Self-managed Super Funds (SMSF)

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As a result of changes in legislation, self-managed super funds (SMSFs) are now able to have up to six members. Previously, the maximum number of members was limited to four. This may increase the popularity of the concept of the 'family super fund' – where parents allow their adult children to become members of the fund. However, whilst this may seem like an attractive strategy, it is not without its complications.

In addition to the fundamental and extensive rules that apply to all superannuation funds, there are specific rules for SMSFs. As an SMSF is a trust, it is necessary to have a Trust Deed document drawn up. As the name suggests, an SMSF is a super fund where the members are the trustees. Here lies the responsibility for the ongoing management, investment and administration of the fund. Although some aspects relating to operating the fund can be outsourced, ultimate responsibility sits with the trustees.

It is important to note that there are multiple factors that determine whether an SMSF is an appropriate solution for a client. Amongst other factors, this may include client circumstances, client knowledge and the level of retirement assets. In order to highlight some of the pros and cons of establishing or expanding an SMSF structure, we have provided 'food for thought' within the below.

Pros

Scale & Intergenerational Asset Transfer - Bringing multiple individuals into a fund will also see them rollover their current member balances, therefore providing additional capital and liquidity for investment. This may facilitate the opportunity for diversification and/or enable investments into more capital intensive assets such as property (if deemed appropriate).

The benefits of holding a large asset (such as a business premises) within super is well known given the low tax environment, however the ability to keep such assets within the fund across multiple generations may be of appeal. This said, the 'flip side' of maintaining sufficient liquidity is a vital and significant ongoing consideration.

Choice on Trustee Structure – An SMSF must have a trustee and there are two different options – individual trustees and a corporate trustee. The appointment of a corporate trustee can provide short and long-term benefits.

Costs - The administrative costs of operating an SMSF are generally fixed in nature. As a result, having additional members will see the average member cost decrease as a percentage of the overall fund value.

Assistance and Involvement - Investment decisions can be shared across all parties. Over time, this may provide opportunity for some greater assistance from the younger generation to ensure continuity in operation.

Cons (and risks)

Different Investment Objectives – As noted above, the assets of an SMSF can be pooled so that each member has a share based on the value of their member account. Given the different stages of life between potential members, there is likely to be differences in the investment needs, preferences and objectives of the various members.

Where the rules of the fund allow, it is possible for each member to operate separate investment strategies with specific assets assigned to their specific member account as opposed to having the assets simply pooled together. There may be additional costs and complexity in utilising this strategy.

Family Dynamics - All parties are able to oversee the assets and member balances within the fund.

Conflicts can range from minor disagreements regarding the operation of the fund, to significant issues such as marriage and relationship breakdown. A breakdown may create additional administration issues or create liquidity issues where there are settlement payments needing to be made.

Estate Planning – SMSFs can provide extra flexibility over other super funds. However, given the substantial wealth held in the retirement system, it is important that this element is addressed so that the balances are distributed in the correct fashion upon death. Trustees and members need to be aware of the rules governing superannuation (and the particular fund) so that the estate planning objectives can be appropriately achieved over time.

Exit Strategy – Trustees should consider an SMSF exit strategy as not all exits are voluntary and/or straightforward. This may include the costs involved in winding up an SMSF, and what happens in the event of a trustee's death.

Conclusion

SMSFs are firmly entrenched in the superannuation landscape. The ongoing operation of an SMSF needs to be weighed against the associated risks. Many of the risks can be managed by putting into place various strategies to assist in limiting their impact. Working to correct documentation is a vital aspect to implementing any such strategy.

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