Superannuation

Overview of a SMSF

Aon Hewitt Financial Education Series

If you want greater control of your super, a Self-Managed Super Fund (SMSF) may be the answer. SMSFs allow you to invest in a broad range of assets, which you may not be able to do within your current super fund, such as direct shares or property.

However, along with the increased control comes an increased level of responsibilities. If you are a member of a SMSF, then you must also be a trustee. A SMSF is not for everyone and you should carefully consider the advantages and disadvantages and speak to a professional adviser before you make a decision to establish a SMSF.

Member restrictions

A SMSF must have between one and four members. Each member must also act as the trustee of the fund. If the fund has a company as a trustee then each member must be a director of the company. No member can be an employee of another member unless they are related.

As you are acting as a trustee of the SMSF, you have increased responsibilities such as, but not limited to, ensuring the fund complies with all legal and regulatory requirements, make, implement and document all investment decisions, and monitor the performance of the fund.

What are the advantages of a SMSF?

Flexibility

SMSFs are a highly personalised and flexible super savings vehicle which can receive contributions in addition to rollovers, and may pay retirement benefits by way of a lump sum or pension.

SMSFs provide their members with greater flexibility than other super funds as the trust deed can also be designed to facilitate a number of options which can potentially cover the retirement and estate planning needs of a whole family, not just one member. They are also able to provide a broad range of taxation and estate planning strategies.

Investment choice

The primary motivation for members in setting up a SMSF is generally the desire for investment control. The trustees determine the investment strategy and select specific investments for the fund. Given the requirement that all members must also be trustees, this provides an investor with a high degree of control over the investment portfolio, including member-directed investments.

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You can choose the investments that the fund invests into, and this can include shares, property, fixed interest and cash. You can choose to invest using a managed fund, or directly. For example, the SMSF could purchase an investment property or a direct share portfolio. A SMSF is able to invest in business real property, which is property used for business purposes. This is advantageous if you run your own business. For example, a mechanic could have their SMSF own the garage where they work. It is also possible for a SMSF to invest in unusual assets, such as artworks or paintings, vintage cars, livestock or wine (however restrictions apply).

Pooling resources

A SMSF is able to have up to four members. This means that you are able to combine your super balance with another person which may result in decreased costs, and may even allow you to invest in a broader range of assets, such as direct property. The majority of SMSFs are two member funds containing a husband and wife.

Tax planning

You are able to select strategies that may legitimately reduce the tax payable on your super investments, for example by investing in direct shares that contain franking credits.

Cost savings

By establishing and running your own SMSF, you may be able to pay substantially less than the fees charged by retail super funds. Ongoing management fees and expenses as a proportion of fund value are usually around 1-2% for a retail super fund.

By contrast, the cost of establishing and maintaining a SMSF can vary widely and is mainly a function of the advice and assistance required from service providers such as Accountants, Financial Advisers and Solicitors, the assets that you invest in and the degree to which you buy and sell assets.

As a guide, SMSFs should only be considered where assets are in excess of $300,000, due to the fixed costs such as accounting and auditing fees.

What are the disadvantages of a SMSF?

Legal and compliance obligations

Trustees are bound by law to responsibly manage the super fund for the members. Non-compliance can result in severe penalties. There are significant administrative and compliance tasks, which must be fulfilled by the trustees of the super fund. These tasks are time consuming, although they can be outsourced to professionals such as Accountants or Financial Advisers.

Trustees need to keep up to date with super legislation. The risk of non-compliance with the super, corporations, trust and taxation laws may be increased due to lack of specialist knowledge. A breach could result in severe monetary penalties or even imprisonment. For example, a breach of the Sole Purpose test could attract a $220,000 fine and deem the fund non-complying, with associated tax penalties. The severity of the Superannuation Industry (Supervision) Act (SIS Act) civil penalty provisions could deter some prospective SMSF trustees.

While many responsibilities can be outsourced, the ultimate responsibility remains with the trustee.

Costs

As noted above, while a SMSF may be cheaper than other types of super funds, in other cases they may be more expensive. This is because of the upfront costs to establish the fund as well as the ongoing costs, such as having the fund audited and the annual income tax return prepared and lodged. Generally, if a fund has a balance of less than $300,000, it is likely to have higher costs than retail super funds. A typical SMSF member could expect to pay around $2,800 per annum. (Source: Investment Trends Survey of 20,000 SMSF members in 2017)

Time consuming

A SMSF will generally take up more of a member's time than an alternative super fund. It is estimated that you will need to set aside approximately 8 hours a month or 96 hours a year to manage your SMSF. (Source: Investment Trends Survey of 20,000 SMSF members in 2017)

Expertise and performance

A professional fund manager with considerable investment expertise and resources is likely to outperform an amateur investor over the medium to long term, even one with relatively sophisticated market knowledge.

There is a danger that trustees will not give due consideration to diversification and accordingly, medium to long term returns may be lower than those achieved from a retail super fund.

In formulating an investment strategy, trustees must consider all of the fund members and the dates at which they will retire, and manage the fund portfolio to be able to make the retirement benefits available on these dates. This skill, as well as being able to watch the investment markets, is not acquired easily. The trustees also need to ensure that each member is comfortable with the investment choices of the fund. This is particularly important if the members have different risk tolerances or expected investment returns.

For more information on requirements for establishing and running a SMSF, visit the ATO's super website at https://www.ato.gov.au/Super/Self-managed-super-funds/ where various guides and documents are available.