Guide to running your own super fund

2022/23

While running an SMSF can give you greater control of your retirement savings, it's a big commitment that involves additional responsibilities.

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Why do people choose an SMSF?

One of the key reasons for their popularity is the level of investment choice they offer.

With an SMSF you can create your own investment strategy and select from a broader range of investments.

Other potential advantages include greater tax and estate planning flexibility and the opportunity to set up one fund for up to six people.

But with these additional benefits comes a range of additional responsibilities not required if you choose to hold your super with a 'publicly available' fund.

In this guide, we explain the:

- possible **benefits of running your own fund**
- **things to consider before setting one up**
- **who can be a trustee and the obligations that need to be met**
- **where a fund can invest**
- **borrowing in a SMSF**
- **insuring in a SMSF**, and
- some **estate planning issues to consider**.

To find out more about setting up an SMSF, we recommend you consider speaking with a financial adviser.

Benefits of running your own fund

SMSFs can offer a number of features and benefits generally not available with other super arrangements.

More investment control

You can establish your own **investment strategy** and directly control where and how your super is invested.

This includes:

- setting the fund's investment objectives
- determining how much to invest in the different asset classes such as shares, property, cash and fixed interest, and
- selecting the specific investments you want the fund to hold.

You can also implement:

- **different investment strategies** for each fund member, which may be appropriate if the members have significantly different ages, super balances or risk tolerances, or
- **one investment strategy** that takes into account the collective needs of all members, which will be easier to administer.

More investment choice

You can select from a wider range of investments, such as:

- all listed shares
- some unlisted shares
- residential and business property, and
- collectables such as artwork, stamps and coins.

One fund for the family

You can have up to six members in an SMSF. By adding family members, such as adult children, you could increase the fund's balance considerably. This could allow the fund to:

- purchase assets it currently doesn't have sufficient money to buy, such as residential or business property, and
- make some significant cost savings, as many of the costs involved when setting up and running an SMSF are a fixed amount (ie they don't increase if the fund balance does).

Having one fund for the family can also give you more flexibility to decide which assets are sold to pay a death benefit if a fund member dies.

Borrowing to make larger investments

SMSFs can **borrow** to buy assets (such as shares and property). Typically this occurs when it doesn't have enough money to purchase the asset outright.

For example, if you're a business owner, your SMSF could purchase your business property using cash already in the fund and borrow the rest.

Tax considerations

With SMSFs you may be able to:

- take greater control over the timing of tax events, such as when capital gains and losses on assets are realised
- transfer certain assets directly into your fund by making 'in specie' contributions, where investment earnings will be concessionally taxed, and
- potentially start a pension without triggering capital gains tax.

Benefits of running your own fund

Greater estate planning certainty and flexibility

You can nominate which of your eligible dependants you'd like to receive your benefit **in the event of your death** without having to meet some of the constraints that apply to other super arrangements.

However, additional care needs to be taken to ensure the rules of the SMSF allow you to achieve what you want, are consistent with the legislation and the appropriate steps are taken to implement.

Other super benefits

Just like other super funds, if you have an SMSF:

- you may be able to make contributions from your pre-tax salary or claim your contributions as a tax deduction
- investment earnings are generally taxed at a maximum rate of 15%
- there's no tax on investment earnings relating to 'retirement phase' pensions[1]
- you won't pay tax on lump sum and pension payments received from an SMSF at age 60 or over, and
- your fund may be able to hold life, total and permanent disability and income protection **insurance**.

[1] These are pensions where a full condition of release has been met. Since 1 July 2017, there is a limit on how much super you can transfer to 'retirement phase' during your lifetime. This is known as the 'transfer balance cap' and in 2022/23 it's $1.7 million. This cap may be indexed in future years. Your personal TBC may differ.

Is an SMSF right for you?

While running an SMSF can give you greater control of your super and retirement savings, it's a big commitment.

Key issues to consider

Some important issues to consider before deciding whether to set up an SMSF include:

1. Do you have enough super money to make an SMSF cost-effective?

The Productivity Commission in its report 'Superannuation: Assessing efficiency and competitiveness' found that on average SMSFs with balances below $500,000 have lower returns after expenses and tax compared to APRA-regulated funds.

2. Do you have enough time, knowledge and skills to manage your own super?

You and all members must be fund trustees (or directors of the corporate trustee). This means you are all responsible for running the fund and meeting a range of legal and administrative obligations.

3. Have you considered whether a publicly available super fund may be more suitable?

With publicly available super funds, such as retail and industry funds:

- you can access a broad range of investment options, which may be more than sufficient for your needs
- you don't have to take on the burden and responsibility of being a fund trustee
- you have access to the Australian Financial Complaints Authority, which can help resolve complaints regarding decisions and conduct of fund trustees, and
- you may be eligible for compensation under superannuation laws if the fund suffers loss as a result of theft or fraud.

Also, if you transfer (rollover) all your super to an SMSF:

- you may lose valuable life, total and permanent disability, income protection or other **insurance cover** provided by the publicly available fund, and
- the cost of taking out replacement cover in your SMSF may be higher.

What are your trustee oblgations?

SMSF trustees are responsible for meeting a range of legal and administrative obligations and penalties may apply if you don't perform your duties. There are a range of **professionals who can assist you** in managing your SMSF obligations.

Some of the key trustee obligations include:

- holding assets for the **sole purpose** of providing retirement benefits to members, or to their dependants if a member dies before retirement
- developing, implementing, adhering to and reviewing an **investment strategy** for your fund
- keeping your super assets separate from other assets such as your personal or business assets and assets of employers who contribute to the fund
- preparing and keeping proper records, including financial statements, tax returns, audits, actuarial certificates (where applicable) and minutes of trustee meetings and decisions
- not lending money or providing **financial assistance** to members or their relatives using fund assets
- not borrowing money except in limited circumstances, such as to purchase investments using a **'limited recourse borrowing arrangement'**
- not allowing certain **'in-house assets'**[2] to exceed 5% of the total fund assets valued at market value, and
- not releasing benefits to members earlier than is legally permitted.

If you are not comfortable with the duties and obligations of being an SMSF trustee, an SMSF is unlikely to be right for you.

[2] An in-house asset is a loan to, or an investment in, a related party of the fund, an investment in a related trust of the fund or a fund asset that is leased to a related party.

Who can help you manage your obligations?

If an SMSF is the right super solution for you and your fellow members, there are a range of professionals who can help you set up and manage your super fund, and manage your compliance risks. It is important to understand however that as trustee of the fund, you remain ultimately responsible for ensuring that the fund complies with super legislation.

These include:

- **solicitors** who can provide you with an appropriate trust deed and governing rules for your fund, and advise you on other legal matters
- **financial advisers** who can help you develop and implement an **investment strategy** for the fund, select investments to match that strategy, determine the right insurances, advise on starting and running pensions in your fund and co-ordinate your estate planning, and
- **accountants** who are registered tax agents and can look after the fund's record keeping and reporting requirements, and provide taxation advice.

There are also companies that offer a comprehensive package of legal, administration, accounting and auditing services to help you meet your trustee obligations.

The key to running your own super fund is to get expert advice and assistance and not try to do it all yourself.

ATO information for SMSF trustees

The Australian Taxation Office website (**ato.gov.au** and search 'self-managed super funds') contains a range of written information, webinars and approved educational courses for SMSF trustees on topics such as:

- News and alerts for self-managed super funds
- Thinking about self-managed super
- Setting up
- Contributions and rollovers
- Investing
- Paying benefits
- Winding up
- Administering and reporting, and
- SMSF auditors.

It's also important to check the ATO website regularly to keep up to date on important SMSF issues.

Steps to setting up an SMSF

If the decision is made to start an SMSF, there are ten key steps that need to be taken to get the fund up and running.

While these steps contain many administrative elements, it's important they are all completed and in the right order. You should consider seeking professional advice from a solicitor, registered tax agent and financial adviser before setting up an SMSF.

Some practical issues can also arise during the start-up phase, including how to meet the preliminary costs of establishing the fund and making time critical investments while waiting for rollovers to be processed.

Step 1: Choose a trustee structure

The first thing you need to do is decide whether you and your fellow members will each be an individual trustee or you will use a 'corporate trustee'.

This is an important decision, as it will impact a range of other steps, such as the name(s) in which the investments are held and how your fund will need to be run.

While individual trustees are common, there are a number of benefits of having a **corporate trustee**.

Step 2: Obtain a trust deed

SMSFs need to have a 'trust deed'. This is a legal document that sets out the rules for establishing and running your fund and, along with the superannuation laws, governs how your fund needs to be operated.

The deed should cover, among other things:

- your fund's objectives
- who your fund's members are
- who can be a **trustee** and how trustees are to be appointed or removed
- when **contributions** can be made
- how and when benefits can be paid
- how professional advisers are to be appointed, and
- the procedures for winding up your fund.

Your trust deed can be tailored to meet the specific needs and objectives of your fund members, but not to the extent that it overrides other legal requirements.

Because the trust deed is a very important legal document, it must be prepared by a suitably experienced legal professional.

You could use a solicitor who specialises in this area or purchase a deed from an SMSF service provider that has been 'pre-prepared' by legal experts.

Step 3: Sign trustee declarations

All new trustees must sign a **'trustee declaration'** within 21 days of becoming a trustee or director of a corporate trustee. This form requires you to acknowledge you understand:

- the rules that apply when making contributions, purchasing and managing investments and paying benefits
- the general duties you will need to meet
- your fund is to be maintained for the **'sole purpose'** of providing benefits to the fund members upon their retirement or the members' beneficiaries if they die
- investment restrictions which apply to the fund, and
- your legal and other obligations.

The ATO has developed a 'Trustee declaration form' that can be downloaded from **ato.gov.au**

Step 4: Record members' TFNs

Your fund will need to record each member's Tax File Number (TFN). If it doesn't, your fund:

- will not be able to accept personal before-tax or after-tax super contributions and contributions on behalf of a spouse, and
- will need to deduct additional tax from employer contributions made in respect of that member.

Also, the fund's members may not be able to receive a co-contribution or Low Income Superannuation Tax Offset from the Federal Government.

Steps to setting up an SMSF

Step 5: Register with ATO

Your fund needs to be registered with the ATO within 60 days of being established and you will need to elect for your fund to be regulated, so that it will be eligible for the superannuation tax concessions. This is achieved by completing the 'Application for ABN registration for superannuation entities' form **(NAT 2944)**, which is available from the ATO website.

You will also need to register your fund for GST if it is likely to have an annual turnover of more than $75,000 pa.

Annual GST turnover does not include contributions, income from financial assets (such as interest, dividends and rent from Australian residential property) and income generated outside Australia, but does include income from the lease of equipment or commercial property.

This registration must be completed within 21 days after becoming required to register for GST.

Once the ATO has approved your fund's registration, you will be issued with a TFN and ABN for your fund.

You may also need to be registered for PAYG withholding tax, such as in the case where your fund is going to make payments (lump sum or pensions) to members aged less than 60 years old.

Step 6: Open a bank account

Your SMSF will need a bank account so it can accept cash contributions, receive income from investments, pay fund expenses and pay benefits to members.

The account needs to be opened in the names of your fund's trustees and the money must be kept completely separate from your personal or business assets.

Also, your fund must hold assets before it can be legally established. This is usually done by making cash contributions into your fund's bank account.

While this can be a nominal amount, you may want to contribute say $3,000 to $5,000 so your fund will have enough cash to cover some or all of the set-up costs. Such contributions will count towards your contribution caps.[3]

Step 7: Prepare an investment strategy

You must prepare an **investment strategy** for your fund that takes into account all your fund's members' needs and circumstances before any investments can be made.

Step 8: Accept contributions and rollovers

Cash contributions can be made into your fund. Money can also be rolled over (transferred) directly from another complying super fund.

The fund that you transfer the money from will usually need to establish that your SMSF is a complying superannuation fund by looking up your fund's details on the ATO website.

It would therefore usually only be possible to rollover money to your fund when it is up and running.

Step 9: Appoint professionals

You need to appoint an independent auditor to review your fund's activities each year and ensure it complies with the relevant laws.

If you have not engaged them already in the establishment of your fund, you may also want to use the services of other **professionals**, such as a solicitor, financial adviser, accountant and registered tax agent and fund administrator.

Step 10: Plan for the future

Your fund's members should consider completing a suitable **death benefit nomination** so their super will be paid according to their wishes when they die.

The options available in your SMSF will depend on what's allowed under the trust deed.

It's important to know what type of nominations can be made in line with your trust deed and the form in which the nominations must be made to ensure they are valid.

It's important that these steps are taken to avoid disputes in relation to death benefits which can include potential beneficiaries. If disputes arise which cannot be resolved by the trustees, recourse is only available through legal advice and possible court action. This may incur significant costs.

Your fund may also want to take a range of **insurances** for you and your other fund members. This can make the cover more affordable than if your fund's members' bought it themselves outside of super.

[3] Care should be taken to avoid breaching your contribution caps as significant tax penalties may apply.

Trustee and residency rules

There are a range of trustee and residency rules that need to be met when running your own fund.

Who can be an SMSF member?

Essentially anyone can be a member of an SMSF provided they:

- are not an employee of another member unless they are related to them, and
- are not a 'disqualified person'.

A **disqualified person** is someone who:

- is disqualified by the Australian Taxation Office or the Australian Prudential Regulation Authority to act as trustee of a superannuation fund
- is an undischarged bankrupt, or
- has been convicted of an offence for dishonest conduct arising out of a law of the Commonwealth, State, Territory or foreign Government, such as fraud.

An SMSF can have between one and six members, although generally funds have two members. Common examples are a couple or two people who are in business together.

The trustee options and eligibility rules

Each member needs to be either an 'individual trustee' of the fund or a director of a trustee company, which is known as a 'corporate trustee'.

Who can be an individual trustee?

You can be an individual trustee if you are a member of the fund and so long as you are not a 'disqualified person' and are not:

- a minor (ie a child under 18 years of age) where you will need a parent (who may also be a member of the fund), a guardian or a Legal Personal Representative to act as trustee on your behalf, or
- a person with a mental or physical incapacity which prevents you from acting as trustee, where you will need another person who is your Legal Personal Representative to act as trustee for you. Typically this is a person who holds an 'enduring power of attorney'.

Which companies can be a corporate trustee?

A company can be the trustee provided:

- a director, executive, secretary or other 'responsible officer' is not a 'disqualified person'
- all directors are members
- a receiver, official manager or provisional liquidator has not been appointed, or
- action has not commenced to wind-up the company.

It is usually considered best to have a separate corporate trustee for your SMSF.

This helps keep your SMSF's assets separate from your other personal or business assets, as required by law.

Also, directors of the corporate trustee can generally only be members of an SMSF, while another company may have directors who will not be SMSF members.

What are the benefits of having a corporate trustee?

A corporate trustee can offer a number of benefits including:

- **Less cost and effort when membership changes.** With individual trustees, the title to the fund's assets needs to be transferred into the new trustees' names when a member joins or leaves the fund. Conversely, with a corporate trustee, the company holds legal title to all the fund's assets, so no transfer of names is required when members are added or removed.
- **Greater protection from litigation.** If individual trustees are involved in a legal dispute, their personal assets may be exposed. With a corporate trustee, any action will generally be limited to the assets of the company, not the company directors'.
- **Greater control for single members.** If a person who is the single member of an SMSF wants to be an individual trustee, another person must be appointed as a second individual trustee. However, a sole member can be the only director of a corporate trustee and have total control of the fund.
- **More longevity.** As a company and SMSF can continue indefinitely, a corporate trustee can provide greater certainty over the control of the fund if a member dies or becomes incapacitated.

How much can it cost to establish and run a corporate trustee?

If a new company is established, the additional costs can include:

- an upfront establishment and registration fee, which can range from around $800 to $2,000, including the cost of registering the corporate entity with the Australian Securities and Investments Commission (ASIC)
- an ASIC annual review fee
- annual accounting costs, which should be minimal unless the company undertakes other activities, and
- the ATO supervisory levy, which is paid by all SMSFs.

What are the residency requirements?

To be eligible for concessional tax treatment, your SMSF needs to meet a range of conditions, including the definition of an 'Australian super fund'.

Broadly, to meet this definition, your fund needs to be established in Australia, or at least one of the fund's assets must be located in Australia. Also, certain tests need to be satisfied.

While these rules are complex, it's important you are aware that certain components of this definition could be breached if you, or another fund member, goes overseas.

Before going overseas for an extended period, you should make sure you don't breach the requirements. If you do, your fund could become non-complying, lose its concessional tax treatment and incur penalties.

To avoid this outcome, you may want to consider your available options, which may include closing the SMSF and rolling over the money to a public offer fund, or converting the fund to a small APRA regulated fund, or if you want to maintain your SMSF you could elect for your Power of Attorney to act as trustee in your place. Your financial and taxation advisers can explain the implications of both these options.

Investment strategy and rules

Specific rules impact how and where you can invest, as well as borrow in the fund to purchase investments.

When creating and implementing an investment strategy for your SMSF, it's important to follow these six steps.

Step 1. Assess your fund's circumstances

This involves considering and addressing:

- your fund members' ages and investment timeframes, risk tolerances, assets and income expectations
- the need for diversification
- the potential risk and return from different investments, and
- your fund's liquidity and cashflow needs.

Liquidity refers to the ability to convert fund assets into cash. This may be necessary to meet fund expenses or make payments to members. This is particularly important if you or one of the other members is starting a **pension**.

It's also a good idea to keep a reasonable amount of cash or similar accessible capital-protected investments in order to avoid having to sell assets at low prices to meet fund expenses when there are fluctuations in asset values.

Some assets are more readily convertible into cash than others. For example, a property is generally considered an illiquid asset as it takes some time to sell and receive the proceeds. Also, you generally cannot sell a part of a property.

Other assets, such as shares or units in a managed fund may be more easily sold or redeemed, as you can choose to only sell a portion of the shares or units in some cases.

Step 2. Identify your fund's investment objective

An investment objective is a statement that captures the desired investment outcomes for your fund (or part thereof).

It must:

- reflect your fund's members' needs and circumstances
- be meaningful and easily understood by interested parties (such as your fund's members, auditors and the Australian Taxation Office), and
- be measurable (eg comparable to a benchmark, such as the cash rate or inflation, or index, such as the ASX200).

Ideally, the objective should include:

- a long-term return target, which may be expressed in percentage or dollar terms, or
- a statement that captures your fund's members' readiness to accept short-term fluctuations in the value of the fund's investments.

Examples of investment objectives that reflect these requirements are:

- to return, on average over a five-year period, at least 2% above inflation as measured by the Consumer Price Index and have a negative annual return no more than once in every five years, and
- to obtain a return at least matching the All Ordinaries Accumulation Index over five years.

Step 3. Prepare your fund's investment strategy

This is where your fund needs to stipulate how much it will invest in each of the asset classes to achieve the stated investment objective. This is known as developing an asset allocation.

One way to do this is to assign minimum and maximum weightings.

Using asset allocation ranges can give your fund the flexibility to achieve returns within set ranges. However, as a general rule, the ranges should not be too wide (eg 0% to 100%) as they will not be measurable or meaningful.

The table below provides an example of a well-diversified range-based asset allocation.

Asset class	Range
Cash	0% – 10%
Fixed interest	10% – 45%
Property	5% – 15%
Australian shares	25% – 40%
International shares	15% – 35%

Note: The asset allocation above is provided for illustrative purposes only and has not been prepared with your circumstances or those of your fund in mind. You should seek professional advice when considering the appropriate asset allocation for your fund.

While investing across different asset classes will suit many funds, it is acceptable from a regulatory perspective to invest solely or primarily in a single asset such as business real property.

Where this is done, the investment strategy should acknowledge the lack of diversification and the risks this can create.

It should also address what the fund plans to do to deal with the lack of asset diversity. For example, a fund could use the earnings from the single asset or new contributions to meet expenses and diversify the portfolio over time.

The investment strategy should also state that sufficient cashflow will be maintained to meet fund expenses, as well as make pension payments if a pension will be or has commenced.

Step 4. Consider insuring your fund members

You should think about whether your fund should take out life, total and permanent disability and income protection insurances on behalf of the members.

While there is no legal obligation to actually take out insurance, it must be documented that **insurance** was considered and the reasons for taking or not taking out the insurance.

Step 5. Accept and implement the strategy

The next step is for you and your fellow trustees to meet, discuss and agree on the strategy for your fund and document the decision in the minutes of the meeting.

The minutes should include the names of your fund's trustees, the date of the meeting and where it took place, and a statement acknowledging that the investment strategy has been adopted.

It may be necessary to include an effective date if the strategy will apply from a date after the meeting. Ideally the minutes should be signed by all trustees.

Investments made after accepting the investment strategy must be consistent with the strategy.

If you want to make an investment in your fund that is inconsistent with the investment strategy, you should review and amend the investment strategy prior to acquiring the asset so the investment is consistent with the fund's investment strategy.

Step 6. Review the investment strategy

You also need to monitor the performance of your fund's investments and review the strategy on an ongoing basis.

This should be done at least once a year, but more frequent reviews are a good idea to ensure you are optimising your investments, and minimise the risk of mismanagement or fraud (which is generally rare but not unheard of due to the close nature of SMSF relationships).

When reviewing your investment strategy some things to consider include:

- have any members joined or left your fund
- have any members made significant contributions
- does your fund need to pay benefits to a member
- has a member's circumstances changed
- have there been significant movements in investment markets, or changes in the economic climate, and
- has there been (or about to be) a significant change in legislation?

If you answer YES to any of these questions, the investment strategy may need to be altered by working through steps 1 to 5 again.

In the case of significant changes in the superannuation legislation, you may also need to review your trust deed and update it.

A good SMSF administrator will assist you by keeping you up to date with changes, and may provide a deed updating service. It is important to remember though, that you (and any other trustees of your fund) are ultimately responsible for ensuring that the fund complies with any changes to legislation.

The ATO provides a wide range of information and resources for trustees of SMSFs to assist you in keeping up-to-date.

Other key investment rules

There are a number of investment rules that apply to SMSFs.

The sole purpose test

The 'sole purpose test' requires that all your fund's investments are made for the sole purpose of providing benefits for your fund's members upon their retirement or their beneficiaries if a member dies. Other ('ancillary') benefits can also be provided, such as total and permanent incapacity benefits or benefits for temporary incapacity, among others.

The related party transaction rules

The general rule is that an SMSF cannot acquire assets from a member or other related party. There are limited exceptions to this rule including:

- business real property (eg a warehouse from which a business is run, either by yourself or another entity)
- listed securities (eg shares in companies listed on a stock exchange)
- units in widely held unit trusts (eg publicly available managed funds), and
- investments in a related party or other 'in-house assets' where the total value of all such assets doesn't exceed 5% of the total market value of the fund's assets.

The Australian Tax Office (ATO) has the power to 'look through' certain arrangements to see whether the related party transaction rules have been breached.

For example, if a member sells an asset that an SMSF cannot acquire from a related party to an unrelated party on the agreement that the SMSF acquires the asset, the ATO could deem that the related party transaction rules have been breached after looking through the arrangement.

Effectively such an arrangement could be seen as having been entered into to circumvent the rules.

Different rules also apply for tax purposes to related party investing by super funds.

Broadly, the types of investments that are not considered to be at arm's length for tax purposes include investments resulting from dealings where the parties are not dealing at arm's length, certain private company investments and non-fixed trusts.

Income from non-arm's length investments and other non-arm's length arrangements is taxed in the super fund at 45% rather than at the concessional rate of 15%.

Running a business in an SMSF

Running a business through your SMSF could breach the superannuation laws.

Some guidance on 'carrying on a business in a self-managed superannuation fund' can be found on the ATO website.

The principal concern is whether the arrangement breaches the sole purpose test (see above).

Activities that provide a benefit, either directly or indirectly, to your fund's members or another related party would be considered inconsistent with the sole purpose test.

This is a complex area and each situation would be assessed by the ATO on a case-by-case basis.

If there is any uncertainty, it may be worthwhile applying for an ATO SMSF specific advice to understand the implications for your specific situation or obtain expert legal advice.

Investment strategy and rules

The 'in-house asset' rules

Certain assets are classified as 'in-house assets' and include:

- a loan to a related party such as a member's private company
- an investment in a related company or trust, and
- a lease to a related party.

The legislation limits the total amount of in-house assets to 5% of the market value of the assets of the fund to ensure investments are made for the sole purpose of providing retirement benefits.

There are certain exceptions to the in-house rules. The most common one is business real property. For example, a commercial property which is owned by an SMSF can be rented to a related party and will not count as an in-house asset.

You must monitor the percentage of in-house assets on an ongoing basis and make any adjustments required.

The arm's length rules

All investments must be made on an arm's length (ie commercial) basis and reflect the market value for the assets regardless of who buys or sells the assets.

The restrictions on providing financial assistance to related parties

SMSFs cannot provide financial assistance to a member or other related party. Financial assistance is defined broadly and includes aid, help or a benefit.

Examples may include:

- gifting an SMSF asset
- selling an SMSF asset at less than market value
- the SMSF purchasing an asset for a higher amount than market value
- forgiving a debt owed to the SMSF
- the SMSF satisfying a financial obligation on behalf of a related party, and
- allowing SMSF assets to be used as security for the benefit of a related party.

Channelling money through or conducting a transaction with other entities, such as a private company or trust, cannot be used to avoid the application of the rules.

Borrowing with an LRBA

SMSFs can use a 'limited recourse borrowing arrangement (LRBA)' to buy assets such as shares and property that it currently doesn't have enough money to purchase outright.

This is a complex strategy and before your fund uses it, you should consider seeking professional advice.

How LRBAs work

To establish an LRBA, your SMSF will need to take out a loan with a lender, usually a bank, and invest the borrowed money and some cash already in your fund in what's called a 'security trust'.

The security trust uses the money to purchase an eligible asset on behalf of your SMSF and the asset is held as security for the loan. The security trust has legal ownership of the assets, while beneficial ownership of the assets rests with your SMSF.

The loan agreement or contract must contain a condition that if your SMSF defaults on the loan, the lender can only access the asset securing the debt and no other fund assets. While this offers some protection for your fund's members, it also generally means banks will generally lend less than if you were to borrow to buy the same asset in your own name, where other assets could be accessed.

Once the LRBA is established, the SMSF:

- receives the income from the investment, which is taxable in the fund
- makes payments to the lender
- may be able to claim the interest and certain other expenses as a tax deduction, and
- has the right to acquire legal ownership of the asset when sufficient repayments have been made.

What assets can be acquired?

SMSFs can only use an LRBA to purchase what is known as a 'single acquirable asset'. Examples include:

- a single property and the accompanying land
- shares of the same type (eg ordinary shares) in a single company at the same market value, and
- units in a unit trust that have the same fixed rights attached to them and at the same market value.

If an SMSF wants to use an LRBA to invest in a range of shares or unit trusts, a separate LRBA will need to be established for each company, share type or unit trust. However, the lender may take care of this administrative task for the fund.

Additional restrictions apply if an SMSF wants to acquire an asset from a fund member or related party. In this scenario, the list of acquirable assets generally does not include residential property (which must be bought from the open market) and is limited to:

- business real property (eg a warehouse from which a business is run either by yourself or another entity)
- listed securities (eg shares in companies listed on a stock exchange)
- units in widely held unit trusts (eg publicly available managed funds), and
- investments in a related party or other 'in-house' assets where the value doesn't exceed 5% of the total market value of your fund's assets.

Also, importantly, the arrangement must be entered into for the 'sole purpose' of providing retirement benefits for the fund's members, or to their dependants if a member dies before retirement.

This generally means that the fund's members cannot derive any other benefits from the investment. For example, your fund's members and their relatives generally can't stay or live in a residential property acquired by your SMSF from a third party.

Often SMSF trustees want to borrow to buy an investment property, and renovate the property to improve its value. While this is possible, improvements to assets acquired under an LRBA are subject to some very important limitations.

Examples of improvements to assets acquired using an LRBA that would not be permitted include subdivision of vacant land, adding a residence to vacant land and renovations which convert the use of a property from residential to commercial.

Examples of acceptable improvements include renovating bathrooms and kitchens or converting a carport to a garage. Importantly, any improvements cannot change the character of the asset and cannot be funded using borrowed money. Other assets of the SMSF must be used to pay for these types of improvements.

Lenders may impose other limitations on their loan arrangements. Many will not lend for vacant land, for example. Maintenance and repairs of an existing property is generally permitted. Please speak to an SMSF specialist if you wish to know more about LRBAs and what is permitted.

Borrowing with an LRBA

General tax considerations

Income from the investment purchased with an LRBA will generally be taxable in the fund at a maximum rate of 15% (or 0% if the asset is being used to support the payment of a retirement phase pension from the fund).

Conversely, earnings from investments purchased personally are taxable at your marginal rate, which can be up to 47%[5].

Borrowing in an SMSF can be more tax-effective than borrowing personally if the investment is positively geared (ie the income from the investment exceeds the loan interest and certain other expenses).

This is because the excess income will generally be taxed at a maximum rate of 15% in the fund, rather than your marginal tax rate.

Conversely, negatively geared investments can be more tax-effective if held in your own name. In this scenario, you'll receive more value for the excess tax deductions than your SMSF would if your marginal tax rate exceeds 15%.

But even if an investment is negatively geared at the outset, borrowing in super may still be a better option. This is because negatively geared investments may become positively geared over time. Also, regardless of whether the investment is positively or negatively geared, less capital gains tax will generally be paid on the sale of the investment if it is held in a super fund.

[5] Includes Medicare levy.

Note: There may be limits to the amount of interest that can be claimed as a deduction under an LRBA, as certain products may be considered to be 'capital protected' for tax purposes.

Is borrowing to acquire an asset appropriate?

Before your fund uses an LRBA to acquire an asset, you should be aware that:

- borrowing can magnify losses, particularly over the short term
- if the loan repayments and other eligible expenses exceed the income from the investment (ie the investment is negatively geared) and there is insufficient cash in your fund to cover the shortfall, your fund's members will need to make contributions, as the SMSF must meet its liabilities as these fall due
- these contributions will count towards the members' contribution caps
- there are often significant costs associated with setting up an LRBA, and
- penalties may be imposed if you don't comply with the rules and obligations.

Before your fund uses an LRBA to acquire an asset, you should think about whether:

- the strategy and its associated risks suits your fund's members' retirement goals, investment objectives and risk tolerances
- your fund will have sufficient liquidity to meet the ongoing costs
- your fund's members will have sufficient money outside super and capacity within their caps to add money to the fund if required to meet any cashflow shortages, and
- you are aware of what you need to do to avoid any compliance breaches.

If the strategy is appropriate, you should also take a number of steps before putting it in place. These include ensuring your fund's trust deed allows borrowing and the arrangement is addressed in your fund's **investment strategy**.

Your fund's members may also need to be insured so that money will be available to service or pay off the debt and pay out their account balances if they were to die or become disabled.

Insurance is particularly important if your fund intends to borrow to buy a single asset of significant value, such as property, where a forced sale may otherwise be required. However, care needs to be taken to ensure the insurance doesn't create a large liquidity problem for the SMSF, or is inconsistent with the law.

General insurance is also critical where real property is acquired by an SMSF. Real property needs to be insured for damage to the property, and third party indemnity insurance must be owned by the trustees of the SMSF in order to cover persons injured while on the premises. The SMSF trustees, as owners of the property, can be sued for personal injury claims.

The lender in an LRBA can be a related party. If this is contemplated you should ensure that any loan is entered into on arms length terms. The ATO has stringent requirements for such loans and failure to meet them can expose the fund to tax and other penalties. Also, the outstanding balance of a related party LRBA can increase the 'total super balance' of members. Total super balance is used for purposes including determining eligibility to make certain types of super contributions.

Insuring in an SMSF

If you need life, any occupation total and permanent disability (TPD) or income protection insurance, you may want to arrange for your SMSF to take it out on your behalf.

This could make the cover more affordable than insuring outside super.

How it works

In simple terms:

- the trustees take out the insurance on your behalf
- your SMSF owns the policy
- the premiums are paid by your SMSF
- the cost of the premiums is deducted from your super account, and
- you can make super contributions to cover some or all of the expense, although this is not essential so long as your super account has sufficient money.

If a claim is paid by the insurance company:

- the proceeds will be sent to your SMSF, and
- the value of the policy payout will be added to your super account balance.

You or your beneficiaries may then be eligible to receive some or all of your super and the options available depend on the type of insurance, your specific situation and the governing rules of your fund.

Note: Similar benefits and concessions may be available if you have insurance in a publicly available super fund, such as a retail or industry fund. You may also find that the premiums are lower in a publicly available super fund than what you'd pay if you took out equivalent cover in your SMSF. In some cases, it may be worthwhile retaining any existing insurance in a publicly available fund. To do this you may want to keep the account open and retain sufficient funds in the account to cover ongoing insurance premiums.

The benefits

A key benefit of insuring in super is that premiums are deducted from your super account balance rather than being paid directly by you from your bank account.

This could be attractive if you currently can't (or would prefer not to) pay the premiums directly due to cashflow constraints. However this is likely to reduce your superannuation savings.

Another benefit is that if you make super contributions to cover the cost of life and TPD insurance, you could benefit from concessions generally not available when buying these insurances outside super. For example:

- if you're an employee, you may be able to arrange with your employer to contribute some of your pre-tax salary into your SMSF, by establishing a 'salary sacrifice agreement', which will effectively enable you to pay for the insurance arranged by your super fund with pre-tax dollars
- if you make personal super contributions, you may be able to claim the contributions as a tax deduction, even when used by your super fund to buy insurance
- if you earn less than $57,016[6] pa and you make personal after-tax super contributions, you may be eligible to receive a Government co-contribution of up to $500 that could help you cover the cost of future insurance premiums, and
- if you have a spouse whose assessable income, reportable fringe benefits and reportable employer super contributions is less than $40,000 pa and you make after-tax super contributions on their behalf, you may be able to claim a spouse tax offset of up to $540 that could be put towards future insurance premiums for yourself or your spouse.

These concessions can make life and TPD insurance more cost-effective. This will usually also be the case if you increase the amount of cover to compensate for any lump sum tax that is payable on death and TPD benefits in certain circumstances.

You should be aware, however, that super contributions count towards the contribution caps (regardless of whether they are used to pay for insurance or make investments). So make sure you take into account your contributions caps before you add money to your super fund to pay for insurance. Breaching the contribution caps may result in significant tax penalties.

Note: You can generally claim the premiums as a tax deduction if you take out income protection insurance outside super. As a result, the after-tax premium costs for income protection insurance will generally be the same within and outside super. The exception is where your income and concessional contributions exceed $250,000 in 2022/23, in which case the after-tax premium costs for income protection insurance will be higher in super than outside super – see **effective tax rate table**.

6 Includes assessable income, reportable fringe benefits and reportable employer super contributions (of which at least 10% must be from employment or carrying on a business).

Insuring in an SMSF

Types of cover

Life insurance

If your SMSF takes out life insurance for you and you pass away, the value of the insurance proceeds that are added to your account must be paid either as a cash or in specie benefit (along with the rest of your super balance) to your eligible beneficiaries as a lump sum, a pension or a combination of both.

You can let the remaining trustees decide who will receive your super, or you can complete a nomination specifying **who will receive the benefit on your death**.

Total and Permanent Disability insurance

If your SMSF arranges any occupation total and permanent disability (TPD) insurance for you and you meet the TPD definition in the policy, the insurance proceeds that are paid to your SMSF will be added to your super account. The payment from your super fund to you can only be made if you meet the definition of 'permanent incapacity' under superannuation law.

This definition requires you to be classified by two medical practitioners as being unlikely to be able to be employed again in 'any occupation' for which you are reasonably qualified by education, training or experience.

Note: Since 1 July 2014, it is not possible to purchase an 'own occupation' TPD policy in any superannuation arrangements (although policies owned before that date are now grandfathered).

Accessing the money won't be an issue because the 'any occupation' policy definition is consistent with the 'permanent incapacity' legal definition. However, some TPD policies acquired by SMSF trustees prior to 1 July 2014 have a TPD definition that is different to the definition of permanent incapacity. A common example is policies that pay a benefit if you can't work in your 'own occupation' rather than 'any occupation' that may be suitable.

For these types of policies, you may not be personally entitled to receive the insurance proceeds on the happening of the insured event. However, the proceeds are usually credited to your account and are available to you once you meet a future 'condition of release'.

Income protection insurance

If you are unable to work due to illness or injury, up to 70%[7] of your pre-tax income will be paid to your fund. However, you will also need to meet the definition of 'temporary incapacity' under superannuation law before the money can be paid to you.

To meet this definition, the trustees will need to decide that you suffer from physical or mental ill-health that means you cannot be employed or self-employed but are not permanently incapacitated.

If you satisfy this requirement, the insurance proceeds must be paid to you as a non-commutable income stream. This is a type of income stream that can be paid by a super fund where the money generally can't be taken as a lump sum and the income payments are taxed at your marginal tax rate, plus the Medicare Levy.

In the rare scenario that you don't meet this definition, you will only be able to access your super as lump sum or pension if you meet one of the other relevant 'conditions of release'.

Effective tax rates payable

The table below summarises the effective tax rate (ignoring the Medicare levy) that will be payable when taking out life, TPD and income protection insurance within and outside super for people who earn above and below $250,000 pa.

[7] Income protection insurance taken out on or before 1 October 2021 will generally replace up to 75% of your pre-tax income.

Insurance	Income <$250,000		Income $250,000+	
	Inside super	Outside super	Inside super	Outside super
Life	0%	Marginal tax rate	15%	45%
TPD	0%	Marginal tax rate	15%	45%
Income protection	0%	0%	15%	0%

Starting a pension

Some steps and rules need to be followed when starting a pension in your SMSF.

Paying a pension from your SMSF can enable your fund's members to receive regular and tax-effective income throughout their retirement.

A pension is generally commenced only when you reach your preservation age, retire on or after age 60, reach age 65, or meet another 'condition of release'. Here are ten steps to consider when starting a pension. While they sound complicated, a specialist accountant, financial planner or SMSF administration service can assist with this.

Note: Since 1 July 2017, there is a limit on how much super you can transfer to 'retirement phase' during your lifetime. This is known as the 'transfer balance cap' and in 2022/23 it's $1.7 million. This cap will be indexed in future years. Your personal TBC may differ.

Step 1. Consult the deed

Before paying a pension, you should arrange for a suitably qualified person to check and review your fund's **trust deed** to make sure it allows a pension to be paid.

Some older or poorly drafted deeds only permit lump sum payments.

Also, many deed provisions will influence when a pension can be paid, who can receive a pension and how pensions are to be operated and administered.

Step 2. Put request in writing

The member who wants to start a pension must make a request, in writing, that the trustees start paying a pension to them.

The request must indicate the pension's intended start date, the level of income required and the frequency of pension payments.

The member must provide the trustees with a Tax File Number declaration and details for the bank account into which the pension is to be paid.

The member should also consider completing a **death benefit nomination** for their super.

Step 3. Validate and record request

The trustees need to validate the request by ensuring the member has satisfied one of the relevant 'conditions of release'. They then need to record in the fund's minutes that a valid request to start a pension has been received and a resolution has been made to pay the pension.

Step 4. Issue a PDS

The trustees must consider whether they need to provide a Product Disclosure Statement (PDS) if they have not already done so. Some legal firms have created a generic PDS that can be amended for specific circumstances.

Step 5. Register for PAYG

If not already done, the trustees must then register for 'pay as you go' (PAYG) withholding tax if the pension is to be paid to a member under age 60. This must be done before the first pension payment is made.

The trustees must also complete a 'PAYG payment summary – superannuation income stream' form if they withhold tax from a member benefit payment.

If a payment summary is issued, the trustees also need to lodge a PAYG withholding payment summary statement with the ATO by 14 August for the previous financial year.

Lodgement of payment summaries and PAYG withholding reports may be done electronically using the ATO's secure data exchange software.

Step 6. Determine market value

The trustees must then determine the market value of the assets supporting the pension on the day the pension commences.

When determining the value of the member's account balance, the trustees must also account for all income and contributions received during the year.

Step 7. Determine components of the member's account

The tax-free and taxable components of the member's account must be determined at pension commencement and this proportion needs to be applied to each pension payment where tax is payable.

If the recipient is 60 years or older and their pension payments are not taxable, the components of the member's account must still be calculated and recorded as they are relevant for death benefit lump sum payments that may be made in the future.

Step 8. Review investment strategy

When starting a pension, it is important to review your fund's **investment strategy** to ensure it reflects the member's retirement needs and adjust the strategy if necessary.

Members will often need to hold more cash in the pension phase than in the accumulation phase in order to meet pension payments and other liabilities.

It's important that the actual investments reflect the objectives and investment strategy.

When changing investments, the objectives and strategy should be amended to ensure consistency.

Step 9. Select segregated or non-segregated method

Your fund may be able to use the 'segregated' or 'non-segregated' method to determine the proportion of the fund's income that is exempt from tax. The trustees should decide which option best suits their fund's needs and situation before they start the pension.

A specialist accountant or SMSF administrator can assist you to understand how these strategies work and which is right for your fund, as well as ensure that your fund's strategy is correctly managed for tax purposes.

Step 10. Start the pension

The trustees then need to start paying the pension.

The member must be notified in writing of the applicable minimum payment as well as the tax-free amount.

If the member is under 60, the trustees may need to withhold tax from the pension payments.

Deadlines apply to making the payment of the PAYG to the ATO. The dates that the payments are due will depend on how much tax has been or is expected to be withheld from members in a financial year.

The SMSF must report the pension to the ATO. The reporting obligations and timeframes depend on a number of factors and you should consult with a specialist accountant or SMSF administrator to assist with meeting this requirement.

Finally, the trustee must ensure all the requirements of a super pension are satisfied for the entire financial year.

SMSFs and estate planning

There are some unique rules, obligations and opportunities for SMSFs when paying death benefits.

When an SMSF member passes away, the list of potential beneficiaries, payment options and taxation treatment of the payments is essentially the same as an ordinary retail super fund.

Also, like other super funds, the trustees generally have the discretion to decide how and to whom a death benefit is paid unless certain legal arrangements exist or are put in place before the member's death (see below).

There are, however, some key differences in the way death benefits can or need to be dealt with in an SMSF, as well as some unique obligations and opportunities.

Ways to remove trustee discretion

Reversionary nominations

Like other super funds, it is possible to nominate for certain beneficiaries to automatically continue to be paid an income stream when the original income stream recipient passes away. The trust deed will set out the types of death benefit nominations that can be made and any requirements for nominations to be valid.

Commonly, this occurs in the case of spouses. Where this occurs, the deceased member's account balance is transferred into the name of the surviving spouse within the SMSF, where it becomes a death benefit pension.

Many SMSF trust deeds provide that reversionary nominations take precedence over any later nominations, at least in relation to the value of that income stream.

It should be noted, however, that some trust deeds provide that a later binding death benefit nomination (see below) would override not only earlier binding nominations, but also reversionary nominations.

Care should therefore be taken to fully understand the rules that apply to the particular SMSF.

Legally binding death benefit nominations

If allowed for in the SMSF's governing rules, it's possible for a binding nomination to bind the trustees to the type of benefit to be paid, as well as who will receive the benefit.

For example, a member could bind the trustees to pay an income stream on their death to an eligible dependant, such as a spouse.

It's important the binding death benefit nomination exactly follows the rules of the particular SMSF that specify what's required for the nomination to be binding on trustees following a member's death.

Contingent nominations

Specific nominations can be incorporated into the trust deed of the SMSF, as part of the fund rules.

This type of nomination provides a greater certainty they will be paid in accordance with the deceased member's wishes. For example, a member may choose to leave 100% of their superannuation to their spouse.

Additional clauses can then provide that in the event of the death of the spouse before the member, 100% will go to alternative beneficiaries – usually the adult children of the deceased or the estate to establish a testamentary trust.

In other words, a contingency can be put in place should part or all of the original nomination fail for some reason.

This contingency option is not available in binding death benefit nominations offered by other super funds. Instead the nomination must be amended to accommodate changes in circumstances.

Discretion or certainty

While the arrangements outlined above can provide greater certainty, flexibility can be important, depending on your fund member's needs and circumstances.

This could include, for example, members who have children whose tax-dependency status can change, or where there are potential creditors or anticipated challenges to the estate.

With discretion, the trustee(s) can determine the best approach at the time of death by taking into account:

- the potential tax treatment of the payments
- how the estate will be divided, and
- the beneficiaries' circumstances at the time.

If this path is taken, careful planning is required to ensure the governing rules have clear trustee succession rules (including allowing the executor to step in for a deceased member) and just as importantly, clear voting rights.

Also, the member needs to be comfortable that the persons acting as trustees will act in the best interests of the potential dependants.

Remember, that should disputes arise between the trustees and beneficiaries, legal action may be required including seeking resolution through the courts.

Note: When deciding which types of death benefit nomination to complete, it is important to take into account broader **estate planning** arrangements, and the impact of the 'transfer balance cap' and a range of other issues that are beyond the scope of this guide to discuss in any detail. You should also seek professional advice.

Your notes

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