INVESTMENT PLUS
ACCOUNTING GROUP

SMSF's – Self Managed Super Funds

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Introduction

Are you thinking about setting up a SMSF (self-managed super fund)? A self-managed super fund (SMSF) is a private super fund that you manage yourself. SMSFs are different to industry and retail super funds.

Many Australians have opened self-managed super funds (SMSFs) to control their retirement savings. In fact, according to the latest statistics from the Australian Tax Office (ATO), around 1.1 million Australians now have an SMSF and the numbers are growing.

The advantages of a self-managed super fund depend on your circumstances, abilities, and inclination. However, SMSFs are becoming increasingly popular and appealing for pre-retirees.

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. It's a major financial decision and you need to have the time and skills to do it. An SMSF must be run for the sole purpose of providing retirement benefits for the members or their dependants. Additionally, all decisions you make as trustee of your SMSF must be in the best financial interests of the members.

Maintaining an SMSF requires extensive financial and legal knowledge which is why competent financial advice is still needed. Before committing to an SMSF, it is important to understand the advantages and disadvantages of SMSFs and how complex it can be to manage it entirely yourself. This guide is a summary of the factors that you need to be aware of when operating your own SMSF.

What is an SMSF?

A self-managed super fund (SMSF) is a superannuation trust structure that provides benefits to its members upon retirement. The main difference between SMSFs and other super funds is that SMSF members are also the trustees of the fund.

SMSFs can have between one and six members, and one of the main advantages is the level of control that trustees have when it comes to tailoring the fund to meet their individual needs.

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 dependents if a member dies before retirement). If the fund complies and remains compliant, it will enjoy significantly reduced tax rates (when compared to 'regular' investments) namely:

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

What types of investments can a SMSF Make?

SMSFs can invest in traditional assets such as shares, property, bonds, and cash as well as more complex financial instruments such as options and certain kinds of warrants. It is best to seek professional advice if you are considering investing in more complex or non-traditional investments.

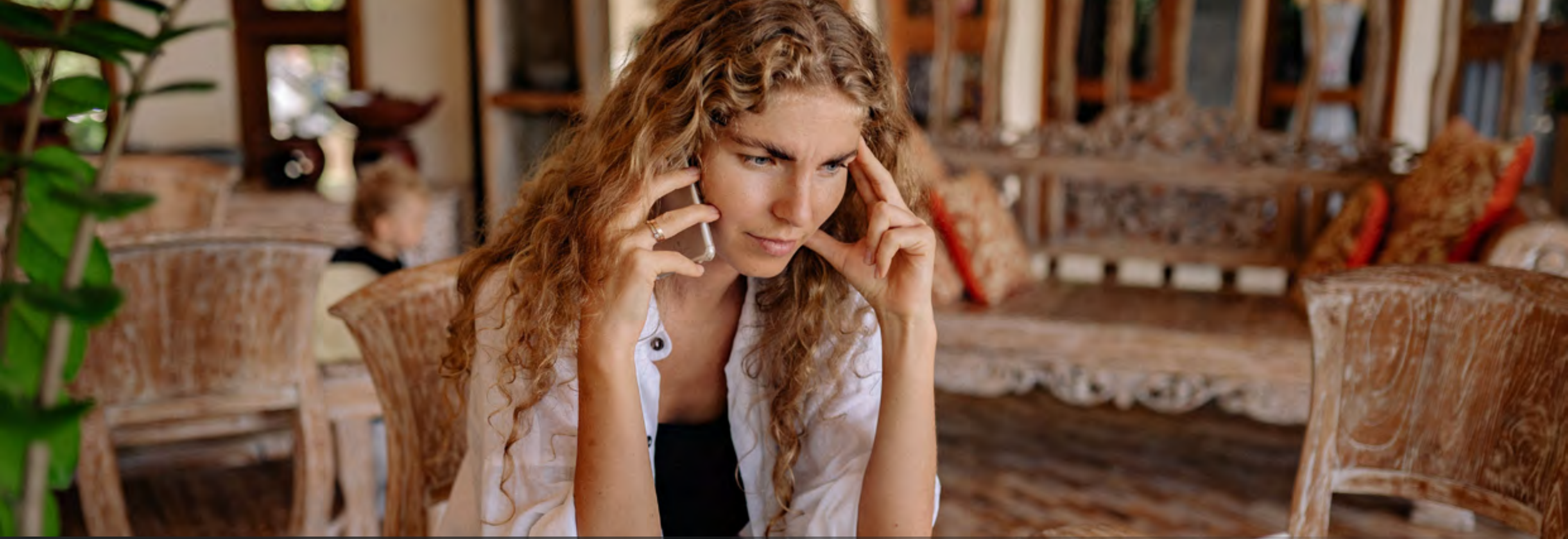
The range of investments you can consider for your portfolio includes almost anything you could invest in as an individual including:

- Direct investments (such as shares, ETFs, cash, term deposits, hybrids, income securities, gold/silver bullion and bonds)
- Cryptocurrencies, Bitcoin, Ethereum, initial Coin Offerings (Just because you can doesn't mean you should)
- Direct property (Residential houses, villas, units, as well as Commercial property such as offices, warehouses, factory units, shops and land.)
- Managed funds (retail or wholesale, domestic and/or international)
- Private Unit Trusts
- A business (non-related party to avoid hassle) and business property
- Non-traditional assets such as coins, antiques, art , taxi plate licences, ATMs (some of these have been subject to major losses)

While superannuation law doesn't stipulate what an SMSF can and can't invest in, there are restrictions on the entities a fund can invest in and acquire assets from. For example, SMSFs cannot

- Acquire assets from a related party.
- Allow in-house assets (such as a loan, investment or lease of a fund asset to a related party) to exceed 5% of total assets.

Borrow money except in limited circumstances.



SMSF – Rules and Regulations

Self-Managed Super Funds (SMSFs) are very popular with Australians wanting to take control and manage their own superannuation assets. As is the appeal of the 'do it yourself' factor. Yes, you gain control, however managing a SMSF is a complex as there are a raft of rules and obligations to meet; set out in the Superannuation Industry (Supervision) Act 1993 (SIS Act) as well as by various regulators such as the Australian Taxation Office ('ATO') and the Australian Securities and Investments Commission ('ASIC').

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

An SMSF can have no more than six 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's 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. SMSF trustee rules state that 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)**
- **has been disqualified from acting as a trustee of a superannuation fund by the ATO.**

What is '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 dependents 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

What is a 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 where they are allowed to access their super.
- the member's death, and the benefits are provided to their dependents, 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

What is an 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
- on the cessation of work due to ill health
- death of a member after retirement 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 provide benefits in situations of financial hardship and/or on compassionate grounds, subject to the SIS Act, the governing SMSF rules and the approval of the appropriate regulator.

General Restrictions

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

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

- trustee covenants concerning investment of member's money
- borrowing restrictions
- regulations applying to investments in collectibles and personal use assets
- general prohibition on giving a security over fund assets
- prohibition on loans to members
- non-arm's length investments
- acquisition of assets from related parties
- in-house asset provisions
- written investment strategy

What are your responsibilities

Trustees must have the time and skill to run their fund or be willing to pay specialists to do this on your behalf. Trustees of an SMSF are personally liable for any decisions made by the fund, even if they engage a third party to assist. It is therefore vital that trustees partner with appropriately experienced and qualified specialists when setting up and managing their SMSF.

Residency rules: There are only very limited scenarios in which you can live outside of Australia and maintain a complying self-managed super fund. If a member moves overseas indefinitely or for a prolonged period of time there are restrictions on who can continue contributing to the super fund and the 'central management and control' of the super fund must reside with someone located within Australia. Therefore, an SMSF may not be appropriate for someone who is likely to spend a significant time living overseas.

Engage licenced professionals: Given the rise in popularity in self-managed superannuation, there are a lot of providers willing to set up, advise and manage an SMSF on the trustee's behalf. Costs can vary significantly and so can the level of service and expertise provided. Even when a third party is engaged to perform functions on behalf of the trustees, ultimately the trustees remain liable for all activities relating to the fund. It is therefore vital for trustees to ensure they are engaging qualified, experienced specialists to assist them. Professionals must be appropriately licenced to provide personalised advice in relation to the establishment of an SMSF. Individuals can check if someone is licenced by asking for their Australian Financial Services Licence (AFSL) number, and the ASIC's adviser register will confirm what that person can advise them on.

Ensure your fund is compliant

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 or by paying someone to do the audit on your behalf. Some of the issues that such an audit should assess are whether:

- Your fund was properly set up
- 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

Reporting requirements

A set of financial statements and tax return is required to be prepared for the Fund, annually. These financial statements are then independently audited (by an auditor who is registered with ASIC) and the tax return lodged with the Tax Office.

The Trustees (or an accountant/ administrator on their behalf) must make available to the auditor source documents verifying the transactions within the fund and other information where applicable. This is an additional degree of accountability that most other entities are not subject to. Record keeping and documentation retention is of particular importance when managing an SMSF.

If the fund is newly established, its first tax return must be lodged by 28 February following the end of the applicable financial year. Future returns after the first one have a due date of 15 May. If the last return lodged on behalf of the fund was late, the fund must lodge its next return by 31 October.

The tax office levies an annual supervisory charge and the fund is liable to pay tax at a concessional rate of 15% on income and contributions, and 10% on capital gains while it is in accumulation phase.

Create an exit strategy

It's impossible to know the future but having an exit strategy will at least ensure you have given some thought to how, and under what circumstance, the fund will be wound up. Preparing this strategy from the outset can avoid potential member disputes down the track. SMSFs may need to be wound up for various reasons, including:

- The trustees no longer wanting to have the ongoing administrative burden of managing the fund due to age, health or other reasons
- The fund's assets reducing over time to the point where it's no longer cost effective to maintain it
- A relationship breakdown between fund members
- When all fund members have passed away or have been paid all their entitlements
- If all the fund members want to transfer their entitlements to another super fund (such as an industry or retail super fund)
- Fund members wanting to relocate overseas and are no longer Australian residents for tax purposes

The exit strategy should ensure that all trustees:

- Can access all SMSF records and accounts
- Have binding death benefit nominations in place (and make provisions for these nominations to be reviewed every three years)
- Consider appointing an enduring power of attorney

Payment of Benefits

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

- 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 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.

The Advantages And Disadvantages Of SMSF's

Retirement may be the end goal for most Australians but with it comes the fact that you will no longer receive a regular income. The Australian Government has implemented many measures to encourage people to plan for their eventual retirement; the biggest being the introduction of compulsory contributions to retirement savings into Superannuation over an individual's working life in a low tax environment.

A popular method of saving for retirement is through a Self-Managed Superannuation Fund (SMSF) which allows people to directly control and manage how their retirement savings are invested.

What are the benefits?
The benefits of a SMSF include:

Investment choice

SMSFs offer a wider range of investment options compared to other superannuation funds. With some limited exceptions, a SMSF can invest in virtually anything providing that this also meets the sole purpose test and adheres to the regulations. This includes investing in direct property.

An SMSF can also borrow to purchase an asset, however this is becoming increasingly difficult as many banks have removed their SMSF lending products from the market.

SMSFs are attractive to small business owners or the self-employed as a commercial property can be purchased by their SMSF. This property can then be rented to their business providing this is at the prevailing market rates. Artwork and other collectables, physical gold and investments in some unlisted entities are all permitted within an SMSF. There are, however, stringent criteria that have to be met for these investments to ensure the SMSF remains compliant with the law.

Flexibility & control

As the members of the fund are also the trustees there is the flexibility to tailor the rules of the SMSF to suit their specific needs and circumstances. This is not available with other superannuation funds. Managing your own super investments directly allows you to make quick adjustments regarding your portfolio following market changes or to take up sudden investment opportunities.

Effective Tax Management

SMSFs have the same tax rates as other superannuation funds, however through a SMSF you can more easily put in place tax strategies that best benefit you and your situation.

Accountability

Being both the trustee and member means you will be more aware of how your super monies are invested and the performance of those investments. This would not be the case with Industry or Retail Super Funds where, due to their size, investment performance is aggregated and not released until many months down the track.

Costs of running your fund

Traditionally, SMSFs were only used by the wealthy due to the high set up and ongoing compliance fees. These days, however, SMSFs are now a much more cost-effective option for all due to advances in technology and competition between service providers. The level of professional support you engage will determine the costs associated with running your SMSF.

Most of the operational costs with running a SMSF are fixed. Therefore, as a fund grows in value its costs will generally reduce proportionally. This is different to Industry or Retails Super Funds where costs are usually taken as a percentage of your overall balance.

Pooling your super with others

SMSFs allow you to pool your superannuation with up to 5 other people. This opens up the opportunity to invest in things an individual may not be able to on their own such as direct property.

Protection from Creditors

Creditors cannot generally access an individual's superannuation. That is unless clawback laws apply where someone has deliberately transferred their assets into a SMSF to escape paying their creditors.

What are the disadvantages?

Although SMSFs carry many benefits they are not suitable for everyone. The disadvantages of having a SMSF include:

Duties & Responsibilities of being a Trustee

When you 'self-manage' your retirement savings you take on the responsibility of all investment decisions; compared to outsourcing this duty to an investment manager within an Industry or Retails Super Fund. Therefore, as a trustee, you should make sure you have a reasonable understanding of investment options and markets as poor investment decisions will have a direct impact on the assets of your fund and also the retirement savings of other members. Some people simply do not have this expertise.

Furthermore, trustees are responsible for ensuring that their fund complies with the legislation and rules which is a responsibility that should not be taken lightly. Trustees should become familiar with the tax laws governing superannuation. If the ATO considers there has been a breach of these obligations and responsibilities it can impose high penalties on trustees who will be personally liable. Serious breaches can result in an imposition of a tax rate of up to 47%.

Apart from the knowledge requirements, SMSFs also demand a lot of time from their trustees to ensure investments are managed properly.

Living overseas

The majority of a SMSF's members must permanently reside within Australia. If you intend to move overseas permanently or make contributions to you fund while living overseas this could make your fund non-compliant with the law.

Costs of running your fund

The cost of running an SMSF can be disadvantageous when the assets held within the SMSF are low in value. As outlined above, many SMSF management costs are fixed and can therefore erode low value SMSFs.

Costs to operate a SMSF do, however, reduce proportionately when the value of the fund's assets are high. You must do the maths and see whether a SMSF is worthwhile for you based on your particular circumstances.

The general consensus is that you should have at least $250,000 of assets in your fund to make the costs of running a SMSF worthwhile.

9 Steps To Setting Up A SMSF

Step 1:
Choose your SMSF members

Step 2:
Structures and Choosing Trustee

Step 3:
Appoint Trustees

Step 4:
Obtain a Trust Deed

Step 5:
Sign a trustee declaration

Step 6:
Apply for an Australian Business Number (ABN) and register your fund with the ATO

Step 7:
Set up an SMSF bank account

Step 8:
Create an investment strategy and make your initial investments

Step 9:
Appoint an Accountant and an Auditor

Step 1: Choose your SMSF members

It's important that fund members (and the fund itself) can satisfy the following residency conditions:

- The fund will be established in Australia or will have at least one Australian-based asset
- The central management and control of the fund will generally happen in Australia.
- Active members of the fund must be Australian residents who will hold at least 50% of its total assets.

These conditions must be met for your SMSF to qualify as an Australian super fund and therefore eligible for the tax concessions available under Australian superannuation legislation.

Step 2: Structures & Choosing Trustee

An SMSF must be set up as a trust. A trust is a legal arrangement where trustees manage assets on behalf of beneficiaries (your SMSFs members). Every member of an SMSF must be either an individual or a corporate trustee. If the fund has individual trustees, it must have six or less members to be a SMSF, where each member is a trustee.

Compared to a corporate trustee, a fund with individual trustees can be less costly to establish and is subject to fewer reporting obligations.

If the fund has a corporate trustee, it must also have six or less members, where each member is a director of the company and each director of the corporate trustee is a member of the fund. While directors of a corporate trustee must comply with more rules than individual trustees, such as the Corporations Act 2001.

If you choose to have a corporate trustee structure, each of your SMSF members must be a director of that company. The company must be registered with the Australian Securities and Investments Commission (ASIC). Although ASIC charges company registration and annual review fees for SMSFs with a corporate trustee structure, it can be easier to record and register assets if there is a membership change.

Step 3. 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 six individual members
- Appointing a corporate trustee

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 last two groups mentioned above, 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.

Step 4. 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.

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 5. 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 6. Apply for an Australian Business Number (ABN) and register your fund with the ATO

All SMSFs must be registered with the ATO within 60 days of being established. This is done by completing and submitting an ABN application form to the ATO. You can do this yourself or a tax professional can do it on your behalf. The ATO will provide your fund with a tax file number once it approves the application. Election to be regulated is a 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.

Step 7. Set up an SMSF bank account

Your SMSF needs its own bank account separate from its members' individual accounts. This SMSF account is used for receiving all member contributions and paying all member benefits. You will need to advise the ATO of the account details.

Step 8. Create an investment strategy and make your initial investments

It's a legal requirement for SMSFs to have a documented investment strategy. This investment strategy should satisfy the sole purpose test and be used to guide trustee decision-making. Important factors to consider when developing an SMSF investment strategy include:

- Each fund member's age, current financial situation, risk profile and other relevant characteristics
- The benefits of diversifying the fund's investments to manage risk. The major investment options are cash, bonds and other fixed interest products, shares and real estate
- How easily its assets can be converted to cash to pay future member benefits when required
- The current insurance needs of members to ensure appropriate coverage is arranged (inside or outside their SMSF)

Once this strategy has been created, the fund's initial investments can be made.

Step 9. Appoint an Accountant and an Auditor

It important that when you set up your SMSF you appoint an experienced accountant who can guide your through the compliance requirements for managing your annual reporting obligations to ATO. It's a legal requirement for SMSFs to be audited by an independent SMSF auditor licensed by ASIC.

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