment strategy should specify whether borrowing is allowed and restrictions on any investments that can be held.

Insurance

Trustees should consider the death and disability insurance needs of each member, as well as what level of cover might be appropriate. The types of insurance that should be considered include life, TPD, trauma and income protection. The outcomes of any consideration should be documented in minutes as well as the reasons for the decision, even if this decision is to not hold any insurance for members.

SMSF Key Investment Rules

Superannuation law places a number of investment restrictions on superannuation funds which aim to protect members by ensuring fund assets are not exposed to undue risks, such as the failure of a related business.

Failure to comply with the investment rules can result in significant penalties for both the Trustees and the fund. Following is a brief summary of some of the investment rules applying to self-managed superannuation funds (SMSFs).

Sole purpose test
The sole purpose test requires your SMSF to be maintained for the sole purpose of providing retirement benefits to members, or to dependents if a member dies before retirement.

If an investment decision is made that provides a member with a financial benefit prior to meeting a condition of release this rule may be breached and the fund could be classified as non-complying. This would result in all earnings (plus the taxable component of the fund) being taxed at the top marginal tax rate plus levies.

Ownership of assets
Assets belonging to the SMSF must be kept separate to your personal assets. Having a separate bank account for your SMSF will help your fund meet this requirement. All fund expenses can then be paid from that bank account only.

The Australian Tax Office (ATO) prefers assets to be owned in the name of the Trustee. If the fund has individual Trustees, assets should be owned by all Trustees in that capacity. If the fund has a corporate Trustee, assets should be owned in the name of the company as Trustee for the fund.

Value all assets at market value
All fund assets should be valued at market value. The market value should be used when preparing your fund's accounts, statements and the SMSF annual return.

Arm's length transactions
All SMSF investments must be made and maintained on a strict commercial basis. This means that the purchase and sale price of assets and any income received from those assets should always reflect the true market value for the asset.

Loans and financial assistance
An SMSF cannot lend money or provide financial assistance to a member or their relative. Financial assistance is defined to include non-arm's length dealings with a related party, loans, provision of a guarantee and forgiveness of a debt.

Related party acquisitions

An SMSF cannot acquire assets from a related party of the fund, except in limited circumstances. These limited circumstances include the acquisition of:

- listed securities
- business real property (generally relates to land and buildings used wholly and exclusively in any business)
- in-house assets providing the total of in-house assets is not more than 5% of total fund assets
- units in widely-held unit trusts.

In-house assets

The value of in-house assets cannot exceed 5% of the total value of the SMSF. These assets are defined to include:

- a loan to, or an investment in a related party of the fund
- an investment in a related trust of the fund
- an asset that is leased to a related party (unless it is business real property).

Borrowings

An SMSF is only able to borrow money in very limited circumstances, including:

- For a maximum of 90 days to meet benefit payments due to members or to meet an outstanding surcharge liability. The borrowings in this circumstance cannot exceed 10% of the fund's total assets
- For a maximum of 7 days to cover the settlement of security transactions if, at the time the transaction was entered into, it was likely that the borrowing would not be needed. The borrowing in this circumstance cannot exceed 10% of the fund's total assets
- If using instalment warrants or limited recourse borrowing arrangements that meet certain conditions.

SMSF Trustee Penalties

As the regulator for self-managed superannuation funds the ATO can impose administrative penalties without reference to a court; require Trustees to take specific action to correct breaches or require Trustees to undertake educational activities.

For contravention of the rules the ATO can apply penalty units ranging from 5 penalty units ($1,050) for minor breaches such as not providing information to the regulator, not completing survey forms or failing to comply with educational directions etc. 10 penalty units ($2,100) for failure to prepare and retain accounting statements, failure to retain Trustee duties declaration forms etc. Or for serious offences up to 60 penalty units ($12,600) for providing financial assistance to members, borrowing funds, breaking the in-house asset rules etc.

These potential penalties are imposed on either the individual Trustees of the SMSF or the directors of a corporate Trustee.

In extreme circumstances where Trustees refuse to take corrective action the ATO can make the SMSF non-complying (which could result in members losing almost 50% of the value of their fund in penalties).

Although the ATO has the ability to apply penalties it prefers to encourage Trustees to seek guidance from their professional advisers and engage with the ATO using the 'SMSF Early Engagement and Voluntary Disclosure Service' to reduce the risk of becoming liable to any administrative penalties.

Important Disclosures specific to SMSF

Responsibilities and obligations for SMSF trustees associated with running an SMSF
• SMSF trustees need to comply with a number of obligations under the superannuation and taxation laws, as well as the trust deed. There may be various consequences—for example, loss of taxation concessions—if an SMSF trustee fails to comply with their obligations. Even if one trustee is less actively involved, all trustees are equally liable for the fund's compliance with the superannuation and tax laws. • The Australian Taxation Office (ATO) requires new trustees to make a declaration that they understand their responsibilities and obligations as an SMSF trustee, including to: • ensure that the SMSF is managed in compliance with the relevant laws and be responsible for and control the SMSF; • maintain the fund for the sole purpose of providing retirement benefits to SMSF members, or to their dependants if a member dies before retirement; • accept contributions and pay benefits (pension or lump sums) to members and their beneficiaries in accordance with superannuation and taxation laws and the SMSF trust deed; • value the fund's assets at market value for the purposes of preparing financial accounts and statements; • have the financial accounts and statements for the SMSF audited each year by an approved SMSF auditor; and • meet the reporting and administration obligations imposed by the ATO. • It is important that you understand that you remain responsible for managing the fund even if you outsource some or all of the responsibilities to external service providers.
The time commitment and skills needed to run an SMSF effectively
Trustees can use external research or advice to develop their financial knowledge over time, but they remain ultimately responsible for ensuring that investment decisions are made and implemented according to the SMSF's investment strategy.

Risks associated with an SMSF

Lack of Insurance

Unlike APRA-regulated funds, SMSFs do not come with insurance. The potential loss of insurance benefits as a result of switching from an APRA-regulated fund to an SMSF is an important issue.

SMSF trustees should consider whether it is appropriate to take out separate life insurance for members, including income and total and permanent disability cover, as part of the fund's investment strategy.

Although taking out this insurance will be at an additional cost to the SMSF, the risk of not having appropriate insurance is that it may leave members worse off in retirement.

Superannuation Complaints Tribunal

As Trustees of your own self-managed super fund it is important to know that you don't have access to the Superannuation Complaints Tribunal to resolve SMSF complaints and as such have no access for compensation arrangements under part 23 of the Superannuation Industry (Supervision) Act 1993 (SIS Act) in the event of fraud or theft. SMSF's have limited access to external dispute resolution (EDR) schemes.

Additional Risks

There may be risks, for example, associated with:

using individual trustees as opposed to a corporate trustee; and

a breakdown in the relationship of fund members.

The laws and policies that affect SMSFs are subject to change

The taxation and superannuation laws and policies that apply to SMSFs may be subject to continual change, including changes to legislation, and regulatory policies and standards.

An SMSF must be run for the sole purpose of providing retirement benefits for the members or their dependents. Don't set up an SMSF to try to get early access to your super, or to buy a holiday home or artworks to decorate your house, these things are illegal.

The need to develop and implement an appropriate investment strategy for an SMSF

- Developing and implementing an appropriate investment strategy is a serious responsibility for SMSF trustees. The trustee will ultimately remain responsible for the fund's investment strategy even if they seek investment advice from an adviser.
- It is important that you understand:
- the benefits associated with asset diversification and investing across a number of asset classes (e.g. shares, real property and fixed interest products) in a long-term investment strategy, such as improving the risk and return profile of an SMSF fund;
- there are some restrictions on SMSF investments and, as part of their obligations, trustees are prohibited from entering into certain transactions, such as lending the fund's money, or providing financial assistance to a member of the fund or their relatives; and
- you should conduct a regular review of the SMSF's investment strategy to ensure that the investment strategy continues to reflect the purpose and circumstances of the fund and its members.

The costs of managing an SMSF

The costs associated with managing an SMSF are potentially significant, and it is important you fully understand these costs before deciding to establish or switch to an SMSF. This will help to ensure you are able to make an informed decision about whether an SMSF structure is a suitable superannuation vehicle for you.

The costs of managing an SMSF include:

- establishment costs (e.g. preparation of a trust deed and development of an investment strategy); and
- ongoing costs associated with operating an SMSF (e.g. annual administration and investment costs, the cost of outsourcing the trustee's compliance obligations and statutory charges).
- Annual ATO levy, actuarial certificate, investment cost, brokerage, accounting, audit and adviser fees.
- For many investors, even those with high superannuation balances, an APRA regulated superannuation fund may be a more appropriate superannuation vehicle than an SMSF.

The need to consider and develop an exit strategy for an SMSF

You need to consider and develop an exit strategy for the SMSF in situations, for example, where the compliance requirements become too onerous or costly for the SMSF trustee.

It is important that you are aware of the process for winding up an SMSF and the likely costs associated with that process.

Winding up a SMSF – The Process

If you set up a self-managed super fund (SMSF), you're in charge – you make the investment decisions for the fund and you're held responsible for complying with the super and tax laws.

There may be some circumstances that you decide a self-managed super fund is no longer suitable for you. To close down a SMSF you would complete the following:

- Check whether the Trust Deed has any information about winding up the fund
- Pay out or rollover all super benefits (leaving a sufficient amount to pay final tax or expenses if required)
- Appoint an approved SMSF auditor to complete the final audit
- Complete and lodge the final SMSF annual return (including wind up details)
- Pay any outstanding tax
- After the ATO confirms the fund's ABN is cancelled, close the fund's bank account