

SELF MANAGED SUPER FUNDS

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INTRODUCTION

By Jenni Eason

Happy New Year and welcome to the first Self Managed Super Funds Email Bulletin for 2009. I have been asked to write this introduction as Pauline is away overseas.

We can only hope that 2009 will be a better year for investors than 2008 but the outlook isn't too good. Even if you got out of the share market in time, interest rates are on the way down, so returns from fixed interest or online accounts will not be very good.

This month we have two articles by Graeme Colley one of which provides us with a timely reminder to review our investment strategy and ensure that trustees comply with the new superannuation rules. The other relates to transferring shares (or managed funds) into your SMSF. If you had planned to do this in the future, it might be worth taking a look at transferring some now to reduce the CGT impact (assuming they will go up in future!).

David Busoli of Tranzact Total Super has also provided an interesting article on recontribution strategies.

There have been a number of changes to superannuation recently and I have summarised the major ones in the February 2009 *Investors' Voice* insert. We have provided a summary of the contents of this publication and a link so that you can download it and I encourage you to send a copy to your family, friends, etc.

If there are any topics you would like us to try and source articles on this year please contact us at aia@investors.asn.au.

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THINKING ABOUT YOUR SMSF IN THESE UNCERTAIN TIMES

By Graeme Colley

In these extraordinary economic times anyone who has invested in shares, fixed interest or property must be wondering where to go next just to protect their current wealth. For those who have self-managed superannuation funds there are a number of issues which need to be considered. These include reviewing the fund's investment strategy, contributions and staying within the superannuation rules as the value of the investments change.

The superannuation legislation has a lot to say about the fund's investments to make sure trustees consider the manner in which the fund invests in a logical way. The most important part of the legislation is to make sure the fund has an investment strategy that takes into account:

- the risks involved in making, maintaining and realising any fund investment;
- the likely returns on those investments after having regard to the cash flow required to pay for the expenses of the fund, including the payment of lump sums and pensions; and
- the diversification of the fund's investments and whether any inadequate diversification in investments can be justified;

At the time when we see huge swings in the value of nearly all investment classes trustees should consider the effect on their current investment strategy. Trustees may now find that investments which were easily sold in the market may now be difficult to liquidate or can be sold at a significantly discounted, and probably unrealistic, price. This may create problems for clients who wish to withdraw lump sums and continue to pay pensions. Investments which are difficult to sell at a reasonable price could substantially affect the ability of the fund to discharge future liabilities of the fund.

The change in the value of investments may have altered the asset allocation of the fund resulting in it having a higher proportion of investments in some asset classes. This may result in some investments having a higher level of risk and now have a longer time before their true value is recovered. While these investments may come good in the long term they may impact on the cash flow of the fund. As a result of any shift in asset allocation the task at hand is to ensure there is sufficient cash flow to pay the expenses of the fund when they fall due. This includes the payment of any pensions and lump sums as they arise. In the short term this may result in the fund being in the unfortunate position of having to sell or transfer investments which were originally intended to be held for the long term.

To assist in alleviating the issues relating to the payment of fund expenses it is always useful for the trustee to establish a cash flow budget that will take into account foreseeable expenses to ensure the fund holds sufficient cash reserves. This would take into account the inflows from the fund investments, for example, dividends and interest, and making any adjustments to the fund's overall strategy, if required.

Hand in hand with any changes to the strategy will be a review of the fund's assets allocation. This may result in an increase in the fund investing more in some asset classes to ensure the fund's cash flow requirements are met. For example, with the changes to the value of many Australian shares the value of the fund's allocation to those shares may need adjusting.

One way of increasing the fund's cash flow and changing the asset allocation is to make contributions to the fund. If you qualify, tax deductible and non-deductible contributions can be made in cash or 'in specie' by the transfer of investments. There are limits on the amount and value of the investments that can be contributed to the fund.

For anyone who qualifies, under age 50, tax deductible contributions of up to \$50,000 can be made without penalty and for anyone older than that deductible contributions of up to \$100,000 can be

made. In addition, it is possible to make non-deductible contributions of \$150,000 each financial year or for anyone under age 65 it is possible to access the averaging rule which allows \$450,000 to be made over a three year period. While there are no work tests for anyone under age 65 to contribute, once you reach age 65 certain work tests need to be met. Once you reach age 75 it is not possible for you to make further contributions to super.

In addition to paying attention to the fund's investment strategy and asset allocation there are also the provisions of the superannuation legislation that need to be considered. In those funds which have more traditional investments, such as listed shares, then many of these rules do not apply. However, for those who are transferring personal investments to the fund or the fund is making investments in enterprises in which they have a link then it is necessary to understand the rules.

Before transferring or making an investment in the fund the trustees need to consider the superannuation rules which:

- ensure that the fund is solely maintained for superannuation and nothing more;
- make sure all transactions of the fund are made on an arm's length basis;
- ensure any fund investments with members, relatives, trustees and enterprises with which they are related come within the specified limits;
- ensure investments you transfer to the fund are permitted under the rules; and
- there is no charge or mortgage over an investment of the fund.

If you wish to transfer a personal investment to your self-managed superannuation fund, any transfer may result in a smaller capital gain or possibly a capital loss on transfer. The advantage of this is that any capital gain that is made on investments held within the fund may be taxed at concessional rates. For investments in accumulation phase that have been held for longer than 12 months there is a one third discount on the tax payable and for investments in pension phase there is no tax payable on any capital gain.

In these times, the administration of a self-managed superannuation is a task which is ongoing. The fluctuation in the value of investments means that greater attention needs to be paid to the fund's investment strategy, asset allocation and the effect of the superannuation rules on the fund.

Graeme Colley is the Technical Manager with Super Concepts.

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SUMMARY OF MAJOR CHANGES TO SUPERANNUATION

There have been a number of significant changes to superannuation over the past several years, including the introduction of transition to retirement pensions and the introduction of tax-free super. As from 1 July 2007 all income and lump sum payments received from taxed superannuation funds are exempt from tax once a person reaches age 60 (treated as non-assessable, non-exempt income) and are not included in the person's income tax return.

Income received from untaxed sources (eg some Government superannuation funds) is still taxed at marginal rates but now receives a 10% tax rebate (previously nil) and lump-sum payments are concessional tax for the first \$1m 2007-08 (\$1.045m in 2008-09).

Concessional contribution limits have been streamlined and non-concessional limits introduced. The self-employed can claim a full deduction for super contributions and are eligible for the Government Co-contribution for non-concessional contributions. Caps and thresholds are indexed to average weekly ordinary time earnings (AWOTE) in \$5,000 amounts.

Other changes include the abolition of Reasonable Benefit Limits (RBLs) and there is no forced payment of superannuation benefits at any age (subject to fund rules), ie superannuation can be left in the accumulation phase indefinitely.

The AIA has produced a 6 page insert using publicly available information. Click here to view the insert (<http://www.investors.asn.au/downloads/Voice/2009/02/0902SuperInsertSingles.pdf>).

RECONTRIBUTION STRATEGIES WITH SMSFS

Provided by David Busoli of Tranzact Total Super

When a death benefit payment is made to an adult child who is not a tax dependant 15% tax is levied on that part of the payment which is sourced from the taxable component of the deceased member's account. The Recontribution Strategy is often used as a plan to minimise the future amount of tax payable by maximising the amount of tax exempt component in that account. Sometimes this is achieved by converting all of the member's benefits to tax exempt or, alternatively, the final result is two superannuation interests (explained below) where one is fully or partially taxable and the other tax exempt. In this circumstance only the minimum pension will ever be drawn from the tax exempt superannuation interest whilst any amounts over the minimum will be drawn from the superannuation interest containing the taxable component. Over the member's lifetime the proportion of tax exempt to taxable component will then increase.

Essentially the strategy involves withdrawing benefits from the taxable portion of a member's benefit and recontributing them as a non-concessional contribution. There are a number of issues that need to be addressed if the strategy is to be effective.

The member must have unrestricted non-preserved benefits to enable the withdrawal. The only exception to this is if they are drawing a transition to retirement pension. In this case the amount they can withdraw is rather limited so the strategy is rarely appropriate.

If benefits can be withdrawn then the issue of tax must be addressed. If the member is over age 55 but under age 60 and in a self managed super fund then the first \$145,000 (08/09 financial year) of the taxable component is tax free with the balance taxed at 15%. Any tax exempt component is tax free. If the member is aged 60 or older there is no tax payable on either component.

The recontribution can only be made if the member is eligible to contribute and the contribution does not breach the non-concessional contribution caps.

In order to achieve the desired result the concept of a superannuation interest must be considered. A superannuation interest is similar to a member account. If the member has several accumulation accounts in a Fund they are regarded collectively as one superannuation interest however a separate superannuation interest exists for each pension account. The proportion of taxable to tax free component is not spread across all the member's accounts but, rather, is specific to each superannuation interest. Since 1st July 2007, it has not been possible to choose the components that must be drawn from a superannuation interest and any merging of interests will immediately mix the tax components. It is therefore advisable, if some taxable component is left in the member's superannuation interest after the withdrawal, to consider implementing the recontribution strategy in a manner which utilises pension accounts to quarantine the tax components and so avoid mixing the non-concessional recontribution with the existing taxable component.

This article first appeared in the Tranzact Total Super E-newsletter on 16 December 2008.

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A SILVER LINING AMONGST ALL THE TURMOIL

By Graeme Colley

Capital Gains Tax

While the turmoil in financial markets may occupy our thinking at the moment there may be a silver lining. With shares being at their lowest levels for some years there may be an opportunity to consider transferring some shares and other permitted investments to your self-managed superannuation fund. This can allow you to access the advantages of future price increases due to market trends once they have been transferred to your superannuation fund.

One of the benefits provided by the changes to the superannuation rules is the ability to transfer investments to superannuation as you approach retirement. The main advantage is that any of the fund's income and capital gains can be retained in a concessional tax environment. Of course, once you reach at least 60 and commence to draw down benefits from your fund you have the additional advantage of receiving totally tax free lump sums and pensions.

Under the superannuation rules it is possible for you to transfer shares that are listed on a stock exchange or as approved under the Corporations legislation, commercial property, some investments you may have with family and business associates and certain insurance policies. However, it is mainly listed shares and some commercial property which people transfer to self managed superannuation funds.

There are a number of ways in which your fund can acquire shares or any other permitted investments from you. It is possible to transfer the shares at market value to the fund as a concessional or non-concessional contribution, if you qualify. As an alternative the fund is permitted to purchase the shares from you at a commercial value. Don't forget there are limits to the value of the shares that can be transferred to the fund as contributions. The amount of the contribution depends on your age at the time it is made and whether you have claimed a tax deduction for the amount contributed.

When you transfer shares or other investments to your self-managed superannuation fund it is generally considered to be a capital gains tax event. This means that you may make a capital gain or loss because of the sale or transfer of the shares to your fund. While the shares or other investments are experiencing historically low prices you may find there is an opportunity to transfer them into your fund. This may have the effect of reducing the amount of capital gains tax payable yet at the same time retaining control over the investment as part of your superannuation fund. Before you decide on the transfer it may be worthwhile to obtain appropriate professional advice to determine whether it will be to your advantage.

Graeme Colley is the Technical Manager with Super Concepts.

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