



SELF MANAGED SUPERANNUATION FUNDS

A FINANCIAL PLANNING
TECHNICAL GUIDE

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If you want greater control over your super and more flexibility than you would get with a conventional super fund, then a Self Managed Superannuation Fund (SMSF) could be an attractive option. However they are more complex and also strictly regulated. This guide outlines the key things you need to know about SMSFs.

The following information is current as at March 2012.

What is a self managed superannuation fund?

A SMSF is a superannuation fund that you manage yourself.

Most people have their super with a fund that is managed by a third party – a fund manager, a large corporation or an industry body. A rapidly growing number of people, however, have decided to manage their own super funds. In many cases they are people who own a business or are self-employed. Following the introduction of Super Choice rules in 2005, many employees are also opting to manage their own super fund via a SMSF.

A SMSF provides retirement benefits for its members in the same way as any regular superannuation fund. A SMSF is free from some of the regulations imposed on regular superannuation funds, but there are a whole set of special SMSF rules that must be adhered to. The key ones are listed below:

- The SMSF must have no more than four members.
- The trustees of a SMSF can be either individuals or companies.
 - If the trustees are individuals, each trustee must be a member (except for single member funds, which must have 2 trustees).
 - If the trustee is a company, each director of the company must be a member of the SMSF (except for single member funds, which can have 2 directors).
- No member of the Fund can be an employee of another member, unless the members concerned are relatives.
- Trustees must carry out their duties without payment.

A trustee cannot be a 'disqualified person' meaning they:

- Have never been convicted of an offence involving dishonest conduct.
- Have never been subject to a civil penalty under the SIS Act.
- Are not insolvent under administration (an undischarged bankrupt).
- Have never been disqualified from acting as a trustee of a superannuation fund by the regulator.

A company cannot act as a trustee if:

- A responsible officer of the body corporate is a disqualified person.
- A receiver, official manager or provisional liquidator has been appointed, or
- The company has been wound up.

What are the benefits?

SMSFs have continued to grow in numbers at a solid rate. Why are they so popular?

- More control – over the investment strategy and the way it is implemented.
- Greater investment choice – although there are some limitations imposed by law and the trust deed.
- Lower costs – because you control the investment management you may have the ability to minimise the fees incurred by the investment portfolio and the degree of trading within the portfolio.
- More opportunities for tax effective investments.
- Potentially higher net returns – due to lower costs, less tax and a more effective investment strategy.

What are the risks?

The main issues and risks to be aware of when establishing a SMSF include:

- Obligations of the Trustee – as a trustee of the SMSF you are bound by law to responsibly manage the Fund and are personally liable for any actions of the Fund. You can delegate the tasks associated with administering your SMSF but not the legal responsibility.
- Costs – costs associated with a SMSF are potentially greater for account balances less than \$200,000 as compared to other funds.
- Time – as trustees you will be required to set aside your time for the ongoing management of the SMSF. Alternatively you can seek, at a cost, professional assistance from your financial adviser or accountant.
- No recourse – a trustee of a SMSF does not have access to the Superannuation Complaints Tribunal should something go wrong.

Establishing a SMSF

Your adviser can help you establish a SMSF, but it is important to understand the steps involved. These are outlined below.

1. Establish a Trust

Before you can register a SMSF with the Australian Tax Office (ATO), you need to establish a trust. A trust is required to have the following:

- trustees;
- assets;
- identifiable beneficiaries; and
- intention to create a trust.

2. Obtain Trust Deed

The trust deed sets out the rules and conditions under which the SMSF will operate. So it is vital to start with a well-drafted trust deed. It should be prepared by a qualified legal practitioner and designed to give the trustees maximum control and flexibility.

The trust deed:

- Stipulates the regulations for the trustee to follow, however it is not permitted to contain clauses that would require the trustee or trustees to breach the SIS Act.
- Should be drafted to achieve the SMSF's objectives.
- Can be amended, but only in accordance with the rules set out in the original trust deed.
- Determines how member accounts will be calculated. In the accumulation phase, the trust deed will indicate how earnings will be credited to each member's account.
- Stipulates whether the SMSF can pay pensions, and if so, how.

Provisions that could be contained within a trust deed

A trust deed for a SMSF could contain provisions that deal with the following:

- Who will be a trustee of the SMSF.
- Who can be a member of the SMSF.
- Trustee rights to amend the trust deed.
- Who can make contributions.
- Member investment choice availability.
- When benefits can be paid.
- How benefits can be paid (lump sum and/or income stream).
- Types of income streams the SMSF can pay.
- Acceptance of binding death benefit nominations.
- Who death benefits can be paid to.
- Rules to establish and administer fund reserve accounts.
- When and how the SMSF should be wound up.

3. Sign a declaration

Upon becoming a trustee or director of the corporate trustee of a SMSF, you are required to sign a declaration form stating that you understand your obligations, duties and responsibilities as a trustee or director of the corporate trustee of a SMSF. The declaration must be in the approved form and completed within 21 days of you becoming a trustee.

Your obligations and responsibilities as a trustee of a SMSF include:

- Acting honestly in all matters affecting the SMSF.
- Exercising the degree of care, skill and diligence of an ordinary prudent person.
- Acting in the best interest of the beneficiaries.
- Keeping SMSF assets separate from the trustees personal and business assets.
- Not do anything that would impede trustees from performing their functions and powers.
- Formulating and implementing an investment strategy.
- Managing reserves responsibly.
- Allowing the beneficiaries access to certain information.

4. Lodge an election with the regulator

Within 60 days of the establishment of the SMSF, the trustees must lodge an election to be regulated with the ATO. This election is irrevocable and advises the ATO that the SMSF will be subject to the requirements of the SIS Act and therefore will be entitled to concessional taxation treatment at the rate of 15% as a complying fund.

If an election notice is not lodged, the SMSF will not be treated as a complying fund for taxation purposes and the SMSF will be taxed at the highest marginal tax rate of 45%.

5. Open a bank account

The trustee of a SMSF will generally need to set up a bank account so the Fund can accept contributions, rollovers and earnings. This account will also be required to pay expenses such as annual supervisory levy, accounting fees and income tax liability.

Stages of the Fund

Accumulation Phase

The accumulation phase of the SMSF is where the SMSF accumulates non-concessional and concessional contributions and earnings. Each member has a specific balance in the SMSF and earnings are generally allocated in proportion to their interest in the SMSF.

Pension Phase

This is where the accumulated funds are used to provide an income stream for the member of the SMSF based on their individual balance in the SMSF.

There are various forms of benefits/pensions that can be paid, including:

- Lump sum benefits,
- Account based pensions, and
- Market linked pensions.

Key rules and regulations

The regulations that govern SMSFs are stringent. The ATO has moved from an education phase to a compliance phase.

The governing legislation for SMSFs is the Superannuation Industry (Supervision) Act 1993 (Cth), known as the SIS Act. Here are some key rules you should be aware of.

The Sole Purpose Test

The objective of the sole purpose test is to ensure that SMSFs are maintained for the purpose of providing benefits to members upon their retirement, or to their dependants 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:

- one or more core purposes; or
- one or more core purposes and one or more ancillary purposes.

Core purpose

A 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 not less than prescribed in regulations;
- the member's death, if the death occurred before they retired, and the benefits are provided to their dependants or legal personal representative or both; or
- 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.

Ancillary purpose

Ancillary purposes for maintaining a 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;
- physical or mental ill health;
- death of a member after retirement where the benefits are paid to their dependants or legal personal representative or both;
- death of a member after reaching an age not less than prescribed in regulations where the benefits are paid to their dependants or legal personal representative or both; or
- another ancillary purpose approved in writing by the regulator.

This purpose allows a SMSF to provide benefits in situations of financial hardship and/or on compassionate grounds, subject to the SIS Act, the governing rules of the SMSF and the approval of the appropriate regulator.

Accepting contributions

As a trustee you must be aware of the minimum standards for accepting contributions under the SIS regulations.

Types of contributions

Concessional Contributions (CCs) are contributions made for you or by you for which a tax deduction is claimed and are included in the assessable income of the SMSF. They include:

- Superannuation guarantee (SG) contributions.
- Contributions made by employers over and above the SG or award obligations including salary sacrifice contributions.
- Payments by the ATO of SG shortfall amounts.
- Award/agreement certified by an industrial authority related contributions.
- Personal contributions for which a tax deduction is claimed.

A cap of \$25,000 (indexed) per person per financial year applies to CCs. A transitional CC cap of \$50,000 per person per financial year will apply through to 2011/2012 if you are aged 50 or over at any time in a transitional year. This transitional cap is not be subject to indexation.

CCs which are not counted towards the CC cap include:

- Taxable amount of an overseas transfer that you elect to have taxed within your Australian superannuation fund.
- Untaxed elements of a rolled over superannuation benefit.
- Tax free component plus up to \$1 million of the taxable amount of Employment Terminated Payments (subject to transitional arrangements) rolled over to superannuation.

Non Concessional Contributions (NCCs) are contributions that are not assessable to the SMSF and include:

- Personal post tax contributions.
- Spouse contributions.
- Certain amounts of an overseas transfer.
- Excess CCs above the CC cap.

A cap of \$150,000 (indexed)¹ per person per financial year applies to NCCs. You can contribute \$450,000 over three financial years if aged less than 65 by bringing forward two financial years of caps.

¹ This cap will be indexed to AWOTE each year but will only increase in \$5,000 increments.

NCCs which are not counted towards the NCC cap include:

- Government Co-Contribution.
- Certain proceeds from the disposal of small business assets.
- Personal injury payments that meet certain conditions.
- Superannuation rollovers.
- Tax free component of Employment Termination Payments (subject to transitional arrangements) rolled over to superannuation.

Investment restrictions

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

- Sole purpose test.
- Trustee covenants concerning investment of member's money.
- Borrowing restrictions.
- Fund assets cannot be used as security for any borrowing.
- Restrictions on loans to members.
- Non arm's length investments.
- Acquisition of assets from related parties.
- In house asset provisions.
- Written investment strategy.

Administering a SMSF

It is the trustee's responsibility to ensure that the ongoing administration and compliance tasks of the SMSF are carried out in accordance with the applicable regulatory requirements. Some of the ongoing responsibilities include:

- arranging the annual return which includes the tax return, regulatory return and a member contribution statement in respect of each member and audit reports;
- valuing the assets of the SMSF at market value; and
- keeping all necessary records and documents.

Managing the fund

Investment strategy

As a trustee of a SMSF, one of your key areas of responsibility is to manage the SMSF's investments. The SIS Act places certain duties and responsibilities on trustees when making investment decisions. These are designed to protect and increase member benefits.

You are required to prepare and implement an investment strategy for the SMSF, and regularly review it. The strategy must reflect the purpose and circumstances of the SMSF and consider:

- investing in such a way as to maximise member returns, taking into account the risk associated with the investment;

- appropriate diversification and the benefits of investing across a number of asset classes (for example shares, property, fixed interest) in a long term investment strategy;
- the ability of the SMSF to pay benefits as members retire and pay other costs incurred by the SMSF; and
- the needs of members (for example, age, years to retirement and the type of benefit to be paid).

The investment strategy outlines how the SMSF will aim to achieve its objectives and should include:

- the asset classes the SMSF will invest in; and
- the relative percentage weightings and benchmarks for each asset class.

The percentage weightings and benchmarks should take into consideration the risk profiles of the members as well as the SMSF's overall objectives.

Separate investment strategies can be formulated for each member of the SMSF. This can assist the trustee to deal with situations where different members of the SMSF have different risk profiles (eg someone who has just started working may have a more aggressive approach to investing whilst someone near retirement age may be more conservative).

Review regularly

The investment strategy should be reviewed on a regular basis for several important reasons. These include:

- Whenever the membership of the SMSF changes or whenever the personal circumstances of the members change.
- The death or departure of an existing member.
- The addition of a new member.
- The retirement of a member.

These reviews are in addition to the regular review of the investments held, which should be undertaken at least annually.

Failure to comply with investment rules carries significant penalties. These penalties can range from the freezing of SMSF assets through to trustee fines, disqualification, prosecution and criminal conviction.

Insurance via superannuation

Death, Total and Permanent Disablement and Salary Continuance policies can be purchased by a SMSF. The premiums for these policies are tax deductible to the SMSF as long as the Fund is a complying superannuation fund. Whilst there is nothing to stop the Fund holding a Trauma or Living policy, it is possible that a condition of release may not be met by the member to access these Funds. Also, a Trauma or Living policy is not a death or disability benefit as defined by the Income Tax Assessment Act 1936 (Cth), because:

- The payment of a trauma or living benefit is not conditional on the death of a member.
- Permanent disability is not part of the criteria under which the policy can pay a benefit.
- A Trauma or Living policy does not provide a benefit by way of income.

Due to this, an SMSF cannot claim a tax deduction for any premium payment relating to a trauma policy.

Beneficiary nominations

- The benefit clauses in a SMSF trust deed outline what benefits may be paid, to whom they can be paid and the procedure for nominating beneficiaries.

For example, the trust deed may:

- require payment to certain beneficiaries;
- allow a member to make a non-binding death benefit nomination; or
- allow a member to make a binding death benefit nomination.

Non-binding death benefit nomination

A non-binding death benefit nomination involves the member advising the trustee to whom they would like the trustee to pay their death benefit. However the trustee retains ultimate discretion as to how the death benefit is actually paid.

Binding death benefit nomination

A binding death benefit nomination involves the member making a nomination to the trustee in a way that binds the trustee to pay the member's death benefit in accordance with their nomination. A binding death benefit nomination should meet the following conditions:

- It must contain the name of each person(s) (eg spouse), and a clear instruction as to the allocation of the death benefit amount.
- Each death benefit nominee must be a legal personal representative or dependant of the member.
- The nomination form must be dated and signed by the member in the presence of two witnesses aged 18 or over, neither of whom is a nominee named in the notice.
- The nomination form must contain a declaration by the witness, stating that the member has signed and dated the nomination form in their presence.

A binding death benefit nomination may be amended or revoked at any time. In any case, the nomination will lapse three years from the day it was first signed, last confirmed or amended by the member. The confirmation need only be signed and dated by the member.

Tax issues

Tax concessions for complying funds

The trustee of a complying fund is liable to pay tax on the taxable income of the SMSF for the year. The taxable income of a complying SMSF is calculated by adding total assessable investment income, taxable contributions and assessable gains, then deducting allowable deductions. A complying SMSF is taxed at the concessional rate of 15% on its taxable income in accumulation phase. However, income earned in pension phase is tax exempt and there are special rules for capital gains.

Capital Gains Tax

Capital Gains Tax (CGT) provisions apply to complying SMSFs where the SMSF disposes of a CGT asset. Any capital gain arising on disposal will form part of the SMSF's assessable income and the subsequent taxable income will be subject to tax at 15% (in accumulation phase). There are, however, some concessions available for complying SMSFs:

- special valuation rules for assets that were acquired by the SMSF before 1 July 1988; and
- the CGT discount.

Where a complying SMSF acquired an asset on or before 30 June 1988, the asset is deemed to have been acquired by the SMSF on 30 June 1988. The cost base of the asset is calculated as the greater of the asset's market value as at 30 June 1988 or its actual cost base on that day.

Where a complying SMSF acquired a CGT asset on or after 11.45 am on 21 September 1999 and subsequently makes a capital gain on disposal of that asset, the fund may be entitled to receive a discount of one-third of the capital gain, provided the asset has been held for more than twelve months.

Where a complying SMSF acquired an asset prior to 11.45 am on 21 September 1999 and disposes of the asset after holding the asset for more than 12 months, the SMSF has the option of calculating the capital gain by using either the frozen indexation method or the CGT discount method. If the frozen indexation method is chosen, indexation is frozen at 30 September 1999.

The CGT discount method operates to reduce the rate of tax applicable to capital gains on assets held for more than 12 months to 10% (standard component rate of 15% x two-thirds capital gain).

Imputation credits

Where a SMSF has investments in Australian equities and managed funds carrying imputation credits, an opportunity exists to improve the tax efficiency of the SMSF. Excess imputation credits may be used to offset other tax payable in the SMSF, or otherwise refunded to the SMSF in cash.

Franked dividends are taxed in the same manner for a complying SMSF, as for an individual. The franked portion of the dividends are required to be "grossed up" and it is on the grossed up amount (dividends received plus imputation credits) that tax is assessed.


Small APRA funds (SAFs) – an alternative to SMSFs

A SAF may be used where the members want control over their superannuation investments but do not wish to undertake the trustee requirements of a SMSF. A SAF may also be useful if a member of the fund is a disqualified person or is at a legal disability.

The main difference between a SAF and a SMSF is that a SAF must have an authorised trustee, whereas the trustees of a SMSF are the members. A SAF is regulated by APRA whereas SMSFs are regulated by the ATO.

To become a SAF a fund must have:

- a maximum of four members; and
- a trustee that is an approved trustee.



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IMPORTANT INFORMATION

The information in this brochure is current at March 2012. It has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on this information, consider its appropriateness, having regard to your objectives, financial situation and needs. The taxation position described is a general statement and should only be used as a guide. It does not constitute tax advice and is based on current tax laws and their interpretation. Your individual situation may differ and you should seek independent professional tax advice on any taxation matters. This information may contain material provided by third parties and is given in good faith and has been derived from sources believed to be accurate at its issue date. It should not be considered a comprehensive statement on any matter nor relied upon as such. To the maximum extent permitted by law: (a) no guarantee, representation or warranty is given that any information in this publication is complete, accurate, up to date or fit for any purpose; and (b) no company in the Westpac group of companies is in any way liable to you (including for negligence) in respect of any reliance upon such information. This publication has been prepared by Securitor Financial Group Ltd ABN 48 009 189 495 AFSL 240687, ACL 240687.