



## Self-managed super funds

Self-managed superannuation funds (SMSFs) are a popular option for investors seeking greater control over their retirement savings. However, the decision to establish an SMSF should not be taken lightly. Whether an SMSF is suitable for you will depend on your needs and circumstances and whether you are willing to take on the responsibility of running your own super fund.

### What are SMSFs?

SMSFs are superannuation funds which are established and operated by the members of the fund. Under the superannuation rules, the members of an SMSF are generally required to act as a trustee of the fund or as a director of the fund's corporate trustee and are legally responsible for managing the fund in accordance with a strict set of legal requirements.

### Structure of an SMSF

The legal structure of an SMSF is a trust, which requires (among other things) the following elements:

- the trust deed which is a legal document that sets out the rules of the fund
- the trustee who is legally responsible for managing and administering the fund in accordance with the trust deed and the superannuation laws
- the members (maximum of six) who are also required to act as trustees and have benefits in the fund.

### Trustees of an SMSF

An SMSF may be a multi-member fund (up to six members) or a single member fund, with individual trustees or a corporate trustee. There are specific rules with regards to being a trustee of an SMSF – if the rules are not followed the SMSF may lose its tax concessions.

You must be 18 years old or over to be a trustee, or director of a corporate trustee, of a super fund and not under a legal disability (such as mental incapacity) or a disqualified person.

You are a disqualified person if you:

- have been convicted of an offence involving dishonesty

- have been subject to a civil penalty order under the super laws
- are insolvent under administration (including being an undischarged bankrupt)
- have been disqualified by a court or regulator (for example, by us or APRA).

Similarly, a company can't be a corporate trustee if a director or other responsible officer of the company is a disqualified person.

The rules regarding trustee structures are summarised in the table below:

Number of members	Structure	Requirements
2-6	Individual trustees	<ul style="list-style-type: none"><li>• Two to six members.</li><li>• Each member of the fund must be a trustee, and each trustee must be a member of the fund.</li><li>• A member cannot be an employee of another member – unless they are relatives.</li><li>• No trustee may receive any remuneration for duties performed as trustee in relation to the fund.</li></ul>
2-6	Corporate trustee	<ul style="list-style-type: none"><li>• Two to six members.</li><li>• Each member of the fund must be a director of the corporate trustee, and each director of the corporate trustee must be a member of the fund.</li></ul>

		<ul style="list-style-type: none"> <li>• A member cannot be an employee of another member – unless they are relatives.</li> <li>• No director of the corporate trustee may receive any remuneration for duties performed as a director of the corporate trustee in relation to the fund.</li> </ul>
1	Individual trustee	<ul style="list-style-type: none"> <li>• There must be two trustees.</li> <li>• One trustee must be a fund member.</li> <li>• If the fund member is an employee of the other trustee, the fund member and the other trustee must be relatives.</li> <li>• No trustee may receive any remuneration for duties performed as trustee in relation to the fund.</li> </ul>
1	Corporate trustee	<ul style="list-style-type: none"> <li>• The corporate trustee company can have one or two directors, but no more.</li> <li>• The fund member must be the sole director or one of the two directors.</li> <li>• If there are two directors and the fund member is an employee of the other director, the fund member and the other director must be relatives.</li> <li>• No director of the corporate trustee may receive any remuneration for duties performed as a director of the corporate trustee in relation to the fund.</li> </ul>

### Trustee duties and responsibilities

Becoming a trustee of an SMSF is a serious decision that involves taking on a number of legal duties and responsibilities. These include (but are not limited to) the legal responsibility to:

- learn and understand the superannuation rules as well as your trustee obligations and duties under both general law and superannuation law
- formulate, implement and regularly review an investment strategy for the fund that aims to provide the required level of retirement benefits and that considers the insurance needs of the members
- invest the fund's assets in accordance with the fund's investment strategy and the superannuation investment rules to provide retirement benefits to members
- keep the fund's assets separate from the trustees' personal assets and ensure the fund is managed and maintained for the sole purpose of providing retirement and death benefits
- accept contributions and pay benefits in accordance with the super and tax laws
- hold regular trustee meetings and maintain proper and accurate records of all trustee decisions and fund transactions
- arrange for all assets to be valued at market value each year
- keep fund records, including details of all trustee meetings and resolutions
- arrange for the fund's financial statements and reports to be prepared and audited each year and for the SMSF annual return to be lodged with the ATO by the due date each year
- report events that affect a member's transfer balance to the ATO on a quarterly or annual basis (depending on the total superannuation balance of members).

All trustees and directors are equally responsible for managing the fund and making decisions – you're responsible for decisions made by other trustees even if you're not actively involved in making the decision.

You can appoint other people to help you or provide services to your fund (for example, an accountant, administrator, tax agent or financial planner). However, the ultimate responsibility and accountability for the SMSF's actions lie with you, as trustee or director.

As an individual trustee or director of a corporate trustee, you may be personally liable to pay an administrative penalty if certain laws relating to SMSFs are not followed.

Trustees are required to sign a declaration confirming that they know and understand their legal responsibilities within 21 days of becoming a trustee. A copy of the declaration, along with a range of SMSF videos and guides to help you understand your trustee duties and responsibilities is available on the ATO website at [www.ato.gov.au/Super/Self-managed-super-funds/Setting-up](http://www.ato.gov.au/Super/Self-managed-super-funds/Setting-up).

### **What are the benefits of SMSFs?**

Because SMSFs are self-managed they can be more flexible and give members more control over how their super savings are invested and managed. For example, SMSFs can allow members to:

- develop an investment strategy specifically designed to meet their needs and circumstances and that takes into account their personal investment preferences
- be directly involved in making the day to day investment decisions for the fund
- invest in asset classes not available in large funds, such as direct property
- invest in commercial property which can then be leased back to a related party to use in a business
- borrow for investment subject to strict requirements
- pay retirement income streams tailored to their specific requirements
- implement estate planning strategies tailored to their specific needs and circumstances.

### **What are the costs of an SMSF?**

Another potential advantage of SMSFs is that they can potentially be more cost effective when compared to large super funds. However, the cost effectiveness very much depends on how involved members are in managing the fund, the level of the fund's assets and the costs of running the fund.

For example, in 2013 the Australian Securities and Investments Commission published a report<sup>2</sup> that found SMSFs with assets of between \$100,000 to \$500,000 will only be cost-competitive where the trustees take on at least some of the administrative duties or outsource using one of the cheaper suppliers, while SMSFs that outsource all of their trustee duties to service providers will need assets of at least \$500,000 to be justified from a cost perspective.

As a guide, some of the costs associated with setting up and running an SMSF include:

- fund establishment costs – these include the legal and administration costs to set up and register the fund with the ATO as well as any upfront investment and advice costs
- ongoing investment management and advice costs
- asset valuation costs
- pension establishment and annual actuarial certificate costs
- annual administration and reporting costs – including annual accounting, tax and auditing costs as well as the cost of preparing and lodging an annual SMSF return with the ATO.

### **Risks and disadvantages**

Before deciding to set up an SMSF there are a number of issues associated with SMSFs that you need to be aware of and understand. These are summarised as follows:

- As a trustee you will be legally responsible for the fund and can be held personally liable for any penalties should the fund fail to be maintained in accordance with the strict legal requirements. See below for more information on penalties.
- SMSFs generally require more effort to establish and maintain compared to being a member of a large fund, as you will have a range of trustee duties and obligations. You will need sufficient time and commitment to manage an SMSF
- As a trustee of an SMSF you have a duty to exercise skill, care and diligence in managing an SMSF, and therefore need to possess a sufficient level of financial literacy to manage the fund and make investment decisions in line with the fund's investment strategy. While you can use external research and advice to develop your financial knowledge over time, you remain responsible for ensuring that investment decisions are made and implemented in line with the fund's investment strategy
- Insurance cover for members may be more difficult or expensive to obtain in an SMSF compared to a large fund as members may not be able to access the benefits of group life insurance arrangements, such as wholesale premium rates and automatic acceptance of cover.
- If one trustee is going to be more heavily involved in the day-to-day running of the SMSF (e.g. a husband or wife managing the SMSF on behalf of a married couple), the less active trustee needs to consider and plan for what they

will do if the controlling trustee becomes unable to manage the SMSF eg ill health or cognitive decline

- Unlike large funds, SMSFs are ineligible to apply to the Federal Government for a grant of financial assistance where the fund has suffered a loss due to theft or fraud
- Any disputes in relation to an SMSF are not able to be resolved by the Australian Financial Complaints Authority (AFCA) and may need to be resolved via legal action.

It is also important to note that any change in member circumstances can have an adverse impact on an SMSF and can result in a fund needing to be wound-up. This in turn could trigger additional costs and taxes being and result in the loss of any concessional tax or social security treatment that may have applied to the members' interests in the fund.

#### **Changing circumstances which may adversely impact an SMSF include:**

- a breakdown in the relationship between members resulting in one or more of the members leaving the fund
- the members becoming non-resident which may result in the fund being subject to significant tax penalties unless adequate measures are taken
- one or more members becoming a disqualified person due to bankruptcy, conviction or disqualification by the regulator
- the death of a member, or
- a member ceasing to be capable of acting as trustee due to age or health related issues.

Therefore, it's important to have an exit strategy which could help you to exit and wind-up an SMSF should the need arise.

#### **Is an SMSF right for me?**

Whether an SMSF is right for you will depend on a range of issues. These include:

- whether you need or want the additional control and flexibility that SMSFs provide
- the size of the fund and how involved you want to get in managing and administering the fund
- whether you have the time required to properly manage the fund and keep up with any changes to the superannuation rules
- whether you want the ability to invest in other asset classes not available in large funds or to get involved in making the investment decisions in relation to your fund

- whether your individual needs and circumstances may indicate whether an SMSF may not be suitable
- whether the members will remain tax residents of Australia.

#### **Superannuation investment rules**

When investing the fund's assets, trustees must be aware of the superannuation investment rules and restrictions. These include (but are not limited to):

- a trustee must not lend money, or provide any form of financial assistance, to a member or a relative of a member of the fund
- a trustee is generally prohibited from acquiring assets from a related party other than certain types of assets, such as listed securities and real property used exclusively in a business
- a trustee is generally prohibited from borrowing money other than in certain limited circumstances, such as via a limited recourse borrowing arrangement
- the total market value of certain in-house assets must not exceed 5% of the market value of the fund's assets
- all investments must be made and maintained on an arm's length basis
- the trustee must not give a mortgage or security over the fund's assets
- the trustee must invest and maintain the fund's assets for the sole purpose providing benefits to members upon their retirement (or attainment of a certain age) or their beneficiaries if a member dies.

It is also illegal to use an SMSF to gain early access to your superannuation savings.

Your role as a trustee will be required to comply with these rules at all times. Any breach of these requirements can result in significant compliance and tax penalties being applied.

#### **Investment strategy requirements**

The trustees of an SMSF are required to formulate, implement and regularly review an investment strategy for the fund that takes into account all of the circumstances of the fund, including:

- the needs, objectives and risk tolerance of the members
- the likely return from the SMSF's investments and the risks associated with those investments
- the fund's cash flow requirements taking into account the fund's expected costs and benefit payments

- the importance of diversification and the need to invest the fund's assets across a number of asset classes to help reduce investment risk
- the liquidity of the fund's assets over and above the fund's cash flow requirements
- the need to hold insurance to provide cover for the members of the fund.

When formulating and implementing an investment strategy you need to pay special consideration to the level of diversification of the fund's assets as it can help reduce investment risk. All investments must be in accordance with the fund's strategy.

### **Insurance considerations**

As part of an investment strategy, trustees are required to consider the need to hold insurance for members. To comply with this requirement, trustees need to consider each member's personal circumstances, including:

- their income, assets and liabilities
- their existing insurance cover
- the availability and affordability of the required level of insurance cover having regard to their current circumstances and their retirement expectations.

It's important that trustees comply with this requirement and document their decision in the minutes of a trustee meeting. Failure to properly consider this issue could result in members being underinsured and expose the trustees to claims for compensation should a member, or their beneficiaries, suffer a loss as a result.

### **Investment strategy review**

Trustees must regularly review the fund's investment strategy to ensure it remains appropriate for the fund on an ongoing basis. This is particularly important where members are approaching retirement as their needs and circumstances are likely to change.

Trustees should also review the fund's investment strategy whenever there is a significant change in the fund's circumstances. This could include where a member retires and commences an income stream or in response to any changes in macro-economic conditions.

### **Comply with operating standards**

Trustees are required to comply with a number of superannuation operating standards. These include (but are not limited to):

- to accept contributions for members age 67 or over, only if they are eligible to contribute
- to ensure all member benefits are preserved until retirement (or until a member meets another superannuation condition of release)

and to not allow members to illegally access their superannuation savings early

- to only acquire insurance policies that align with a condition of release, and
- to keep certain fund records and reports for specified periods of time.

### **Event based reporting**

With the introduction of the transfer balance cap (TBC) from 1 July 2017, SMSF trustees that pay retirement phase income streams are required to report TBC events to the ATO.

Reporting is completed via a Transfer Balance Account Report (TBAR), which can be provided to the ATO as a paper or online form, or through the ATO Business and Tax Agent Portal. A separate TBAR is required for each member but up to four events can be reported per TBAR.

The timing of reporting TBC events that occur on or after 1 July 2017 depends on whether the SMSF is classified as a 'quarterly' or 'annual' reporter.

From 1 July 2023, all SMSFs will be required to report quarterly. This will apply even if the members total super balance is less than \$1 million. An event must be reported that affects the members transfer balance within 28 days after the end of the quarter in which the event occurs.

If an SMSF has any unreported events that occurred before 30 September 2023, it must be reported by 28 October 2023.

If an SMSF does not lodge a TBAR by the required date, the member's transfer balance account will be adversely affected. The members may need to commute more money to rectify any excess and pay more excess transfer balance tax.

### **Breaches and penalties**

The ATO as the regulator monitors SMSFs for their compliance with the superannuation laws and can take action against trustees where a breach occurs. This includes:

- requiring a trustee to undertake an approved course of education in relation to their trustee duties
- issuing a rectification direction to require a trustee to rectify a breach
- issuing administrative penalties of up to \$12,600 per trustee
- disqualifying one or more trustees

- revoking the fund's complying tax status – in which case severe tax penalties can apply
- taking legal action against trustees in which case a judge can impose civil and criminal penalties of up to \$420,000 per individual trustee or \$2.1 million for funds with a corporate trustee, and/or five years imprisonment.

Trustees should also note that where an ATO administrative penalty is applied they will be personally liable and they will not be able to be indemnified out of the assets of the fund. It is therefore vital that trustees understand their obligations and comply with them at all times.

### ATO SMSF Publications

The ATO has produced a number of educational videos and guides in relation to the different aspects and obligations of running an SMSF. These videos and guides are available on the Super page of the ATO website at [www.ato.gov.au/Super/Self-managed-super-funds](http://www.ato.gov.au/Super/Self-managed-super-funds):

- Setting up a self-managed superannuation fund

- Running a self-managed superannuation fund
- How your self-managed superannuation fund is regulated.

### Getting help

There are a number of professional SMSF service providers that can assist you to set up and run your fund. These include:

- an accountant that provides SMSF administration services
- a specialist SMSF administration service
- a financial adviser to help formulate and investment strategy and manage the fund's investments
- a solicitor to assist with any trust deed/estate planning requirements.

You can also subscribe to the ATO's News and alerts service for SMSFs at: [www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News-and-alerts/](http://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News-and-alerts/)

<sup>1</sup> [Costs of Operating SMSFs](#), Rice Warner Actuaries, December 2020

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