GFM Wealth Advisory

SMSF SMART

An Introduction to SMSFs

Edition #1

190 Through Road, Camberwell VIC 3124 T: (03) 9809 1221 F: (03) 9809 2055 enquiry@gfmwealth.com.au

www.gfmwealth.com.au

Australian Financial Services Licence No. 229401 ABN 69 006 679 394

An Introduction to SMSFs

Edition #1

SMSF Smart is designed to assist existing SMSF trustees with their understanding of an SMSF. This is an eight–part education series which will provide a comprehensive guide on how an SMSF works.

In this first edition of the eight–part series, we will be covering:

- What is Superannuation?
- What is a self–managed super fund?
- Advantages of SMSFs
- Disadvantages and Risks of SMSFs
- Multi–member funds
- Single member funds
- Individual versus Corporate Trustee Structure

What is Superannuation?

Superannuation is a dedicated vehicle to save for retirement. Contributions made are invested and accumulated until the member's retirement or another specified event, such as death or incapacity.

Many people consider superannuation to be a different investment option in contrast to the investments they may make in their name. Nothing could be further from the truth. The investments that you make via your superannuation fund are virtually the same and behave in the same way as those made by you in your name. Superannuation funds can invest in cash, property and shares in the same way as other investors. The main difference is that superannuation earnings are generally taxed at a lower rate than those from investments made by individuals or by using trust or company structures.

What is a self–managed super fund (SMSF)?

An SMSF is a private superannuation fund, regulated by the Australian Taxation Office (ATO). It is a legal tax structure with the sole purpose of providing for your retirement and operates under similar rules and restrictions as ordinary super funds.

Since the official introduction of SMSFs in 1999, they have grown to represent a significant component of the superannuation sector.

An SMSF can currently have up to four members. Being a member of an SMSF requires you to actively participate in the fund's investment, administration and management. In an SMSF, all members take on the responsibility and control of managing all of the members' retirement savings.

SMSF trustees perform the same role as other superannuation fund trustees; receiving and investing member contributions and making them available s as lump sums or pensions to members when they meet a condition of release.

Australian Financial Services Licence No. 229401

An SMSF is most appropriate for those who:

- Prefer to have direct control over their superannuation;
- Wish to be involved in investment decisions,
- Wish to gain from the potential strategic flexibility and estate planning benefits associated with SMSFs; and
- Have a significant superannuation balance, making the costs associated with running your own SMSF more effective

Advantages of SMSFs

There are many possible advantages of an SMSF:

Direct investment choice	You can invest in your own combination of investments that are aligned with your risk profile and objectives. This can include direct shares, high–yielding cash accounts, term deposits, income orientated investments, unlisted assets and direct property. Typically not all of these investments are available via mainstream superannuation funds.
Flexibility	Within an SMSF you can adjust your investment mix as it suits you, allowing for a faster response to changes in market conditions, legislative changes or personal circumstances.
Transparency	SMSFs provide a platform which allows you to understand where your money is invested, with complete visibility over costs, performance and tax treatment.
Consolidation	You can have up to four members in an SMSF. You are therefore able to combine your superannuation benefits into one strategy to increase the SMSF's balance, which increases the assets and potential for compounding capital growth as well as the investment opportunity set.
Tax planning	An SMSF can grow with carefully considered tax strategies. You can reduce tax liabilities within an SMSF by selecting a tax effective mix of investments, including franked dividends.
Estate planning	A member of an SMSF can a have a non–lapsing, cascading binding death benefit nomination which allows them to specify how their benefits are to be distributed on their passing. SMSFs also allow members to run multiple pension accounts. This can help achieve better estate planning outcomes.
Strategy implementation	It can be easier to implement strategies such as super splitting, personal concession contributions, in–specie asset transfers when compared to mainstream superannuation funds. This is in addition to the previously stated SMSF tax and estate planning strategies.
Long term financial planning tool	SMSFs also allow members to run a mixture of accumulation and pension accounts within the same structure, meaning an SMSF can be a suitable long term financial planning tool.
Cost considerations	SMSFs become more cost effective with larger balances. SMSF trustees must lodge an annual tax return and audit and pay ATO fees. These are not based on a percentage of your super balance.

Disadvantages and Risks of SMSFs

We encourage you to ask your adviser any questions if you need further information or clarification concerning the disadvantages and risks of an SMSF.

Cost barriers	The cost may vary depending on the SMSF balance, complexity of investments and level of outsourcing. Once you are in the pension phase, there may be a point at which the SMSF ceases to be cost–effective because fixed costs will remain constant or increase while the balance of the SMSF diminishes. Additional charges will also be incurred upon winding up an SMSF.
Legal and compliance obligations	Although many responsibilities can be outsourced, the ultimate responsibility remains with the trustee. Even if one trustee is less actively involved, they are equally liable for complying with the trustee obligations under superannuation and tax laws
Expertise and performance	A high level of flexibility in investment choice requires sound knowledge and experience on behalf of the members.
Time–consuming	It is reasonable to expect an SMSF will take up more time for the member than alternative superannuation funds.
Succession planning issues	If one trustee is more involved in the management of the SMSF, the less active trustee may be forced to take on more responsibility and could incur problems if the dominant trustee is unable to manage the SMSF.
Lack of statutory compensation	When transferring (the whole or part of) an existing superannuation account balance from a superannuation fund regulated by the Australian Prudential Regulation Authority (APRA) to an SMSF, you should be aware that SMSFs are not subject to the same government protections that are available in APRA–regulated superannuation funds, such as statutory compensation in the event of theft or fraud.
Impact on insurance	The only Life and TPD insurance cover that many hold is through their superannuation. Moving to an SMSF may leave you without any life or other insurance cover unless the trustee(s) take out insurance for SMSF members. SMSF insurance can be harder to get and more expensive than in other superannuation funds.
Access to complaints mechanisms	Certain dispute resolution mechanisms, such as the Superannuation Complaints Tribunal, may not be available to SMSFs. However, the types of disputes and complaints that may arise for SMSF members may be different from those in an APRA–regulated superannuation fund, and access to other complaints mechanisms may be available (e.g. the Financial Ombudsman Service Limited).

Multi–member funds

An SMSF must meet the following criteria to comply with the law:

- Have four or fewer members
- Each member of the SMSF must be either an individual trustee or a director of the corporate trustee
- If the trustee of the SMSF is a company, also known as a 'corporate trustee', then each director of the company must be a member
- No member of the SMSF can be employed by another member unless those two people are related
- The trustees of an SMSF are responsible for running the fund and cannot receive any remuneration for performing this role.

Single member funds

An SMSF may have only one member if it satisfies certain necessary conditions.

An individual cannot be both the sole trustee and sole beneficiary of a trust. The SIS Act addresses this by allowing an SMSF to have a single member if the member is one of two individual trustees or a director of a company (corporate) trustee of the fund.

The most common arrangements are:

- Two trustees – one is the member and the other is a relative of the member or can be another person providing they are not an employer of the member.
- The company acting as trustee – where the member is the sole director of the corporation or the member is one of only two directors of the company, and the member and the other director are relatives or another person, and that person is not an employee of the member.

In certain situations, other people may be permitted to act as an SMSF trustee on a member's behalf without causing the fund to fail the SMSF definition. These situations might include:

- If the member is under a legal disability, their Legal Personal Representative can act as trustee on their behalf.
- A Legal Personal Representative can act as the truste should a member pass away until the deceased member's benefits commence to be paid from the SMSF.
- If an Enduring Power of Attorney has been made for a member, they can act as trustee.

Individual Trustee versus Corporate Trustee Structure

SMSFs can have an individual or corporate trustee.

SMSFs are structured as trusts, meaning that the SMSF's trustees are responsible for all the fund's affairs. The trust can be set up in one of two ways. It is a requirement that you appoint either a group of individuals or a company to act as the trustee of the fund to qualify as an SMSF. The trustee structure you choose will influence how your SMSF is administered.

1. Individual Trustee Structure

Generally, all trustees must be members of the SMSF, and all members must be trustees. This gives all members input into, and control of the SMSF's administration and investment decisions. For example Michael Smith and Susan Smith as trustee for the M & S Smith Super Fund

2. Corporate Trustee Structure

Under this structure, a company is the trustee of the SMSF. For example Michael and Susan Super Pty Ltd as trustee for the M & S Smith Super Fund.

Generally speaking, all the directors of the company need to be members of the SMSF. This upholds the principle that all members have an interest in the SMSF's administration and decision–making.

It is best practice to use a sole purpose trustee company in the case of a corporate trustee to minimise the possibility of intermingling SMSF's assets with other assets belonging to the company or another related entity.

Individual Trustee and Corporate Trustee Structure: Key Differences

Trustee Requirements:

Individual Trustees

- Each member must be a trustee. Single member SMSFs must have two individual trustees
- If a member leaves the SMSF and resigns as a trustee, leaving only one member, a second individual trustee must be appointed.

Corporate Trustee

- Each member must be a director. Single member SMSFs can have a corporate trustee with the member as the sole director.
- If a member leaves the SMSF and resigns as director, leaving only one member, they do not have to appoint a second director.

Administration:

Individual Trustees

- More administrative impact if a member/trustee leaves the SMSF, as all ownership documents must be amended to reflect the new trustee composition. If a member leaves the SMSF and resigns as a trustee, leaving only one member, a second individual trustee must be appointed.

Corporate Trustee

- Less administrative impact if a member/trustee leaves the SMSF, as ownership documents remain unchanged.

Cost:

Individual Trustees

- No additional cost.

Corporate Trustee

- There are costs associated with establishing a company for the corporate trustee and an annual fee payable to the Australian Securities & Investments Commission (ASIC).

ASIC and the ATO prefer a corporate trustee structure. ASIC has released some documents which outlined the advantages of an SMSF corporate trustee structure. We at GFM have a firm preference for a corporate trustee structure as well.

By far the easiest way to deal with changes to membership is for an SMSF to have a corporate trustee in place.

Disclaimer

This document is not an offer or invitation to any person to buy or sell any interest in or deposit funds with any institution. The information here is of a generic nature, and does not take into account your investment objectives or financial needs. No person should act upon this information without firstly seeking competent, professional advice specifically relating to their own particular situation.