

A guide to self managed super

Do-it-yourself super via a self managed super fund (SMSF) is becoming an increasingly popular choice for investors who want to have control over how their super is invested.

What is an SMSF?

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

Why establish an SMSF?

Three key reasons for establishing your own SMSF are control, flexibility and investment choice. As trustee of your fund, you decide on your fund's investment strategy and choose how your fund's assets are invested. This means you can tailor your fund's investments to suit members' specific needs. Your fund can invest in most asset classes, although there are some limitations and legal restrictions.

Like all super funds, an SMSF receives concessional tax treatment. The top tax rate for the investment earnings of your SMSF is 15%. It's important to note that this tax concession is only available if your fund complies with all the rules and regulations that apply to SMSFs (a 'complying fund').

Understanding the rules and obligations of an SMSF

As a trustee, you need to consider your fund's investment philosophy. Investing successfully takes time, effort and discipline.

How will you spread your money to manage risk? How long will you give an investment to prove itself? What's an acceptable rate of return? How much risk are you willing to take with members' retirement savings?

Another important consideration is your fund's performance – how is it performing relative to other funds after expenses? If it's not doing better, or at least as well, you may want to consider using a professional to manage your fund.

Rules and obligations applying to SMSFs are complex. Even if you employ specialists to help you with investment strategy, compliance and administration (particularly with Australian Taxation Office requirements), as trustee of your fund you are still legally responsible for making sure your fund complies with all the rules under superannuation law. Let's look at some of the key rules and obligations:

Sole purpose test

The sole purpose of your fund must be to provide retirement benefits to your fund's members. If you use your fund for other purposes (such as running a business) your fund may be considered non-compliant and you risk losing the 15% maximum tax concession.

Compliance

Some key areas of compliance for an SMSF relate to:

- in-house asset rules
- conducting all transactions at arm's length
- borrowing (or gearing) in super
- acquiring assets from related parties
- separation of assets.

In-house asset rules

You can't lend to (or invest in) a related party or related trust of the fund, or lease an asset of the fund to a related party of the fund, if the total of the related party investments or assets being leased is worth more than 5% of the market value of the fund's total assets.

Arm's length requirement

The arm's length requirement means that if you lease any asset that belongs to the fund to a related party, it must be at commercial rates. Any asset purchased must be for its market value.

Gearing in super

There is a general prohibition of borrowing in super, although certain exceptions apply. You can, borrow funds (i.e. use gearing) to invest in certain limited circumstances. Gearing, where appropriate, may help beneficiaries to accelerate the level of savings they have in super for their retirement. However gearing may also magnify losses and the loan must be established on a 'limited recourse' basis.

Acquiring assets from related parties

The trustees of SMSFs are generally prohibited from acquiring assets from related parties of the SMSF. This rule generally prohibits such parties from selling most assets to their SMSF, or from contributing assets in-specie. However some assets such as listed securities (shares, units or bonds listed on an approved stock exchange) or business real property are exempt from this rule.

Separation of assets

Your fund must maintain its assets separately from those of a business involving one or more of your trustees. If a trustee were to hold assets in their own name instead of the fund, the fund risks losing the asset if that trustee is declared bankrupt or if their business goes into receivership.

Investments

To help ensure that the assets of an SMSF will be available to provide retirement income, SMSFs are restricted in the investments they can make. Whilst there is an ability to invest in property, where it forms the primary or sole asset of the fund the trustees need to consider whether this lack of investment diversification is appropriate. Fund liquidity and the ability to pay out benefits should also be part of the trustee's investment considerations.

There are now particular compliance requirements that SMSFs investing in collectibles such as art must adhere to. Central to this requirement is for members not being able to benefit from the investment prior to reaching their preservation age (so, for example, a trustee cannot display a piece of art belonging to the fund in their home or office). They must also purchase insurance cover for these assets.

Fiduciary responsibilities

Meeting fiduciary responsibilities is also important, particularly in relation to your SMSF having its own bank account (rather than banking being done through personal accounts of one or more of the trustees) and not overdrawing that account.

Aside from the initial set-up costs, the cost of sound administration of an SMSF, including compliance with all the regulations, generally means that fund members collectively need a minimum amount of between \$200,000 and \$250,000 to invest for an SMSF to be worthwhile.

Contact your financial adviser to discuss what super options are available to you and what solution may best suit your circumstances and investment needs.

Things you should consider

If you're thinking of leaving your current public offer fund to start up a SMSF to get better returns or other benefits, you should discuss your options in detail with your financial adviser.

It's important that you know your obligations as a trustee for running an SMSF from an administrative and compliance perspective. The rules associated with the super regime are complex and subject to change and the opportunities and effects will differ based on your personal circumstances.