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THE Top 10 Reasons to set up a SELF-MANAGED SUPERANNUATION FUND

PAT CASEY

TOP 10 REASONS TO SET UP A SELF-MANAGED SUPERANNUATION FUND

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Self-managed super funds (SMSFs) continue to grow in popularity for financially savvy investors looking to accumulate more savings for their retirement. After growing at a rate of 23% over the past five years, SMSFs currently hold nearly $600 billion in investments according to official stats from the Australian Taxation Office (ATO).

$600 billion is a massive figure in anyone's language. Plus, the average SMSF balance is approximately $1 million. One can't help but wonder; **why are SMSFs so attractive to financially successful people?** What do they know that the rest of the population doesn't?

What is a Self-Managed Super Fund?

A self-managed superannuation fund is a retirement fund that is set up for between one and four people. The members of the fund also act as the trustees, meaning that they have **discretion over all decisions and actions of the fund,** whilst being accountable for compliance within the Australian Tax Office's (ATOs) regulations.

1. CONTROL

This is perhaps the greatest attraction that the self-managed super fund has to offer. As a trustee of an SMSF, you have a say in the direction the fund takes, from what investments the fund makes, to how much risk is taken, to how and when the returns made on those investments are withdrawn and shared amongst the members.

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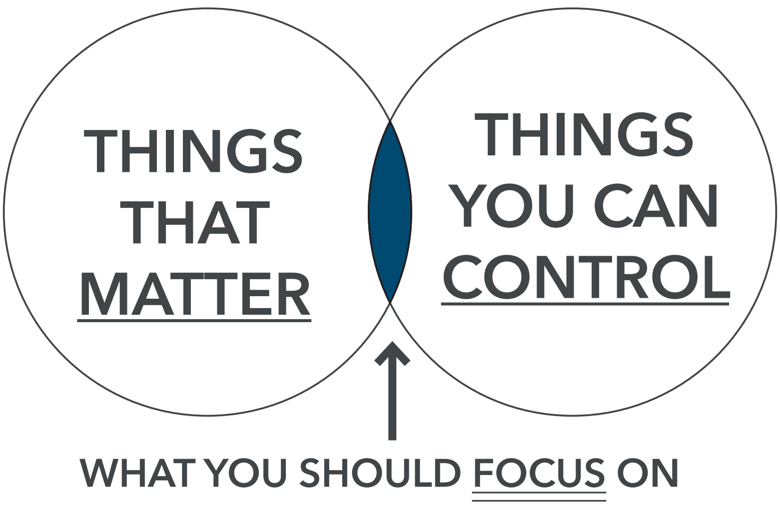
Due to the fact that the members of an SMSF are also the trustees, they are naturally very motivated to participate and engage in the decision making process of the fund and keep track of investments, maximise the returns and minimise the taxation liability to the members.

However, the day to day administration of the SMSF can be outsourced to non-members that specialise in this work so that they can administer it on your behalf, plus offer professional advice on the investments you choose to make within the fund.

However, you cannot pass on the responsibility of being a trustee to this outsourced adviser. If you decide to set up an SMSF you are personally liable for all the decisions made by the fund, even if it's based on the advice of a professional or made by another member.

A Financial Planner must operate under an Australian Financial Services License to provide advice of SMSFs. It is also worth noting that accountants must now also comply with the same conditions if they are providing advice about an SMSF.



2. FLEXIBILITY

There is no doubt that competition between the retail and the industry funds has over the years forced them to offer a wider choice of investments to their members. However, SMSFs still remain the king of flexibility when it comes to superannuation funds.

Within the bounds of the superannuation laws, trustees of a self-managed superannuation fund can invest in the traditional options such as shares and managed funds, or choose to go with less conventional investments like art and collectibles.

Traditionally, a superannuation fund could not borrow money to purchase an investment property, however this is now a real option for people with an SMSF.

Trustees of a SMSF can also invest in residential property, commercial property, listed property funds, bonds and derivatives, plus more. It has become more popular for Trustees of an SMSF to purchase an investment property within the SMSF. Traditionally, a superannuation fund could not borrow money to purchase an investment property, however this is now a real option for people with an SMSF.

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INVESTING IN YOUR PERSONAL NAME VS. INVESTING VIA AN SMSF		
	PERSONALLY	SMSF
TAX RATE	30%-45%	15%-0%
DEPOSIT / STAMP DUTY	Personal Savings	Use funds in super
CAPITAL GAINS TAX	30%-47%	10%-0% after 55
LOAN REPAYMENT	30 years	*15 years
RENTAL INCOME	30%-39%	15%-0%

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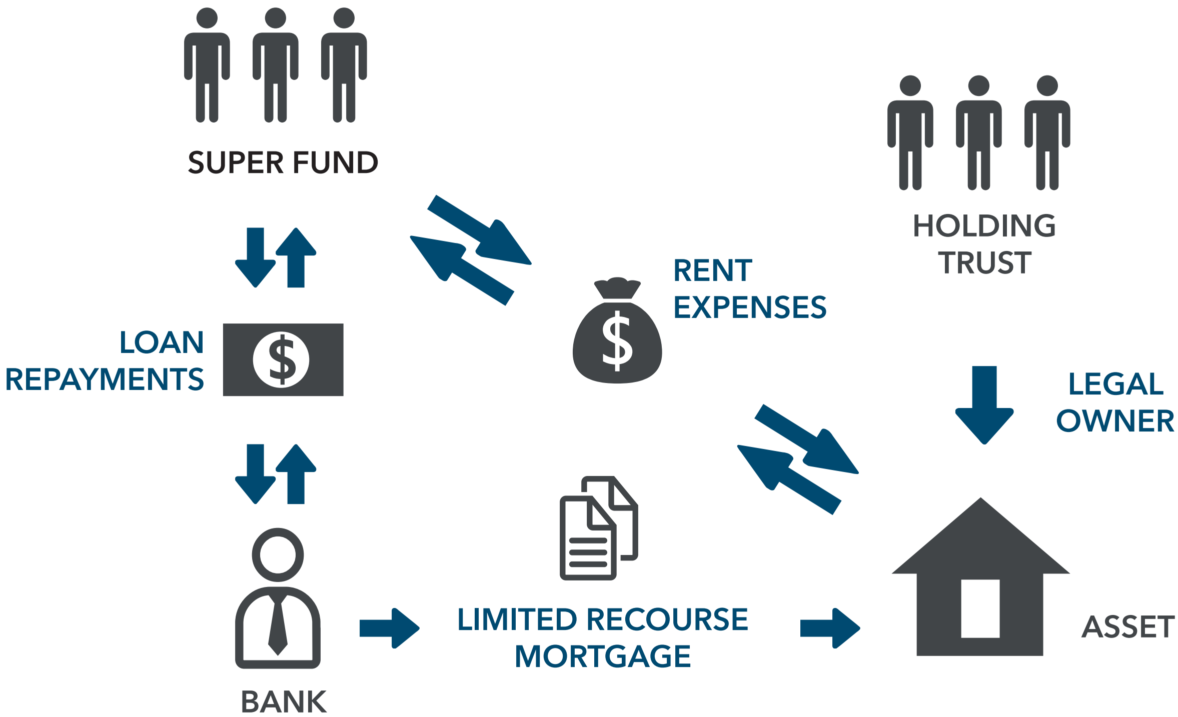
3. LEVERAGE

Prior to 2007, superannuation funds could not borrow money (leverage) to purchase an investment. However, the introduction of new borrowing regulations has allowed SMSFs to take out a loan to acquire assets including residential and commercial property.

The tax concessions available in the superannuation system, coupled with this new found ability to borrow money to invest, grant the members of the fund the ability to grow their SMSF and potentially achieve their retirement savings targets in a shorter time.

You can use a Limited Recourse Borrowing Arrangement (LRBA) to borrow 70% to 80% of the purchase price of a property. The asset is held in trust, and the liability is limited to the single asset that is acquired e.g the residential property.

HOW TO BORROW MONEY THROUGH A SMSF TO PURCHASE AN INVESTMENT PROPERTY



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4. COSTS

Every superannuation fund has associated running costs, be it a retail fund, industry fund or self-managed super fund. These costs are usually in the form of administration fees and investment management fees.

While retail and industry funds usually charge a certain percentage of the balance as a fee, self-managed super funds have a fixed cost for taking care of the administration of the fund and accounting. The fee charged for administering an SMSF is usually higher than that of the other types of funds.

This should not discourage you from setting up a self-managed super fund, because an SMSF has other ways to limit your costs when compared to the other types of funds.

To make this easier to understand, imagine an SMSF has a fixed administrative cost of $3,000 whereas a standard retail fund charges a 1.5% fee. This means that as soon as the balance of the retail fund is greater than $200,000 the SMSF becomes the cheaper option to administer.

However, cost should not be the only factor when considering an SMSF because it is just a small part of a larger picture. Generally, for an SMSF to be cost effective you would need to have at least $200,000 to start the fund. This amount can come from the combined account balances of the members of the fund. For example, a husband has $125,000 accumulated in his retail super fund, and his wife has $75,000 invested in an industry fund. Combine these amounts and they have hit the magical $200,000 mark to cost effectively set up their SMSF.

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There are also significant costs savings when you retire. When you stop working and retire, your super moves into the 'drawdown' or pension phase to start accessing your money to provide an income. Under a traditional retail or industry fund where your money is 'pooled' with other investors, this move can attract high transaction costs and therefore reduce your super balance. This is because assets will need to be sold down. However, with an SMSF these transaction costs are avoided because your super money is segregated from other investor's money, and therefore your assets don't have to be sold to move into pension phase.

5. TAX MANAGEMENT

For many of us, when that time of the year comes to pay the tax accountant a visit, the most important questions we take into consideration are the following two

1. **How much do I have to pay?**
2. **When do I have to pay it?**

SMSFs provide you with more flexibility around tax planning, and therefore as Trustee you can choose to structure and time your actions to pay as little tax as possible. This is a luxury that other super funds cannot offer.

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Contributions into the superannuation fund are considered as income for the fund, and as such are liable for tax at a concessional rate of 15 per cent. For the retail and industry funds, the tax has to be deducted from the contributions before the money can be invested.

However, for the SMSF, the taxable income cannot be determined before the returns are prepared and lodged. This means that the contributions can be invested until such a time that the taxes are due. This means more money invested for longer, earning returns for the members before tax is eventually paid.

A self-managed super fund also provides an advantage in the form of being able to hold off the sale of an asset until retirement, so that you can gain significant capital gains tax benefits. For example, if you purchased an asset such as investment property before you retired for $400,000. Then, sold the property after you retired for $600,000, you would not pay ANY capital gains tax. This means that the entire capital gain of $200,000 would be added to your retirement savings without paying any tax. A pretty good deal in anyone's book!

In other funds, changing from a superannuation account to a pension account may involve the change of the superannuation trustee. When this happens, you are liable to pay capital gains tax. An SMSF does away with all this because switching from a superannuation accumulation account to a pension/retirement account within an SMSF does not involve change of trustee.

6. ESTATE PLANNING

Retail and industry funds offer a death benefit nomination and this is usually sufficient for people with very simple estate planning needs. With the SMSF, however, there is the flexibility of being able to instruct the trustee on how to distribute the superannuation benefits. This is especially advantageous to those who have really young children, or those with more complex family structures including ex partners, and children to multiple marriages.

SMSFs also have an edge over the other funds when a member or trustee is incapacitated and cannot carry out their trustee duties. In such a case under an SMSF, the Trustee has the ability to nominate a Power of Attorney as their nominated legal representative to act on behalf of the Trustee to carry out their wishes.

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7. ECONOMIES OF SCALE

If one person has a balance of say $200,000 in their superannuation fund, and pays a fixed administration fee of $3,000, then this equates to 1.5% of their fund. As their balance grows, so does their % based fee. However, under an SMSF the $3,000 administration fee remains the same no matter how large your balance grows. In essence, an SMSF applies the economies of scale principle so that the administrative cost reduces as a percentage, as the fund's balance grows.

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In this scenario, the fund has just grown to $600,000 from the original $200,000, meaning that the administration fee of the SMSF accounts for only 0.5% of the balance. However, if you had remained in the retail fund the 1.5% fee would now be costing you $9,000. Therefore, the larger your balance, the more it makes sense to consider moving your super to an SMSF.

8. INSURANCE

Trustees of public offer superannuation funds usually give some sort of personal insurance offer to their members such as life insurance, income protection as well as total and permanent disability insurance.

In the retail or industry funds, the trustees usually take on the services of one insurance service provider to cover all the members of the fund. The coverage offered is usually limited though due to the fact that the insurer offers a one size fits all approach.

In an SMSF, the trustee is not limited by the insurer because they have the ability to select from a large number of insurers, plus a variety of options. This enables each member to have insurance policies that are tailored for each of their specific personal needs and situations.

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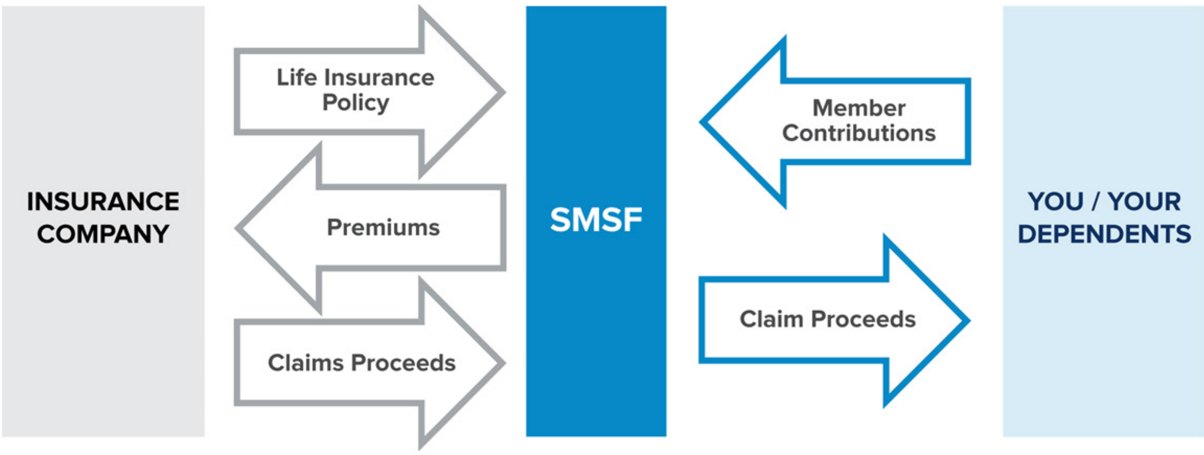
INSURANCE AND YOUR SELF-MANAGED SUPERANNUATION FUND



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9. AN SMSF CAN BENEFIT YOUR BUSINESS

One of the greatest advantages about having an SMSF is that business owners can purchase a commercial property to operate their business out of. Your SMSF will be the owner or the commercial property, and your business would be the tenant paying a market rate of rent to your SMSF. This strategy increases the retirement balance of the SMSF member, and on top of that, the lease payments are deductible as expenses from the business. An example of this would be a specialist doctor, lawyer, physiotherapist or real estate agent who conducts their business out of an office owned by their SMSF.

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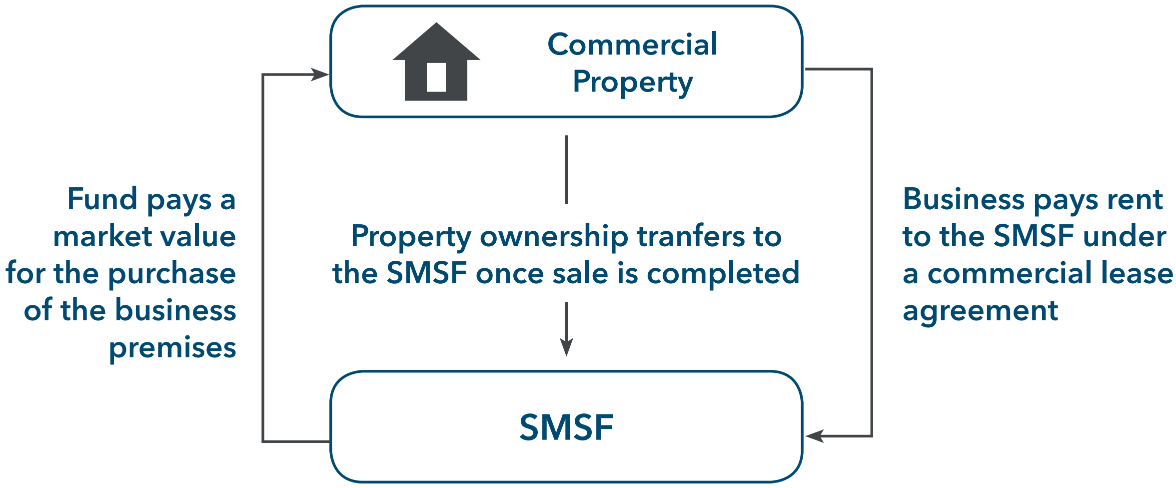
BUYING AND RENTING A COMMERCIAL PROPERTY THROUGH A SELF-MANAGED SUPERANNUATION FUND



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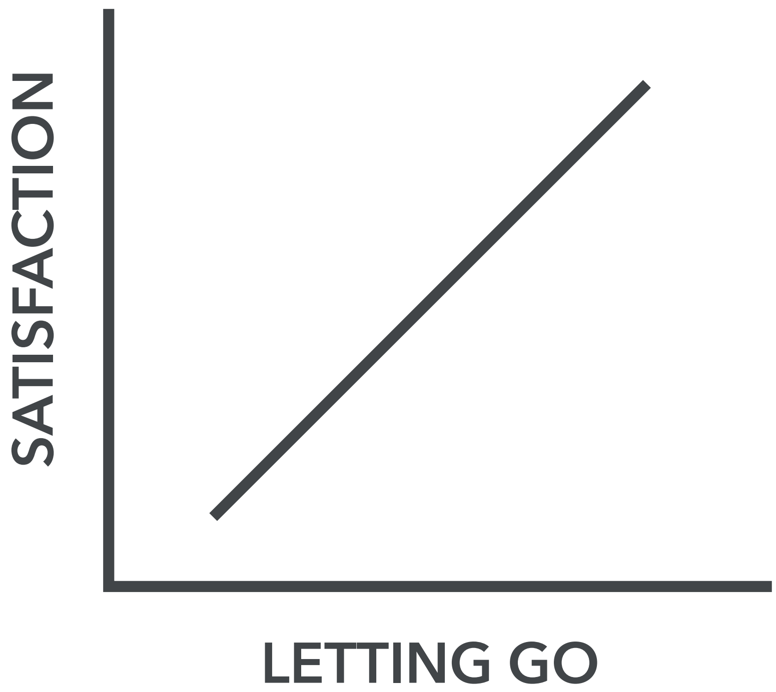
10. YOU DON'T HAVE TO DO IT ALL YOURSELF

The above points not only highlight the advantages of setting up a self-managed super fund, but they also reveal how much work running an SMSF can be. From setting and following an investment strategy, to keeping comprehensive financial records, plus arranging an annual audit by an approved SMSF auditor, the duties of running an SMSF can be quite stressful. The consequences of getting it wrong are not to be discounted.

It's unlikely that you will want to track every single compliance task and carry out the administration yourself. External help is essential for the establishment, day-to-day operations of the fund, plus meeting the annual compliance requirements. Ultimately, the control and final say on investment decisions still remain with the members of the fund.



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BONUS SECTION

3 Things to Consider Before Changing Your Super Fund

If you have seen the Industry fund TV advertisements, you would be familiar with their catch phrase, which states that 'low fees can make a lifetime of difference' and they are not wrong, but they are missing a big part of the story. In fact, most people only compare fees and returns when judging the performance of their super fund. So what features should you compare?

1 FEES

Fees can vary depending on the type of fund you are in. An important fact is to consider the fees you pay in relation to the benefits you receive from your fund. If you are paying high fees and receiving no service, you should investigate your options.

For members with a balance of **$50,000** the industry average fee is **1.67% or $835**

For members with a balance of **$100,000** the industry average fee is **1.62% or $1,620**

For member balances **$100,000 - $200,000** annual SMSF fees generally vary between **$2,000 and $5,000**

2 YOUR PERSONAL INSURANCE

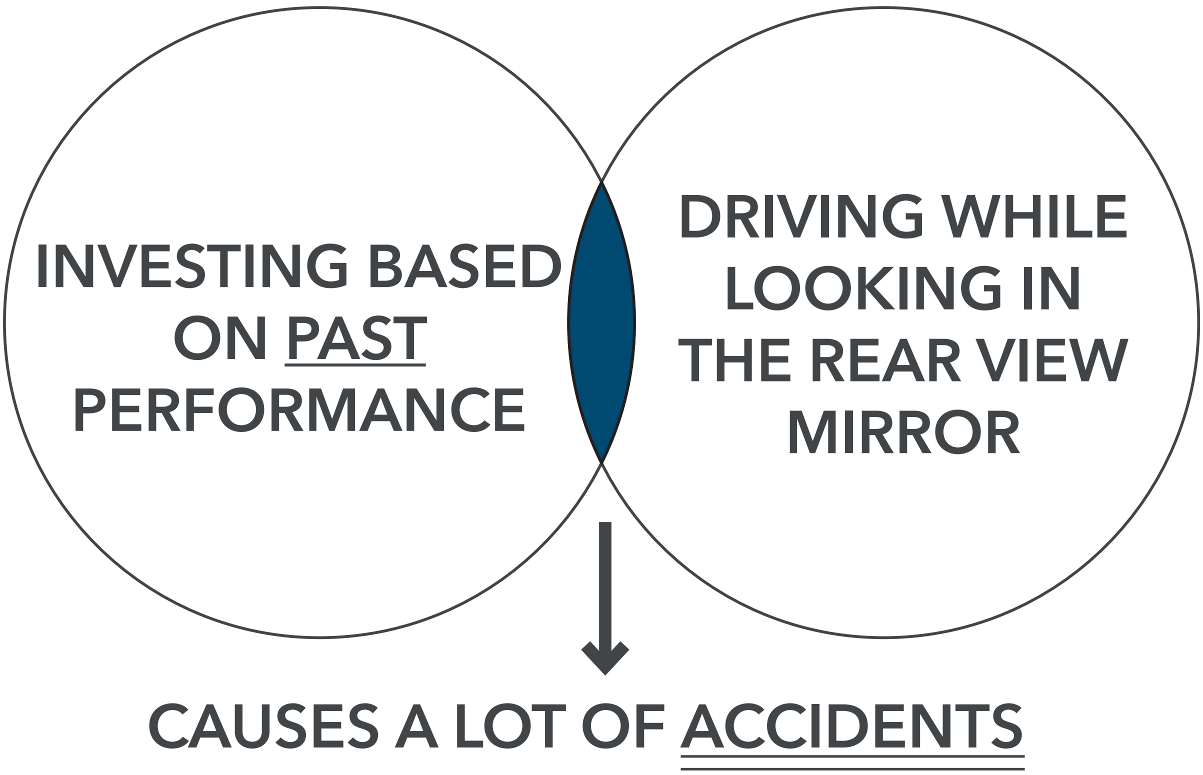
If you joined your employer's super fund, you may be receiving a group insurance benefit with no need for medical tests, plus very competitive insurance premiums. In some cases, your employer may pay for part or all of the insurance cover. This is a very important benefit of employer super funds. The downside however, is when it comes to a future insurance claim, as group super insurance is not underwritten i.e there are no medical tests when you join. Therefore, the insurer can potentially reject a claim on the basis of non-disclosure. Having all of those medical tests when taking out personal insurance can be a hassle. However, it does provide you with certainty that you know exactly what you are, and are not covered for, therefore increasing the likelihood that a future claim will be paid in the case of illness, injury or death. Insurance cover in super requires sound financial advice from a qualified professional.

3 RETURNS

Returns are ultimately one of the most important considerations with any superannuation fund. However, it should be noted that past performance is a poor indicator of future performance. Therefore, don't go rushing into last year's top performing fund expecting it to shoot the lights out again this year.

Does your super fund actually disclose where your money is invested? Some funds only disclose the top 10 holdings, and some funds only disclose very broad categories such as 'alternative assets'. This could mean any number of investments, either high or low risk, you would never know!

One final suggestion is that you consider completing a formal SMSF trustee education course or employ the professional services of an experienced financial adviser, if you intend on setting up an SMSF, as the responsibility of managing your retirement money can be a minefield if not managed correctly.



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- A step-by-step guide on how to start a self-managed superannuation fund

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