Self-managed superannuation funds

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The term self-managed superannuation fund – otherwise known as an SMSF – basically refers to do-it-yourself super. Having an SMSF means simply having control of how your super is being invested, and it has recently become a popular method of saving for retirement.

If you choose to go down this path, it's essential that you are aware of the administrative and compliance requirements of SMSFs. The information below should answer many of the questions and obligations specific to managing your own SMSF.

Before you consider leaving your current superannuation fund to establish an SMSF, you should discuss your options in detail with a financial adviser.

What is an SMSF?

An SMSF is a trust where funds or assets are held and managed on behalf of a maximum of four individuals, to provide future retirement benefits. Subject to certain exceptions, all members of an SMSF must be trustees of the fund or directors of the fund's corporate trustee.

What are the benefits of establishing an SMSF?

The main rationale for establishing your own SMSF is the increased level of control you have, as well as the investment choice and flexibility. You become the trustee of your fund and therefore make decisions on your fund's investment strategy and the type of assets that are held within your fund.

Your SMSF can also invest in investments not usually available in a public super fund (please note, however, that these investments are subject to certain limitations and legal restrictions). This will allow your fund's investments to be customised to suit the precise requirements of members, before and after retirement.

Furthermore, similar to all complying super funds, an SMSF is taxed at a concessional rate. The top tax rate for investment earnings from your SMSF is 15 per cent. This tax concession, however, is only available for complying funds – which are SMSFs that fulfil all the rules set out by the ATO, the Superannuation Industry (Supervision) (SIS) Act 1993 and the SIS Regulations.

Things to consider

Who are the governing bodies?

The Australian Taxation Office (ATO) is responsible for overseeing the regulation of SMSFs.

Understanding the obligations and rules associated with an SMSF

As an SMSF investor, you need to consider your fund's investment philosophy – like any other super investment, you will need to establish what the acceptable rate of return is and how much risk you are willing to take with your retirement savings. These are areas where professional management can be a good idea.

As an SMSF trustee, you are required to regularly review the investment strategy of your fund and also consider insurance for the members of your fund.

Many investors who open an SMSF employ the services of specialist administrators to take on the difficult compliance activities on behalf of their fund. This is beneficial as they can still enjoy the investment control and flexibility without the added burden of administration.

Your fund's compliance with superannuation law is vital and you are legally accountable for ensuring your fund complies with all the rules – even if you pay for professional management.

The main components of compliance for an SMSF relate to:

- how and when an SMSF is permitted to borrow
- in-house asset rules
- acquisition of assets from related parties, and
- conducting all dealings at arm's length.

Sole purpose test

The foundation of the SMSF regulatory system is the 'sole purpose test' – the sole purpose of your fund should be to provide retirement benefits to fund members.

Separation of assets

The assets of the fund must be separate to those of a business where one or more of the trustees are involved. The failure to separate assets is a clear contravention of the super legislation and associated regulations.

Investments

To assist in making sure the assets in an SMSF are available to produce retirement funds, SMSFs are limited in the investments they can make. One of the concessions that the SMSFs can enjoy is the ability to invest in business real property. However as a fund trustee you also have to be aware of the need for diversity and sufficient liquidity for the SMSF to meet its expense commitments.

More restrictive rules apply to investments in personal use assets and collectables, that are in addition to the sole purpose test. Under the latter members cannot enjoy the benefit from the investment prior to reaching their retirement age.

The in-house asset rules suggest that the particular investment can make up a maximum of 5 per cent of the fund's entire assets and the arm's-length requirement means that it should be leased to the related party at commercial rates.

Fiduciary responsibilities

It is of the utmost importance to meet fiduciary responsibilities, especially in regards to the SMSF holding its own bank account (and not personal accounts), and ensuring this account isn't overdrawn.

SMSFs that comply with all regulations are demonstrating to the ATO that they are appropriately managed. It is also important to note that the costs associated with the management of the SMSF, including ensuring compliance with all regulations, generally means that fund members collectively need between $200,000 and $250,000 to make the exercise of establishing an SMSF worthwhile. This does not include the initial set up costs involved.

Call us on 0398240001 for more information.

Email: admin@pmdadvice.com.au

Tel: 0398240001

Fax number: 03 9824 1110

Address: Level 6 136 Exhibition St Melbourne Vic 3000

Website: www.pmdadvice.com.au

Consultum
Financial Advisers