SELF-MANAGED SUPER FUNDS

Three tips on how to nurture your fund

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If you're a self-managed super fund trustee, you will likely already be aware of the benefits of running your own super fund, including the choice, control and transparency you have in your retirement planning.

But while there are many benefits to managing your own SMSF, there are also many pitfalls to avoid. An SMSF is by no means a set-and-forget venture; much like growing a garden, growing your wealth through an SMSF requires time, care and an understanding of your environment for it to flourish and bloom in the springtime of your life.

Over and above asset allocation, administration and portfolio management are crucial, particularly since the decisions you make today will affect your financial wellbeing tomorrow. If this sounds intimidating, that's because it can be. Many Australians are now opting to outsource these responsibilities by partnering with professionals, given the changeable financial environment in which we live. Indeed, keeping abreast of market fluctuations and adjusting your retirement strategy accordingly can be complex and time-consuming — particularly following legislation changes, with the latest super reforms presenting just one example of the complexities of operating an SMSF by yourself.

The government's superannuation overhaul this year has changed the environment within which you grow your super. Many core rules remain unchanged, including the 9.5 per cent Superannuation Guarantee and the work test for the over-65s. However, of the many substantial changes that were implemented, one of the most significant was the reduction in the amount of non-concessional (or after-tax) contributions that you can make over a year. These changes not only affect how much you can contribute to super, but also the kinds of contributions you can make — and getting this wrong as a do-it-yourself SMSF trustee could set your growth trajectory back and potentially result in harsher penalties than in years past.

As the value of your savings typically underpins the overall quality of your retirement, ensuring you're up-to-date with the super changes is important to your financial wellbeing. For many SMSF trustees, this could mean re-evaluating market movements, taxation, compliance, succession planning; a whole lot of paperwork and time that many simply do not have. However, while the super reforms have presented a complicated time for SMSF trustees, they have also presented them with the opportunity to clear out the weeds in their portfolios and realign their retirement strategy with their long-term goals. Here are some things you can do to ensure you're on track:

Review your financial strategy. As you near retirement, it's important to regularly re-evaluate your wealth strategy. Some of the most important decisions you'll make about your SMSF will occur within the 10-15 years leading up to retirement. Therefore, it's essential that as you move from a career into life after work, your retirement strategy is still aligned with your long-term goals. This can include reviewing your contribution strategies, cashflow requirements and asset management structure. It may also include reviewing or updating your estate plan as changes to legislation may affect the ways in which your wealth is distributed when you pass away.

Consider options beyond cash and shares. While traditional assets such as cash and Australian shares can be tried and true avenues for investment, in a low-interest-rate environment, you may also benefit from considering alternative options outside these asset classes. Property, renewable resources and disruptive technologies are all good examples of the kinds of assets you could invest in to further diversify your portfolio and grow your wealth faster.

Get on top of your portfolio for good. Finally, you'll have the opportunity to thoroughly review your methods to ensure you're meeting compliance requirements. From reconsidering the viability of arrangements, such as salary sacrifice and limited recourse borrowing arrangements, through to the appropriate placement of your funds, now is your opportunity to streamline your processes and reviewing your strategies. Running your own fund can certainly be complicated and time-consuming, but the good news is that you don't have to do it alone.

A lot of people take the DIY route or work with multiple

> The government's superannuation overhaul has changed the environment

professionals who simply don't have a holistic view of your wealth strategy. But when you partner with a specialist SMSF supported service, you retain full control over the decision-making of your SMSF, with the benefit of direct access to advice from a diverse team of highly qualified advisers who will support the day-to-day management of your fund. Your team will actively monitor your portfolio, give you access to online reporting systems and ensure you have all the tools you need to keep your bases covered — including complex administration, compliance, taxation and portfolio-management aspects. Did we mention that while you retain control, they also handle the lion's share of the paperwork?

While partnering with a team can help take the weight off your shoulders so you can spend less time worrying about portfolio management and more time on the things you love, you can't just partner with anyone. The difference between "good" and "great" among SMSF service providers can be their team's commitment to education, personalisation and true partnership. Indeed, your team's diverse skillset, industry knowledge and dedication to their craft will determine how well they guide you — a process which could make or break your wealth-creation journey. If your wealth is a garden, get the tools you need to help it flourish and bear fruit through every season of your life.

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Rules for reporting are tougher

While administration of self-managed superannuation funds has never been a simple process, a raft of new (and proposed) rules mean the paperwork has become much more arduous and it is questionable whether fund trustees are fully aware of the heightened requirements.

Most of the changes relate to the so-called post-July 1 regimen, although the Australian Taxation Office has been progressively updating reporting requirements (and attendant penalties for breaches) for some years.

The July 1 changes relating to pension fund and contribution caps were well heralded and even created a high-profile kerfuffle in some blue-ribbon seats including Peter Costello's old domain of Kooyong.

Given that, ignorance is no excuse but the minutiae of the requirements are complex enough to catch out many trustees (and even their advisers).

Under the changes, the tax-free component of super pension balances was capped at $1.6 million.

Annual concessional contributions were reduced from $30,000-$35,000 to $25,000 and the after-tax contributions cap was pared from $180,000 to $100,000 (with the ability to contribute three years of payments, or $540,000, before July 1).

While the new cap and contribution rules were estimated to affect only 4 per cent of the general populace, the SMSF Association calculates 90,000 of the country's 600,000 SMSFs — 15 per cent — will be affected.

With July 1 now a dot in history, the time has passed for pre-emptive strategies such as transferring excess pension fund amounts to the spouse's fund by the allowable $540,000 before July 1.

Still, says Adelaide financial planner Theo Marinis, "various matters" need to be addressed. These include removing any small remaining balances in excess of the $1.6 limit, due to any miscalculation or underestimation of the June 30 balance.

Under a transition period that ends in December, amounts above the cap up to $100,000 are not subject to penalty — as long as they are dealt with by December.

Other housekeeping actions include revising super sacrifice arrangements to fit under the $25,000 cap. Contributions over and above this level could incur the excess contribution tax (ECT) rate of a hefty 49 per cent.

Under a transitional measure, the ATO applied capital gains tax relief for assets moved from the pension to accumulation phase. Under the concession, the value of the asset is reset to the July 1 market valuation.

But funds doing so need to apply actively for this relief. More importantly, they need to avoid the temptation to inflate the value of assets to create an artificially high cost base to offset future CGT liabilities.

Marinis warns the ATO is generally wary of funds that manipulate valuations, including underestimating them to squeeze assets within the $1.6m pension cap.

Borrowings are another key area for administrative attention.

Unlike normal super funds, SMSFs can borrow but the loan must relate to a specific asset (and must be non-recourse: the lender cannot recoup losses from other fund assets).

The government considered making the outstanding borrowings part of the $1.6m cap. Instead, it is proposed the only repayments form part of the pension account.

Under a proposed framework, the ATO proposes to take it further with a so-called "event-based" or real-time reporting regimen, replacing the requirement for most funds to report only annually.

On the reporting side, trustees need to notify the ATO of significant changes to pension fund balances. This includes conversions of pension amounts to lump sums and limited recourse borrowing arrangements.

SMSF Association head of policy Jordan George says advisers are starting to realise they don't need to just counsel on investment strategies but also on how to comply. While the ATO has not set the rules in stone — an options paper attracted an unprecedented 170 submissions — it is proposed the funds report quarterly over a two-year transition period, from July 2018. After that, monthly reporting would apply.

Originally, the ATO was not planning a threshold, even though the majority of funds are not affected (at least immediately) by the new pension cap.

The SMSF Association proposes individual funds with $1m or less should be exempt from the requirements.

"We have to see where they land on that one," George says. While slipping up has never been easier, the penalties for reporting and other breaches are now harsher.

For breaches of reporting rules, the value of a "penalty unit" has increased to $210 from $180, with per-breach penalties ranging from $1050 to $12,600.

These penalties have already been increased twice since being introduced in July 2014.

Examples of transgressions include breaching the borrowing limits, failing to properly prepare financial accounts and statements and failing to keep SMSF amounts separate from personal assets.

The good news is that heavy-handed powers available to the ATO have been watered down.

Under the old regime, the ATO could fine half of the assets and disqualify (or even jail) a trustee. Instead, the ATO can impose a range of penalties or plump for rectification or education orders.

Officially, the ATO is willing to assist trustees "who are willing to engage with the ATO to self-correct and rectify regulatory issues in their fund."

Despite this "firm but fair" credo, the tighter pension rules and concomitant reporting requirements appear to have deterred new self-managed funds.

On ATO numbers, there were 585,000 self-managed funds at the end of December 2016, with $654 billion under management.

Investment bank Credit Suisse estimates about 13,000 funds were created in the December half, compared with the historical average of 15,000.

"We are not surprised with the drop off in new 'selfies'," the firm says. "We think the changes to superannuation make it less attractive to start up an SMSF and we should expected less new funds starting in the future."

George concurs there has been a "slight slowing" in new SMSFs over the last 18 months to two years.

Not so much about the new rules, but years of speculation about all manner of superannuation rule changes. It will be very interesting to see whether the numbers bounce back in the next year or two," George says.

"We think it's more about uncertainty rather than people saying super isn't such a good deal any more."

Financial planner Theo Marinis says the Taxation Office is wary of valuations that may be an attempt to fit under caps

Perils of estate planning: it takes more than a will to find a way

The July 1 changes to the treatment of super balances created complexity in spades — and one tax-effective solution may be early gifting to children.

In any event, the unwelcome changes hopefully will prompt SMSF members to plan for their own mortality and ensure that beneficiaries — both the surviving spouse or children — are not unnecessarily disadvantaged.

"As you age, planning for the management of your SMSF and the effective distribution of your estate can be a very personal, sensitive and complex issue," Dixon Advisory managing director David Calvert says.

"Many of us understandably don't like to talk about it. But it's an incredibly important area to manage properly."

At the nub of the estate planning issue are two impediments: the new $1.6 million pension cap and the 17 per cent tax on payments to non-dependant beneficiaries (the unambiguously titled death benefits tax).

According to Ben Smythe of Smythe Financial Management, spouses have usually nominated a reversionary pension to the surviving member on death.

But the new rules mean the surviving spouse may not have space in his or her own tax-free pension balance to fit in the deceased spouse's assets.

The practice of making a binding nomination — the statement of intent as to whom the benefit should go to — is still valid. But the surviving member cannot roll back the inherited income stream and keep it in the accumulation account.

"It is important to note that any death benefit amounts that would push an individual above the $1.6m limit need to be paid out as a lump sum to the beneficiary," Superconcepts director Kris Kitto says.

"One tip to deal with this scenario is for the surviving spouse to partially commute a portion of their pension back to their accumulation account prior to receiving the death benefit pension from their spouse. This enables more monies to be retained in the low-tax SMSF environment."

Another hint is to treat amounts over and above the mandated minimum pension payment as partial commutations, rather than additional pension payments. This is because commutations reduce a person's transfer balance account balance, allowing room for additional amounts to be added in the future.

Couples not hellbent on spending their kids' inheritance should consider early gifting of these assets to adult children.

"One strategy is to withdraw excess amounts as a lump sum and give (or lend) it to the children tax free," Adelaide financial planner Theo Marinis says. "While they are taxed when investing it personally, they could choose re-invest it into their super fund whether it's the SMSF in question or not."

Marinis says with a mandatory draw down requirement of 7 per cent a year (for those aged 80-84), a pension account with $1.6m generates $112,000 of annual tax-exempt income.

For the majority of 80-somethings without expensive lovers on the side, that's more than enough to fund a very comfortable lifestyle.

As for the death benefits tax, it becomes due when there's no one left in the SMSF to draw the pension. This means the fund assets revert to accumulation phase with the earnings then taxed at 15 per cent. They're then subject to the death tax when paid to non-spouses and non-dependants.

While death and taxes are meant to be inevitable, Marinis describes the death benefit tax as an "optional" impost because with careful estate planning it can be avoided.

He adds that for some unfortunate beneficiaries, it's possible to cop the 17 per cent death benefits lump sum after the fund has already paid capital gains tax on any fund assets that need to be sold to fund the impost.

This is because in addition to the lump-sum death benefits tax, CGT is levied at 10 per cent on a fund asset held for more than a year and 15 per cent if the asset has been held for less than 12 months.

"To work around the CGT sting, the only solution is to regularly review and rebalance the portfolio periodically and thus reset the CGT cost base," Marinis says, adding the taxman won't accept any manipulation of a CGT cost base.

Smythe says it's critical that any SMSF estate plan set up before July 1 2017 is reviewed and updated. "You may well find that you have an estate plan for your pension balance up to $1.6m and a different estate plan for your balance over $1.6m," he says.

Another key aspect of estate planning is that the super fund is only one part of the member's greater wealth. As with all super, SMSF assets are not covered by the personal will of the member.

Usually the SMSF benefits are paid to the legal personal representative (the executor) but this does not happen automatically as many people (even advisers) believe.

As always, it is important to have a well-drafted will (and power of attorney) and a well-structured SMSF trust deed. The time to take control is now, not after the Grim Reaper knocks. If the $1.6m cap is not an issue — and that's the case for the majority of SMSFs — the cleanest way remains to have the pension automatically revert to the spouse.

This is not considered a superannuation death benefit and overrides any death benefit nominations that are in place.

Dixon's Calvert says it is vital to document the important legal things in the event of a critical event, which may not be death but mental incapacitation or illness.

He says SMSF members should think carefully about whether the surviving spouse really wants the responsibility of restructuring the fund. If that's the case, a professional corporate trustee is advisable.