Fact File

Self-Managed Super Funds:
what you need to know

Self-managed superannuation funds (SMSFs) are a popular option for investors seeking greater control over their retirement savings. However, the decision to establish an SMSF should not be taken lightly. Whether an SMSF is suitable for you will depend on your needs and circumstances and whether you are willing to take on the responsibility of running your own super fund.

What are SMSFs?

SMSFs are superannuation funds which are established and operated by the members of the fund. Under the superannuation rules, the members of an SMSF are generally required to act as a trustee of the fund or as a director of the fund's corporate trustee, and are legally responsible for managing the fund in accordance with a strict set of legal requirements.

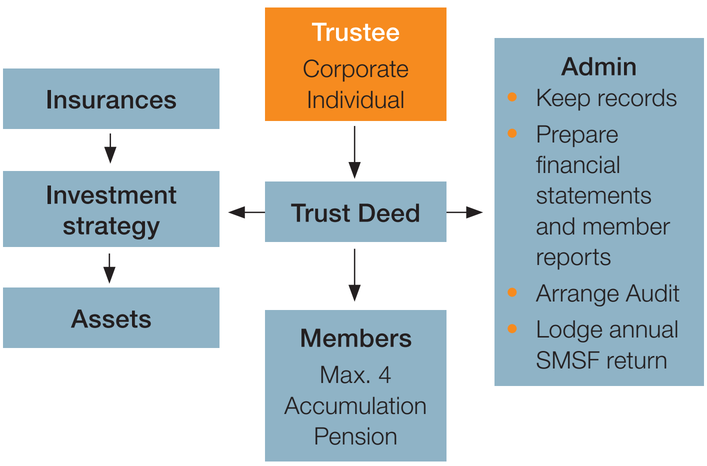
Structure of an SMSF

An SMSF is composed of a number of key elements. These include:

- the trust deed which is a legal document that sets out the rules of the fund
- the trustee who is legally responsible for managing and administering the fund in accordance with the trust deed and the superannuation laws
- the members (max of 4) who are also required to act as trustees and have benefits in the fund
- the investment strategy which specifies the fund's investment objective, how the trustees should invest the fund's assets and whether it will hold insurances for members

The structure of an SMSF is represented as follows:

SIS Act and Regulations



Trustee duties and responsibilities

Becoming a trustee of an SMSF is a serious decision that involves taking on a number of legal duties and responsibilities. These include to:

- learn and understand the superannuation rules as well as your trustee obligations and duties under both general law and superannuation law
- formulate, implement and regularly review an investment strategy for the fund that aims to provide the required level of retirement benefits and that considers the insurance needs of the members
- invest the fund's assets in accordance with the fund's investment strategy and the superannuation investment rules to provide retirement benefits to members
- keep the fund's assets separate from the trustees' personal assets and ensure the fund is managed and maintained for the sole purpose of providing retirement and death benefits
- accept contributions and pay benefits in accordance with the super and tax laws
- hold regular trustee meetings and maintain proper and accurate records of all trustee decisions and fund transactions
- arrange for all assets to be valued at market value each year
- keep fund records, including details of all trustee meetings and resolutions
- arrange for the fund's financial statements and reports to be prepared and audited each year and for the SMSF annual return to be lodged with the ATO by the due date each year.

Trustees are also required to sign a declaration confirming that they know and understand their legal responsibilities within 21 days of becoming a trustee. A copy of the declaration, along with a range of SMSF videos and guides to help you understand your trustee duties and responsibilities, is available on the ATO website at www.ato.gov.au/superfunds.

What are the benefits of SMSFs?

Because SMSFs are self-managed they can be more flexible and give members more control over how their super savings are invested and managed. For example, SMSFs can allow members to:

- develop an investment strategy specifically designed to meet their needs and circumstances and that takes into account their personal investment preferences
- be directly involved in making the day to day investment decisions for the fund
- invest in asset classes not available in large funds, such as direct property
- invest in commercial property which can then be leased back to a related party to use in a business
- borrow for investment subject to strict requirements
- pay retirement income streams tailored to their specific requirements
- implement estate planning strategies tailored to their specific needs and circumstances.

What are the costs of an SMSF?

Another potential advantage of SMSFs is that they can potentially be more cost effective when compared to large super funds. However, this very much depends on how involved the members are in managing their fund, the level of the fund's assets and the costs of running the fund.

For example, in 2013 the Australian Securities and Investments Commission published a report that found SMSFs with assets of between $200,000 to $500,000 will only be cost-competitive where the trustees take on at least some of the administrative duties while SMSFs that outsource all of their trustee duties to service providers will need assets of at least $500,000 to be justified from a cost perspective.

As a guide, some of the costs associated with setting up and running an SMSF include:

- fund establishment costs – these include the legal and administration costs to set up and register the fund with the ATO as well as any upfront investment and advice costs
- ongoing investment management and advice costs
- asset valuation costs
- pension establishment and annual actuarial certificate costs
- annual administration and reporting costs – including annual accounting, tax and auditing costs as well as the cost of preparing and lodging an annual SMSF return with the ATO.

Risks and disadvantages

Before deciding to set up an SMSF there are a number of issues associated with SMSFs that you need to be aware and understand. These are summarised as follows:

- As a trustee you will be legally responsible for the fund and can be held personally liable for any penalties should the fund fail to be maintained in accordance with the strict legal requirements. See below for more information on penalties.
- SMSFs generally require more effort to establish and maintain compared to being a member of a large fund, as you will have a range of trustee duties and obligations
- As a trustee of an SMSF you will be responsible for investing the fund's assets yourself. Therefore, you will be relying on your own investment skills and knowledge rather than those of a professional investment manager.
- Insurance cover for members may be more difficult or expensive to obtain in an SMSF compared to a large fund as members may not be able to access the benefits of group life insurance arrangements, such as wholesale premium rates and automatic acceptance of cover.
- Unlike large funds, SMSFs are ineligible to apply to the Federal Government for a grant of financial assistance where the fund has suffered a loss due to theft or fraud
- Any disputes in relation to an SMSF are not able to be resolved by the Superannuation Complaints Tribunal and may need to be resolved via legal action.

It is also important to note that any change in member circumstances can have an adverse impact on an SMSF and can result in a fund needing to be wound-up. This in turn could trigger additional costs and taxes being and result in the loss of any concessional tax or social security treatment that may have applied to the members' interests in the fund.

Changing circumstances which may adversely impact an SMSF include:

- a breakdown in the relationship between members resulting in one or more of the members leaving the fund
- the members becoming non-resident which may result in the fund being subject to tax significant penalties
- one or more members becoming a disqualified person due to bankruptcy, conviction or disqualification by the regulator
- the death of a member, or
- a member ceasing to be capable of acting as trustee due to age or health related issues.

Therefore, it's important to have an exit strategy which could help you to exit and wind-up an SMSF should the need arise.

Is an SMSF right for me?

Whether an SMSF is right for you will depend on a range of issues. These include:

- whether you need or want to additional control and flexibility that SMSFs provide
- the size of the fund and how involved you want to get in managing and administering the fund
- whether you have the time required to properly manage the fund and keep up with any changes to the superannuation rules
- whether you want the ability to invest in other asset classes not available in large funds or to get involved in making the investment decisions in relation to your fund
- whether your individual needs and circumstances may indicate whether an SMSF may not be suitable.

General SMSF information

SMSF definition

To qualify as an SMSF a super fund must satisfy a specific set of requirements. These include:

- it must have fewer than 5 members
- all members must act as a trustee of the fund and all trustees must be a member of the fund. Alternatively, if the fund has a corporate trustee – all members must be a director of the corporate trustee and all directors must be a member of the fund
- no member of the fund is permitted to be an employee of another member unless they are related
- no trustee or director of the corporate trustee can receive any remuneration for any trustee duties performed in relation to the fund.

An SMSF can also be established with a single member. In this case, the fund must have a corporate trustee or a second person must be appointed to act as a trustee of the fund.

You are able to choose between having individual trustees or a corporate trustee structure. Corporate trustees can have a number of advantages over individual trustees. These include:

- limited liability for directors
- easier identification and segregation of fund assets
- simpler succession and administrative requirements where there is a change in fund membership.

Superannuation investment rules

When investing the fund's assets, trustees must be aware of the superannuation investment rules and restrictions. These include:

- a trustee must not lend money, or provide any form of financial assistance, to a member or a relative of a member of the fund
- a trustee is generally prohibited from acquiring assets from a related party other than certain types of assets, such as listed securities and real property used exclusively in a business
- a trustee is generally prohibited from borrowing money other than in certain limited circumstances, such as via a limited recourse borrowing arrangement
- the total market value of certain in-house assets must not exceed 5% of the market value of the fund's assets
- all investments must be made and maintained on an arm's length basis
- the trustee must not give a mortgage or security over the fund's assets
- the trustee must invest and maintain the fund's assets for the sole purpose providing benefits to members upon their retirement (or attainment of a certain age) or their beneficiaries if a member dies.

You as a trustee will be required to comply with these rules at all times. Any breach of these requirements can result in significant compliance and tax penalties being applied.

Investment strategy requirements

The trustees of an SMSF are required to formulate, implement and regularly review an investment strategy for the fund that takes into account all of the circumstances of the fund, including:

- the needs, objectives and risk tolerance of the members
- the likely return from the SMSF's investments and the risks associated with those investments
- the fund's cash flow requirements taking into account the fund's expected costs and benefit payments
- the importance of diversification and the need to invest the fund's assets across a number of asset classes to help reduce investment risk
- the liquidity of the fund's assets over and above the fund's cash flow requirements
- the need to hold insurance to provide cover for the members of the fund.

When formulating and implementing an investment strategy you need to pay special consideration to the level of diversification of the fund's assets as it can help reduce investment risk. All investments must be in accordance with the fund's strategy.

Insurance considerations

As part of an investment strategy, trustees are required to consider the need to hold insurance for members. To comply with this requirement, trustees need to consider each member's personal circumstances, including:

- their income, assets and liabilities
- their existing insurance cover
- the availability and affordability of the required level of insurance cover having regard to their current circumstances and their retirement expectations.

It's important that trustees comply with this requirement and document their decision in the minutes of a trustee meeting. Failure to properly consider this issue could result in members being under insured and expose the trustees to claims for compensation should a member, or their beneficiaries, suffer a loss as a result.

Investment strategy review

Trustees must regularly review the fund's investment strategy to ensure it remains appropriate for the fund on an ongoing basis. This is particularly important where members are approaching retirement as their needs and circumstances are likely to change.

Trustees should also review the fund's investment strategy whenever there is a significant change in the fund's circumstances. This could include where a member retires and commences an income stream or in response to any changes in macro-economic conditions.

Comply with operating standards

Trustees are required to comply with a number of superannuation operating standards. These include:

- to only accept contributions for members age 65 or over where they are eligible to contribute
- to ensure all member benefits are preserved until retirement (or until a member meets another superannuation condition of release) and to not allow members to illegally access their superannuation savings early
- to only acquire insurance policies that align with a condition of release, and
- to keep certain fund records and reports for specified periods of time.

Breaches and penalties

The ATO as regulator monitors SMSFs for their compliance with the superannuation laws and can take action against trustees where a breach occurs. This includes:

- requiring a trustee to undertake an approved course of education in relation to their trustee duties
- issuing a rectification direction to require a trustee to rectify a breach
- issuing administrative penalties of up to $10,800 per trustee
- disqualifying one or more trustees
- revoking the fund's complying tax status – in which case severe tax penalties can apply
- taking legal action against trustees in which case a judge can impose civil and criminal penalties of up to $1.7 million and/or 5 years imprisonment.

It is therefore vital that trustees understand their obligations and comply with them at all times.

ATO SMSF Publications

The ATO has produced a number of educational videos and guides in relation to the different aspects and obligations of running an SMSF. These videos and guides are available on the Super Funds page of the ATO website at www.ato.gov.au:

- Setting up a self-managed superannuation fund
- Running a self-managed superannuation fund
- How your self-managed superannuation fund is regulated.

Getting help

There are a number of professional SMSF service providers that can assist you to set up and run your fund. These include:

- an accountant that provides SMSF administration services
- a specialist SMSF administration service
- a financial planner to help formulate and investment strategy and manage the fund's investments
- a solicitor to assist with any trust deed / estate planning requirements.

Speak to us for more information

If you would like to know more about self-managed super funds, talk to your Count Financial Adviser. They can give you more detailed information on the best approach for your situation.

21002/0915