

Version 1.2

Reference Guide Self Managed Superannuation Funds



What this document is about

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Section 1 – Self Managed Superannuation Funds (SMSF)

1:1 Self Managed Superannuation Fund (SMSF)

Self-Managed Superannuation Fund (SMSF), also called Do It Yourself (DIY) Super Fund, is a superannuation fund that is regulated by the Australian Taxation Office (ATO) and all members of the fund (maximum of 4) are the Trustees of the fund. A self managed superannuation fund (SMSF) is a fund that meets the definition of an SMSF in Section 17A of the Superannuation Industry (Supervision) Act.

This generally means that a fund is an SMSF if:

- Has less than 5 members;
- Each individual Trustee of the fund is a fund member and 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;
- The Trustee can be a corporate entity;
- Trustees receive no remuneration for their services as Trustees.
- The members fully control the investment decisions of the fund.
- There must be fewer than five members and each member must be a Trustee.

The principle that all members of the fund are also the Trustees, ensures that each Trustee takes part in the decision making process of the fund. Trustees also ensure that the fund complies with the Superannuation Industry (Supervision) Act 1993 (SIS), the rules governing the operation of Self Managed Super Funds, as well as with other legislative and administrative requirements. Breach of any legislative requirements could result in the fund losing its complying status and Trustees facing civil and criminal penalties.

The main difference between an SMSF and any other type of superannuation fund, such as government, industry, retail, or corporate fund, is the fact that SMSF Trustees also being the members of the fund cannot pay themselves any fee for performing Trustees' duties.

An SMSF can provide you with greater control over your superannuation investment strategy and allow you to continue developing a specific investment strategy tailored to suit your own objectives, asset allocation and risk profile that can be amended to meet your changing needs. Current government regulation allows SMSF Trustees to invest in a variety of assets, which include shares, exchange traded options and property provided the Trust Deed make provisions for these investments.

An SMSF can also offer you greater control over the management of the tax applicable to the fund by way of imputation credits and control over when to realise capital gains within the fund. Excess imputation credits within a superannuation fund can be used to offset tax payable on other sources of income and/or is refundable within the fund.

SMSFs can be powerful tools when utilized to their full potential; however significant penalties apply to trustees for non compliant funds, which can include hefty fines and even jail. It is important that all parties are comfortable with the responsibilities of running a fund and that you understand the obligations you are required to fulfill.

1:1:1 The sole purpose test

Underpinning the SMSF regulatory regime is the sole purpose test. The sole purpose test sets the primary and ancillary purposes for which a superannuation fund must be operated, namely to provide benefits to members after their retirement, on reaching retirement age, or on their death. The test is in section 62 of the Superannuation Industry (Supervision) Act 1993 (SIS).

The object of the sole purpose test is to ensure that regulated superannuation funds are maintained for the purpose of providing benefits to members upon their retirement, or their dependants in the case of the member's death before retirement. The Trustee of a regulated superannuation fund must comply with the sole purpose test to be eligible for the taxation concessions available to a complying superannuation fund.

A complying superannuation fund is basically a regulated superannuation fund that meets the operational standards of the Superannuation Industry (Supervision) Act 1993 (SIS). In other words, to be a complying fund the fund has to first be a regulated fund. A complying superannuation fund's income will be taxed at the concessional rate of 15%, while a non-complying fund's income will be taxed at 47%.

The sole purpose test is divided into core and ancillary purposes. A regulated fund must be maintained for at least one core purpose OR at least one core purpose and one or more ancillary purposes. It is unacceptable for a fund to be maintained for one or more ancillary purposes only.

1:1:2 Relevant factors for consideration in regards to the sole purpose test.

To determine the purpose for which a self-managed super fund is being maintained, the tax office will survey the events and circumstances relating to the maintenance of the fund.

Satisfying the test

Factors that may lead the Commissioner to a conclusion that a self-managed super fund *is being maintained in accordance with the sole purpose test* are:

- The benefit is an inherent or unavoidable part of other activities that are consistent with the provision of benefits under the law.
- The benefit is remote or isolated, or is insignificant (whether it is provided once only or considered cumulatively with other like benefits) when assessed in light of other activities undertaken by the Trustee that are consistent with the law.
- The benefit is provided by the self-managed super fund on normal commercial terms consistently with the financial interests of the fund and at no cost or financial detriment to it.
- All of the activities of the Trustee are in accordance with the covenants set out in the law (for example in the best interest of the beneficiaries and exercised with the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally obliged to provide).
- All of the self-managed super fund's investments and activities are undertaken as part of, or are consistent with, a properly considered and formulated investment strategy.

Not satisfying the test

Factors that may lead the Commissioner to a conclusion that an SMSF is *not being maintained in accordance with the sole purpose test* are:

- The Trustee negotiated for, or sought out, the benefit (whether or not the Trustee does so in the course of undertaking other legitimate activities).
- The benefit has influenced the decision-making of the Trustee to favour one course of action over another.
- The benefit is provided by the DIY fund to a member or another party at a cost or financial detriment to the fund.
- There is a pattern of events that, when viewed in their entirety, amount to a material benefit being provided that is not specified under the law.

Breaching the test may:

- cause an SMSF to lose its complying fund status; and
- involve the Trustee being fined.

One of the Trustee's key responsibilities is to invest the money paid into the fund. However, Trustees must respect the restrictions that apply to these investments, especially when making an investment that may constitute the carrying on of a business.

1:2 Trust Deed

The Deed is the foundation of the SMSF. All activities of the fund must first be checked against the Deed wording to see if they are allowable then, if allowable under the SMSF Deed, the SIS Act and the Tax Act to confirm that they do not breach the legislation. Lastly it is important that the SMSF documentation is also in order and is regarded as part of the Governing Rules as set down by the Deed.

It is advisable to consider updating existing SMSF Deeds every now and then and necessary when there has been a major legislative change or a member wishes to carry out some action or achieve some result that they are unable to with their current SMSF Deed.

An effective Trust Deed may:

- Ensure you are able to establish and maintain separate accumulation and pension accounts going forward;
- Amend the definition of a SMSF member for pension purposes to include your legal personal representative to avoid potential negative tax ramifications on death while in the pension phase.
- Allow the SMSF the power to create reserves for maximum flexibility in certain circumstances including for example, distributing insurance proceeds as appropriate to other SMSF members account or reserves or alternatively to recoup contributions tax paid by a deceased member under the anti-detriment provisions.
- Allow the SMSF member can remain in the accumulation stage indefinitely;
- Extend the SMSF contribution eligibility to allow anyone who can legally contribute to do so including a spouse, child or the government (co-contribution).
- Allow a member to make a binding death benefit nomination which is non lapsing and does not require upgrading every 3 years;
- Allow fund to borrow under the instalment warrant provisions
- Stipulate more specific estate planning provisions through a Superannuation Will.
- Provide adequate or detailed provisions for winding up the fund.

Updating your Trust Deed will provide you with greater flexibility and control over your superannuation investment strategy, which is consistent with the level of control you currently have over your personal investment portfolios.

1:3 SMSF Trustees

It is the duty of all SMSF Trustees to:

- Act honestly and in the best interests of members and beneficiaries and abide by the rules of the fund at all times.
- Keep money and assets in the fund separate from Trustee personal assets or another person's personal assets.
- Determine and document an investment strategy.
- Ensure that the fund complies with all relevant legislation (with the assistance of your accountant and advisors) and does not breach any law.
- Ensure that the fund files compliance, taxation and accounting returns on time and members records are kept accurately.
- Meet all regulatory obligations.
- Ensure that only appropriate assets are acquired in the right manner to carry out the fund's investment strategy.

Trustees are able to engage an accountant and other professionals to assist them in carrying out their duties, but all of the responsibility lies with the trustee and ignorance will not satisfy as an excuse for any negligence.

Failure to comply with the above requirements could result in substantial penalties and result in the fund losing its tax exemption or right to operate as a superannuation fund.

Trustees must:

- develop an investment strategy and comply with it; and
- make and maintain investments on a commercial arm's length basis. This can be determined by asking whether a prudent person acting with due regard to his or her own commercial interests would have made such an investment;

Trustees must NOT:

- acquire assets from related parties (although there are certain exceptions)
- lend to, or provide financial assistance to, other members of the SMSF or to their relatives.

If you are uncertain about whether an SMSF is complying with these rules, you should seek legal advice as early as possible.

1:3:1 Corporate Trustees

When you have a Corporate Trustee, all members must be the Directors of the Company. All Directors must be members of the Fund. The Corporate Trustee carries out its role as a Trustee of your superannuation fund just the same as you as individuals do.

The major disadvantage of a corporate trustee is the up-front cost of establishing the company. However there are long term benefits of having a corporate trustee which will outweigh the costs.

One of the key aspects of a corporate trustee is litigation exposure. Individuals acting as trustee of the Fund are jointly and severally liable for any actions taken against the Fund, as they hold the assets of the Fund in their individual names. Should litigation against the Fund exceed the assets held in the name of the trustees as trustees for the Fund, the personal assets of the individuals personally may become at risk. Companies on the other hand have limited liability. This ensures litigation against the Fund is limited to the assets held in the name of the company and do not stretch to the directors of the company.

Benefits of a Corporate Trustee

- Borrowing in Super Funds

If you want to take advantage of Limited Recourse Borrowing Arrangements to borrow to fund SMSF assets, many lenders only agree to lend you money if you have a corporate trustee. Furthermore, if a SMSF wishes to borrow under an instalment warrant arrangement the lender will insist that the SMSF has a corporate trustee. For this reason, we recommend a corporate trustee arrangement.

- Minimising administration costs due to trustee changes

The very nature of a family SMSF means that members and trustees may come and go from the fund. Parents may introduce adult children as members until such a time as the child has enough superannuation or their own family to commence their own SMSF. Members of an SMSF may pass away requiring them to exit the SMSF as members and trustees. An executor may also need to be appointed as a trustee for a short period of time from the death of the fund member until the death benefits exit the fund.

Changes in trustees and members can be a costly exercise as when the trustee's change it is necessary to prepare a deed of appointment and retirement to officially retire the outgoing and appoint the incoming trustees. The trustees must also notify all relevant share registries and banks of a change in trustee to reflect the new ownership in assets on behalf of the fund which can be a time consuming process. In contrast, where a new member joins a fund with a corporate trustee it simply requires the appointment of that member as a Director of the Trustee Company. Where a member leaves the fund it is simply necessary for them to resign as director.

- Reduced trustee litigation exposure

Where the trustee of a fund is subject to litigation – such as a personal liability action in relation to one of the fund's properties, then the trustees may potentially be personally liable for the costs if they are unable to be recovered from the assets of the fund. Whilst this type of action is uncommon, having a corporate trustee will provide additional protection by limiting liability to the assets of the company not those of the underlying directors.

- Single Member Funds

Single member funds with a corporate trustee allow the sole member to be the only director of the company and have full control over the running of the fund. If the fund had individual trustees it would be necessary for another individual to act as the second trustee and assist in the running of the fund.

- Greater flexibility to make lump sum payments

The definition of a regulated fund in section 19 of the SIS Act states that a regulated fund is:

A fund that has a constitutional corporation acting as trustee pursuant to a role in the trust deed of the fund: or

A fund that has individual persons acting as trustees where rules of the fund require that the sole or primary purpose of the fund must be to pay old age pensions.

This small glitch in the superannuation legislation is a controversial issue. However should the tax office interpret this section based on its literal wording it may indicate that if a member would like to take their benefits as a lump sum the trustee of the fund needs to be a company. Having a company may allow greater future flexibility for the members to take a lump sum without the need to start a pension first and then commute that pension to a lump sum.

1:3:2 individual Trustees

Setting up a SMSF with individual trustees is quick and simple.

Appointing individual trustees is generally inexpensive compared to appointing corporate trustees as there are no additional establishment costs, less ongoing annual fees and less paperwork associated with setting up the SMSF.

Individual trustees require all members to be trustees and inversely, every trustee to be a member. If the SMSF is a single member fund, then the sole member cannot be the only trustee.

In this situation, a second individual (who is not an employee of the member, unless related) must be appointed as a trustee, but they do not have to be a member of the fund. Anyone over the age of 18 can be an individual trustee of a SMSF, unless they are a 'disqualified person' under section 120 of the SIS Act (SISA). A disqualified person is someone who at any time was convicted of an offence involving dishonesty, has been subject to a civil penalty order under SISA or are an insolvent under administration (eg an undischarged bankrupt). Minors are considered to be under a legal disability and are unable to be a super fund trustee, however, a parent or guardian can be a trustee in their place.

1:4 Trustee Investment Strategy

A key compliance requirement for trustees of SMSF's is that they must formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity, including, but not limited to the following:

- The risk involved in making, holding and realising, and the likely return from, the entity's investments having regard to its objectives and its cash flow requirements.
- The composition of the entity's investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification.
- The liquidity of the entity's investments having regard to its expected cash flow requirements.
- The ability of the entity to discharge its liabilities.

While a financial planner can assist you with determining an appropriate strategy, overall responsibility remains with the trustee.

1:5 SMSF Borrowing Conditions

Firstly, a SMSF may borrow where it satisfies all the following conditions:

1. The borrowed money can only be used to acquire a single asset, or a collection of identical assets that have the same market value. They are all treated as a single asset and are called the 'acquirable asset'. These can only be assets that the fund is not otherwise prohibited from acquiring.
2. The borrowed money can be applied to expenses incurred in connection with the borrowing or acquisition (e.g. loan establishment costs, stamp duty etc), or expenses incurred in maintaining or repairing the acquirable asset.
3. The borrowed money cannot be applied to improving an acquirable asset.
4. The acquirable asset is held on trust (the holding trust). The SMSF trustee receives a beneficial interest in the asset and has the right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest.
5. The lender or any other person under the arrangement only has recourse against the SMSF trustee limited to rights relating to the acquirable asset. This limitation applies to rights directly or indirectly relating to a default on the borrowing and related charges or directly or indirectly relating to the SMSF trustee's rights in respect of the acquirable asset (for example, rights to income from the asset).

6. The acquirable asset cannot be subject to a charge other than as provided in relation to the borrowing by the SMSF trustee.
7. As long as it is not otherwise prohibited from acquiring it, the acquirable asset can be replaced by another acquirable asset, but only in very limited circumstances as listed under super law.

A number of commercial SMSF borrowing products are available in the market to fulfill the above requirements and enable SMSF trustees to borrow to invest.

The 14 steps in a typical SMSF borrowing

Note, these steps are usually performed by the fund provider / administrator and your legal and professional representatives and have been provided as a guide to assist you in understanding the process.

1. Check the trust deed to ensure trustee has power to borrow, grant security & allow assets to be held by custodians/nominees for the trustee (if not, amend the trust deed).
2. Check the investment strategy to ensure it allows for the acquisition of the investment asset and permits borrowing for that purpose (if not, amend the investment strategy).
3. Source the asset for purchase, negotiate the price and reach agreement with the vendor.
4. Finalise borrowing arrangements with the lender including in-principle loan approval.
5. Determine who is to be the custodian – if a new company, purchase the new company.
6. Custodian resolves in writing to act as custodian for the super fund trustee in the purchase of the asset.
7. Super fund trustee resolves in writing to purchase the asset and to appoint the custodian to act for the super fund trustee as bare trustee of the bare trust.
8. Signing of the purchase contract by the custodian (note: not the super fund trustee).
9. Super fund trustee provides all the deposit money for the purchase (should come directly from the super fund's account).
10. Custodian and super fund trustee sign the bare trust deed.
11. Super fund trustee signs all loan documents with the lender (note: super fund trustee is the borrower).
12. Purchase of the asset is completed using only money coming from the super fund's account or from the loan by the lender.
13. The bare trust deed is submitted to your local Office of State Revenue for payment of stamp duty.
14. When the loan is eventually repaid the asset can be transferred from the custodian to the super fund trustee for nominal stamp duty provided the bare trust deed has been stamped already.

It is important to note that without sufficient cash resources or income flowing into the fund, ongoing funding of debt repayments cannot be sustained.

1:6 Compliance and Administration through Tranzact

Health Super Financial Planning is able to arrange the ongoing compliance and administrative requirements of your fund through a specialist superannuation administrator we have engaged (Tranzact Total Super) to take care of this important requirement.

Outsourcing the day-to-day administration of the fund can assist in ensuring that your fund remains compliant with the relevant legislation.

As a part of the service Tranzact provide they will undertake the following administrative functions:

- maintenance and storage of Fund records including Trustee's Minutes, correspondence and Investment Certificates,
- annual Member & Trustee Reporting including Member Statements, Minutes & supporting documentation;
- daily on forwarding of evidence of portfolio activities if applicable;
- maintenance of Member accounts' changing component position & benefit payment documentation;
- maintenance of Capital Gains Tax and Deferred Tax records;
- preparation of drawdown and rollover documentation;
- daily updates to the World Wide Web of Fund details including valuations, transactions and asset allocations
- maintenance of established pensions;
- annual Fund Financial Statements preparation & lodgement;
- preparation & lodgement of GST & Tax returns for the Fund including BAS;
- facilitation of external Audit;
- facilitation of Actuarial Certificate and Solvency Certificate if required; and
- production of Group Certificates.

Please note that upfront and on-going fees apply.

1:7 The 'In-House' Asset Test

All superannuation funds are subject to limits on in-house assets. Generally, the limit is 5% of the market value of the fund's assets.

From 30 June 2009, an "in-house asset" is any of:

- a loan to, or an investment in, a related party of the fund, including: members, standard employer-sponsors, and "Part 8 associates" of members and standard employer-sponsors. Part 8 associates are widely defined, to include related companies, partnerships and family members, and, for an SMSF, other members of the fund.
- an investment in a related Trust - that is, a Trust controlled by a member, or by a standard employer-sponsor of the fund. But the following Trusts are not included: Trusts arising under instalment warrant arrangements; widely held unit Trusts; unit Trusts which meet the requirements of regulation 13.22C of SIS (where the Trust has no leases in place with related parties, no borrowings etc); and pooled superannuation Trusts if the investment is made at arm's length. You can ignore these excluded Trusts when considering the impact of an SMSF's investments in related Trusts.
- an asset leased by the fund to, or from, related parties. However, the definition does not include a lease of business real property.

Notes