

Self-Managed Super Funds

An essential guide to taking
control of your super



It's all about control

Superannuation is now a household term. It is a long-term, tax-advantaged savings vehicle specifically designed to provide for retirement.

It is a fact that superannuation will grow to be the largest investment for many Australians.

The majority of assets invested within the superannuation environment are controlled by professional managers in retail or industry super funds. Having an experienced investment manager to look after their superannuation suits many people. However, it means members have limited control over their investment strategy or selection of assets.

Consequently, more and more people are realising the advantages of making their own investment decisions and taking control of their retirement strategy.

An increasingly popular choice is the self-managed superannuation fund.

What is an SMSF?

Setting up a self-managed super fund, (SMSF), gives control and involvement back to the members.

Generally an SMSF has the following features:

- a personal or family super fund with no more than six members
- each individual trustee of the fund is a fund member
- each member of the fund is a trustee
- no member of the fund is an employee of another member of the fund, unless those members are related
- no trustee of the fund receives remuneration for his or her services as a trustee
- a written trust deed and investment strategy that meets all members' objectives.

The primary motivation for members in setting up an SMSF is generally the desire for investment control. The requirement that all members must be trustees of the fund means the control of the fund is shared between the members of the fund.

Members of an SMSF can tailor their own investment strategies and select specific investments such as:

- listed securities
- managed investments
- cash, securities and term deposits
- both direct and listed property

- business real property
- international equities
- collectables and exotic assets
- life insurance policies
- agribusiness
- instalment warrants.

Why an SMSF?

Advantages of SMSFs include:

- greater investment choices – direct and indirect investing offers greater control over your investment strategies
- access to investment gearing opportunities
- the ability to manage fees effectively which results in lower costs over the long term
- preferable tax arrangements as legislated by the Federal Government
- a secure income in retirement utilising your personal investment strategy
- efficient estate planning opportunities.

Important notice

Potential SMSF trustees need to be aware there is no access to statutory compensation arrangements in the event of theft or fraud. Additionally, there is a reduced access to dispute resolution bodies to resolve complaints. In contrast, APRA-regulated funds do have access to such arrangements.

Where have we come from?

There is no doubt SMSFs are gaining a more prominent place in the world of superannuation. The introduction of Super Choice in 2005 made it easier for employees to have their super guarantee contributions from their employers directed to SMSFs.

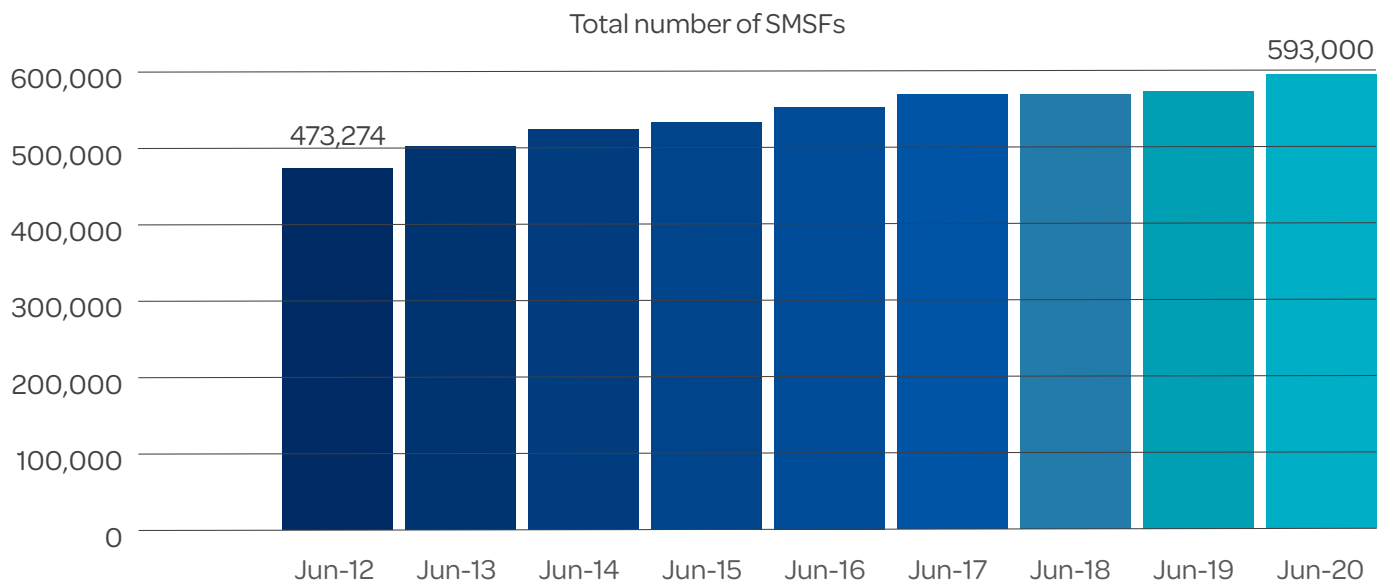
The statistics on the growth of SMSFs in Australia are staggering. According to the latest statistical report from the Australian Tax Office (ATO), as at June 2020, there were more than 593,000 SMSFs and it remains the fastest growing sector in the superannuation industry.

There is approximately \$733 billion invested within SMSFs, which represents approximately one-third of total funds in superannuation. More than 98% of superannuation funds in Australia today are self-managed family based investment accounts.

Snapshot of growth statistics

- The number of SMSFs has grown to approximately 593,000 as at 30 June 2020.
- The fastest growing sector in the superannuation industry
- Approximately \$733 billion invested as at June 2020.
- Typical member is aged between 45 and 64 years, however, evidence supports the assumption younger Australians are now considering SMSFs.
- More than 98% of superannuation funds in Australia today are self-managed family-based investment accounts.

Growth of self-managed super funds, to June 2020



Source: ATO, Morgans

Quite evidently, self-managed super funds are a major force in Australia's superannuation industry.

The times are changing



For many people, the complexity of the superannuation rules has been a deterrent to getting more involved in their super. New laws were introduced in 2017 that further changed the superannuation and retirement landscape.

What does this mean for SMSFs?

As a result of the superannuation changes more attention has focussed on the SMSF environment resulting in significant growth in this area. For example, baby boomers (1946 -1961) are taking advantage of the changes in the super environment, and SMSFs are becoming the vehicle of choice for many.

Unfortunately, as a result of the constant changes to superannuation law, more than half of active SMSFs may not have a compliant, up-to-date trust deed. Not having an updated trust deed means members could be missing out on:

- transition to retirement (TTR) pensions
- divorce and super splitting
- catch up concessional contributions
- seniors downsizing contributions
- non-lapsing binding death benefit nominations
- contributions splitting to spouse
- removal of work test for individuals under age 67 and not working
- limited recourse borrowing arrangements.

Total super balance

From 1 July 2017 a new concept, total superannuation balance, was introduced.

An individual's total superannuation balance (TSB) is the new measure for valuing an individual's total superannuation interests and will be used to determine the following:

- the ability to use the new carry forward provisions which take effect from 1 July 2018
- the ability to make additional non-concessional contributions to your super
- eligibility for the Government Co-contribution
- eligibility for the tax offset for spouse contributions.

The calculation for TSB is always done at 30 June each financial year. This then determines what strategies the individual can employ for the next financial year.

The total super balance measure is not to be confused with the transfer balance cap. An individual's total super balance relates to all superannuation interests whereas the transfer balance cap only relates to retirement interests. There is no specific 'cap' for TSB, rather it determines the availability of particular strategies that relate to that individual for the next financial year.

Ready, set, go!

Is an SMSF right for you?

There is no doubt control, involvement and tax effectiveness are very good reasons for establishing your own SMSF.

However, you should also consider other factors when deciding if an SMSF is the most appropriate vehicle for you. If you set up an SMSF, you're in charge; you make the investment decisions for the fund and you are responsible for complying with the law. Civil and criminal penalties may apply if you contravene the law.

Setting up an SMSF

Once the decision has been made to proceed with an SMSF the actual establishment does not have to be onerous. Professionals such as financial advisers, accountants and solicitors who specialise in this field are available to assist trustees with the necessary processes.

Key procedures include:

- obtain a trust deed
- appoint the trustees
- trustees to each sign a trustee declaration
- elect to be regulated by the ATO
- identify the members
- apply for a tax file number for the SMSF, an ABN (if applicable) and/or GST registration (if applicable)
- prepare an investment strategy
- open a bank account
- arrange appropriate wealth protection cover for all members
- transfer existing super accounts.

Requirements of a trustee

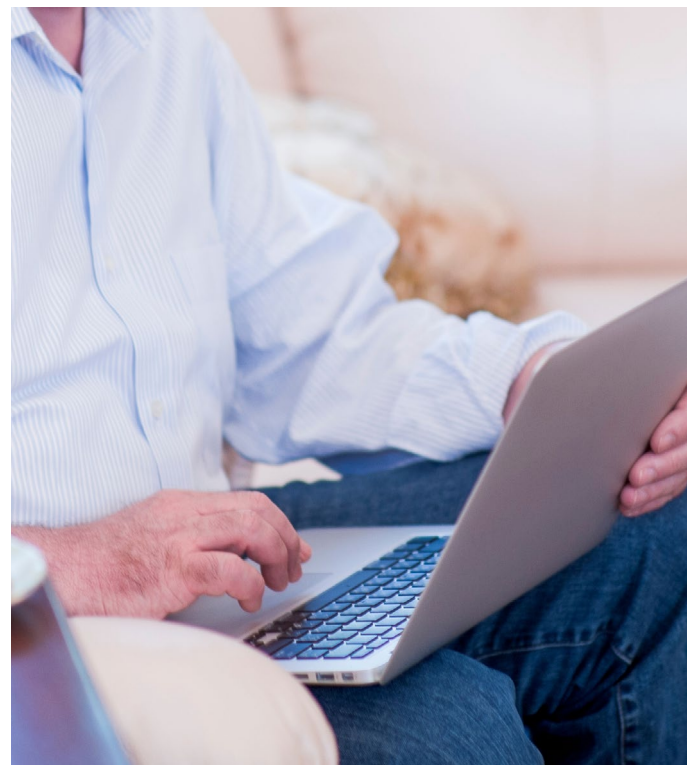
Potential trustees of superannuation funds must understand their role is not to be taken lightly. The Superannuation Industry (Supervision) Act (SIS Act) contains covenants that impose minimum requirements on trustees and reflect the duties imposed on a trustee under trust law in general. They are deemed to be included in the trust deed of every regulated fund.

A trustee of an SMSF must act in accordance with:

- the clauses of the superannuation fund trust deed (governing rules)
- the provisions of the SIS Act and other general rules, for example those imposed under tax law and trust law.

The SIS Act binds trustees to:

- act honestly in all matters
- exercise the same degree of care, skill and diligence as an ordinary prudent person
- act in the best financial interest of the fund members
- keep the assets of the fund separate from other assets (e.g. the trustees 'personal assets')
- retain control over the fund
- develop and implement an investment strategy
- allow members access to certain information.



Consider this

When deciding if an SMSF is appropriate, consider these questions:

- Is the fund strictly for retirement benefits?
- Do you have the time to manage your own fund?
- Will the benefit be worth the cost?
- How will switching to your own SMSF affect your current superannuation benefits?
- Do you understand the risks in managing your own fund?

Strategically speaking

To the average person, the professional investors make investing look easy. However, even the professionals have a guideline for what they can and can't invest in. It's called an investment strategy and, after the trust deed, it is the most important document for an SMSF.

The investment strategy should set out the investment objectives of the fund and detail the investment methods the fund will adopt to achieve these objectives. It's not just a matter of 'set and forget'. As the needs and objectives of the members change so too will the investment strategy.

Investment rules and restrictions

The SIS Act quotes a number of restrictions regarding investments within SMSFs which aim to protect fund members by ensuring fund assets are not overly exposed to undue risk (for example the possible risk of an associated business failing). They also aim to ensure that trustees make investment decisions with the primary purpose of generating retirement benefits for members rather than providing current day support, this is known as the sole purpose test.

The rules and restrictions are complex in nature and it is recommended trustees seek professional assistance from their fund administrator, accountant or financial adviser.

Some of the major restrictions include:

- the fund cannot lend money or provide financial assistance to a member or a member's relatives
- the fund cannot invest more than 5% of its total super account balance in a related trust or company.

Example of what you can't do

Bill owns a residential investment property in his own name. He would like to transfer this property to his SMSF as part of his investment strategy. Unfortunately, if Bill did this he would be breaching the SIS Act rule which prohibits the acquisition of residential property by an SMSF from a related party (that is, Bill's fund can't purchase residential property directly from Bill).

Example of what you can do

Bill would need to sell his investment property to an unrelated third party. He could then contribute some or all of the proceeds of this sale into his SMSF as a cash contribution. If Bill was eligible to make a personal deductible contribution, he could claim a deduction up to allowable limits which will help offset capital gains tax that may have been realised as a result of the property sale.

Consider this

Investment strategies should take into consideration:

- investing in such a way so as to maximise member returns having regard to the risk associated with holding the investment
- appropriate diversification and the benefits of investing across a number of asset classes (e.g. shares, property, fixed interest, etc.) in a long term investment strategy
- the ability of the fund to pay benefits as members reach retirement and other costs incurred by the super fund.



It's all about tax

One of the reasons why superannuation as a retirement savings vehicle is so popular is due to the tax concessions afforded to complying resident superannuation funds.

The maximum tax rate within a complying superannuation fund is 15%. This tax rate applies to deductible contributions coming into the fund, income from investments within the fund and capital gains when assets are realised in the accumulation phase of the fund. If an asset has been held for more than 12 months the maximum tax rate on any capital gains will be discounted to 10%.

There are also various tax deductions available within an SMSF that are not usually available to an individual. For example, premiums on life insurance policies held within an SMSF can generally be tax deductible. Accounting, administration and other costs incurred as a result of the ongoing investment review process of an SMSF may also be deductible for the fund.

The most attractive tax concession available is, of course, when a member is drawing an income stream (also called a pension) from the fund. When an SMSF starts to pay a pension, the trustee can claim a tax exemption on the earnings of the assets used to fund the pension. This means the tax rate on investment earnings and capital gains for that pension account is zero.

The initial account balance of a pension must be in accordance with the pension transfer balance cap*.

This nil tax environment provides a significant benefit for retirees, particularly when the fund holds Australian equities that pay imputation credits (franking credits) on distributed dividends.

The power of fully franked shares

One of the most popular assets held in an SMSF is listed Australian shares which pay dividends with attached imputation credits; better known as fully franked shares.

These imputation credits can provide significant tax benefits within SMSFs because they can be used as an offset against the super fund's tax liability. The surplus credits are refunded to the account and have the effect of 'topping up' the members' superannuation account balance. Over the long term this can add substantial value to the fund.

*The pension transfer balance cap applies to retirement income streams including account-based pensions, annuities, defined benefit pensions and market-linked pensions.

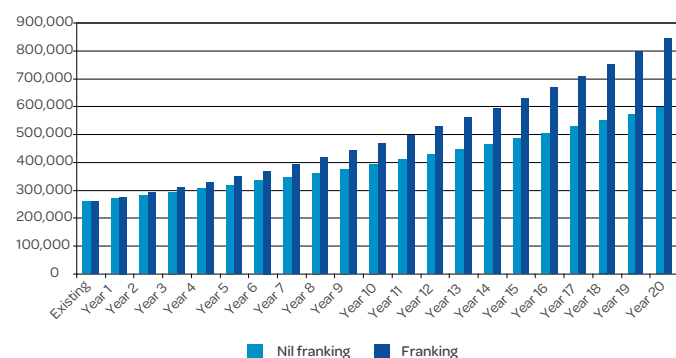
The income and tax schedule demonstrates the tax effectiveness of holding fully franked shares within a superannuation fund. Instead of paying \$1,950 in tax the SMSF will receive a refund of \$2,785 due to the surplus franking credits.

	Accumulation nil franking	Accumulation fully franked
Investment income*	\$13,000	\$13,000
Plus franking credits	Nil	\$5,571
Taxable income	\$13,000	\$18,571
Tax payable	\$1,950	\$2,786
Less refundable credits	Nil	\$5,571
Tax paid/ (refund)	\$1,950	(\$2,785)

When you compare the effect of excess franking credits over a 20-year period with compounding returns, you can see the SMSF account with fully franked shares has earned an additional \$200,000 approx compared with the SMSF account without franked shares.

You should speak with a registered tax agent about the tax implications of SMSFs.

The Power of Fully Franked Shares



Source: Morgans

Don't risk it

Protect your wealth

Creating wealth is the primary objective of investors. Protecting this wealth so it will provide a desired lifestyle in the future is often overlooked.

The main types of wealth protection include: life insurance (also known as term or death insurance), total and permanent disability (TPD) insurance, trauma and critical illness insurance, income protection insurance and business insurance.

Why is it important?

Research has consistently shown Australians don't take out adequate levels of insurance to protect themselves and their family. Research commissioned by IFSA (Investments and Financial Services Association) in 2005 showed parents with dependents were critically underinsured by \$1.37 trillion. To put this another way, only 4% of the total population with dependents were critically underinsured by \$1.37 trillion; only 4% of the total population with dependent children have adequate levels of life insurance cover.

Financing insurance premiums through superannuation

Insurance within superannuation is tax effective because the SMSF may be able to claim a tax deduction on the premium costs. In addition, premiums are funded through the superannuation account balance, rather than the member's own after-tax dollars. This potentially enables the fund to offset the 15% superannuation contributions tax with the deductible premiums. This tax-effective approach can significantly reduce the cost of the insurance cover.

Effects of the simpler super changes

A major change announced by the Federal Government in their 'Simpler Super' paper was the complete abolishment of reasonable benefits limits. The removal of RBLs is significant for people considering insurance within their SMSF as it removes the issue of potential excess benefits tax upon payment of death benefits.

Insurance within SMSFs has now become an even more attractive proposition.

Note: there are other tax consequences where insurance payments are paid to non-dependants as part of a superannuation death benefit payment. Speak to your Morgans adviser or accountant about the tax treatment of death benefits.

Consider this

If you were unable to provide for your family:

- Would your family cope financially?
- Would there be any debts your family would be burdened with?
- Could your family afford to keep living in the family home?

Many people do not fully appreciate the expenses involved with accidents or illness. Apart from the obvious medical expenses, which may include long stays in hospital and specialists' fees, you may incur costs for modifications to your house or car and ongoing remedial costs including physiotherapy and in-home care.

In addition, accidents and illness often lead to extended periods away from income-generating work. The effect of this on a small business could be devastating to the future financial viability of the business.

Most of us would like to think that if we were unable to work, for whatever reason, we wouldn't be a financial burden for our family or loved ones. However, without a wealth protection plan in place, financial pressures would only be exacerbated if a spouse or loved one needed to give up work to become a full time carer, or if an external carer was required.

For this reason, the government has now made it a requirement for trustees to consider insurance for all members as part of the fund's investment strategy.

Until death do us part

Special estate planning issues arise with SMSFs. Considering a super fund's obligation is to comply with the SIS Act, any action taken upon the death of a member must fit into that regulatory framework.

Although no one likes to think about dying, planning your estate now effectively means the distribution of your assets is managed according to your wishes. In this regard, SMSFs can be a useful vehicle for estate and succession planning as trustees and members can ensure they have the final say in the distribution of death benefits via the trust deed.

The trust deed of a fund outlines how, and to whom, death benefits are paid. For this reason, if estate planning has not been considered when drafting up the trust deed, beneficiaries may find they are unable to receive any benefits from the member's superannuation.

Payment of death benefits

When a member dies, the benefits may be paid to his or her dependants, or paid to the estate. It is important a trust deed adequately provides for payment of benefits on death. It should also allow for any new legislation that may be introduced in the future.

Dependants under SIS Act legislation

The definition of a dependant for superannuation purposes differs slightly from the definition used by the Australian Taxation Office. For superannuation purposes, dependants include spouses (including same sex and/or de facto), children, financial dependants and/or interdependants. However, for tax purposes an adult child (i.e. a child over 18-years) of the member will be considered a non-dependant.

Binding/non-binding death benefit nominations

It is important to consider the role of both binding death benefit nominations and discretionary (non-binding) nominations in the estate plans of SMSF members. Generally binding nominations can provide greater certainty over the destination and proportion of death payments (and reduce the risk of legal challenge upon death) but tend to be more rigid compared to discretionary nominations.

SMSF trustees can choose whether or not to accept binding death nominations or discretionary nominations in favour of the SIS Act dependants or the deceased's estate, subject to the governing rules of the fund.



Consider this

A trust deed should consider:

- in what form the benefits are to be paid (i.e. lump sum, pension or mix of both)
- to whom the benefits can be paid (including the estate if necessary)
- any restrictions on access to lump sum if paid as a pension
- ability for the trustees to transfer any death benefits to another fund under certain terms and conditions.

Call in the specialists

Often, getting a complete service will require contact with a financial investment adviser (for your investment strategy), a solicitor (to establish a trust deed) and an accountant or administration service (to administer your SMSF).

One way to make this process easier is to find a financial provider who can offer all of the above services.

The SMSF approach of Morgans

Morgans is able to offer a complete service for SMSFs, including an holistic portfolio management service, a trust deed service and/or administration service, investment advisers who specialise in superannuation and a technical research team who provide updates and support on the latest in superannuation developments.

Successful investment management requires constant supervision, accurate up-to-date information and the ability to change your portfolio and implement new investment strategies quickly. This is particularly true with SMSFs.

Morgans Wealth+ managed portfolio service offers investors an individually managed account (IMA) service, which makes investing easier, while managing a tax efficient outcome. The service records all investments, collects and manages dividends and distributions and provides comprehensive reports (including CGT).

The superannuation research team ensures advisers are not only up to date on developments in the sector, but also that recommendations made regarding investments and strategies are relevant and compliant.

The Morgans SMSF trust deed service uses a high quality SMSF trust deed. The trust deed is drafted by specialists with the client in mind, while ensuring it's kept up-to-date with changes in superannuation legislation. The service can also review older trust deeds to ensure they take into consideration the plethora of changes over the last ten years.

Morgans can also provide an holistic superannuation service, Wealth+ SMSF Solution, which provides fund set up, portfolio management, reporting and fund administration. The Wealth+ SMSF Solution is provided by a wholly owned subsidiary of Morgans, Your Entire Superannuation Solution Pty Ltd (YESS).

Experience

Morgans is a leading provider of investment and superannuation advice.

A number of Morgans advisers are accredited SMSF specialist advisers, having completed additional SMSF education courses and programs. Some of these advisers are members of the Self-Managed Superannuation Professionals Association of Australia (SPAA), which specialises in education and training for professionals in the SMSF sector.

Working with other professionals

While Morgans advisers can provide a complete service to establish, implement and manage your SMSF, consultation with other professionals should still take place to ensure you get the most out of your SMSF.

Where to now?

If the information in this booklet has raised interest or questions, there is a wealth of experience and knowledge available to you. Speak to your Morgans adviser without delay.

If you would like to read further, the following resources are useful:

- Australian Taxation Office Publication – 'Running a Self-Managed Super Fund'
- Australian Taxation Office Fact Sheet – 'Self-Managed Super Funds – Key Messages for Trustees'
- Morgans Superannuation Research Services 'SMSFs Frequently Asked Questions'
- Morgans Superannuation Research Services 'Self-Managed Super Funds vs Retail Super Funds'
- ato.gov.au/super
- asic.gov.au
- moneysmart.gov.au

Glossary

ASIC (Australian Securities and Investment Commission): is responsible for consumer protection in financial products covering superannuation, life insurance, general insurance and deposit taking (but not credit).

ATO (Australian Taxation Office): the Commonwealth body which administers Australia's taxation system. Also known as the Tax Office. The superannuation guarantee legislation, superannuation contributions tax ('surcharge'), and SIS Act provisions relating to self-managed superannuation funds are administered by the ATO.

Binding death benefit nominations: a member may complete a form which advises trustees of his/her wishes regarding payment of death benefits (what proportion to pay to whom). Since 31 May 1999, trustees may elect to make provision for 'binding nominations of beneficiaries'. Rules apply in relation to who can receive a superannuation benefit and to ensure that the nomination is current. The nomination will not be binding on the fund trustee(s) unless it complies with strict provisions set out in the SIS Act.

Franking credits (also known as Dividend Imputation): the tax arrangement operating in Australia which eliminates the double taxation of Australian resident company profits, firstly as taxable income of the company and later as taxable dividend income in the hands of the shareholders. It is called an imputation system because, in effect, the payment of company tax is imputed, or notionally allocated, to the shareholder by means of imputation credits attaching to franked dividends.

IMA (Individually Managed Account): an IMA is an account in which investments are held in an individual's name but the holdings are managed and administered by a professional adviser. IMAs differ to managed funds in that the underlying assets in a managed fund are owned by the fund while the investor owns units in the fund.

SIS Act (Superannuation Industry (Supervision) Act): prescribes prudential standards for superannuation entities, commencing on 1 July 1994. Essentially, the SIS Act:

1. provides an enhanced supervisory role for the Australian Prudential Regulation Authority (APRA) (e.g. it enables APRA to remove trustees, investigate superannuation entity breaches, take action on behalf of members)
2. sets out the duties and responsibilities of trustees, with legislative sanctions for non-compliance
3. establishes a regulatory regime for superannuation entities which receive tax concessions.

Spouse splitting: members of accumulation funds are allowed to split contributions, including superannuation guarantee contributions, to their spouse. This provides the receiving spouse with an opportunity to develop his or her own superannuation benefit.

Trust deed: a document which sets out the rules for the establishment and operation of a fund. A superannuation trust deed includes provisions covering such issues as: who can be appointed and the processes involved in appointing trustees, who will be admitted as members of the fund, the process for receiving and investing contributions, discretionary powers of trustees and the payment of benefits to members.

Source: Association of Super Funds Australia (ASFA)

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