

SELF MANAGED SUPER FUNDS

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INTRODUCTION

By Pauline Hammer

Happy New Year Investors!

I hope you all enjoyed the festive season and have had a positive start to the new year.

We commence our first edition for 2010 with an article by an AIA Member, Mr G Smith, who has written about his SMSF. The Smith's have been managing their own SMSF since 1996 and we very much appreciate this contribution.

I would also like to thank Bryce Figot and Dan Butler from DBA lawyers for their informative article on the ATO's focus on compliance of SMSF's. The implications for non-complying funds can be quite severe. Please take the time to read the article and apply a "health check" to the compliance of your fund. I recommend that you seek professional advice to assist you if any uncertainty.

Many of us make provisions to ensure our death nominations state to whom the benefit is to be paid to on death but have we considered *how* the benefit is to be paid? Bryce Figot from DBA Lawyers sheds light on this subject.

We have included a publication from the *Eureka Report* which provides interesting statistical information relating to SMSFs as a result of Jeremy Cooper's - *A Statistical Summary of Self-Managed Superannuation Funds*.

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OUR SMSF

By G Smith

Our SMSF has been running since the end of 1996. Being a government employee on a defined benefit superannuation scheme, a decision needed to be taken and I took the option of “retiring” at 54 years 11 months. At that time, salary-sacrifice was not an option.

After visiting several financial planners, I chose the only person who had suggested taking out contributions plus interest and starting a self-managed super fund. By doing this, it meant that I would receive a reduced state government pension, accumulate investments in the SMSF while my wife continued to work in a part-time job. All of the other planners encouraged me to convert my superannuation holdings to cash and invest it in various schemes mainly linked to their particular organisation.

Our investments were divided between six managed funds spread locally and internationally and six direct share investments focused mainly on blue-chip companies.

Of course in 1996, there was little choice but to accept the 4% entry fee for the managed funds, the annual MER plus our advisor’s trailing commission. It should be pointed out that no investments were made without our consent – we used a Macquarie CMT account for all transactions. One of the largest companies in Melbourne was used as our SMSF services provider. Initially, we found it very beneficial keeping us up to date with any changes in the operation of our SMSF.

We were fortunate that the stock market had started a run of five or six good years where our fund accumulated very nicely. My wife retired in 1998 enabling us to rollover what amounted to another 30% of value into the fund.

Our financial advisor initially was very responsive to any queries and requests and we met with him on a six-monthly basis. As time went on and with him changing to a larger company, we found that his advice at times was not always financially sound and his contact with us became more infrequent. It was about this time, early 2000, that we considered the task of running all investments ourselves.

At the same period of time, we investigated the cost of moving the SMSF into my wife’s name and to start paying her a pension. It culminated in several big changes. The SMSF service company’s leading financial officer at the time, advised us, that to move from accumulation to pension mode, we should sell all our holdings and buy them back in my wife’s name!! You can imagine how well this advice was received and eventually resulted in us moving our SMSF operations to another group. Annual compliance costs were almost identical (approx. 1% of value).

So in six years, our portfolio had changed from the initial six stocks/six managed funds to seven managed funds and fourteen stocks (a mixture of industrials, property trusts and resources); we had taken over all financial investment and had changed to another SMSF management group. My wife’s pension had commenced in March, 2001.

Through the 2000’s, our investment strategy changed and we sold all our managed funds (why pay an MER to lose money?), one mortgage trust was maintained and we reduced our stock holdings to <15. One cannot help but feel how fortunate for us that from mid-November, 1996 to early November, 2007 the Australian All Ordinaries grew almost 200%. One could not complain.

Currently, with interest rates going up, money was invested in term deposits with Westpac, ING Direct and ESANDA/ANZ using the proceeds from the sale of several stocks (IOF, MIG, BEN, BLD, SKE) made before the dip around November, 2008.

Since 2007, for servicing our SMSF, we have used i) a registered tax agent and ii) an auditor. It would come as no surprise that their combined charges are 45% cheaper than using a large service company!!

Best Buy: Origin Energy
Worst Buy: Connect East

We are members of the Australian Shareholders Association and the Australian Investors' Association and recommend both these organizations highly. Share transactions are done using Commsec, and Macquarie Equities. An excellent little website is www.smartportfolio.com.au for share market movements, watch lists and charts. Income Investor (via hotmail) is also helpful in reminding one when ex-dividend dates are approaching.

Best advice

Spend a short but regular amount of time to keep your SMSF up-to-date. Dividend growth is one of the best fundamentals. Take full advantage of Australian company imputation credits. Invest, don't speculate.

G Smith is a member of the AIA.

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ATO'S STEP UP IN RENDERING SMSFS NON-COMPLYING: WHAT IT MEANS TO YOU

By Bryce Figot and Daniel Butler

Recent times have seen a significant increase in the number of self managed superannuation funds ('SMSF') being rendered non-complying.

	2007	2008	2009
SMSFs made non-complying	5	24	99

The government states that the 'increase in the number of compliance outcomes in recent years is primarily due to an increase in the number and intensity of compliance activities being undertaken by the ATO, rather than a deterioration in compliance behaviour.' This article discusses the key issues and provide a number of practical tips.

Implications of being rendered non-complying

Receiving a notice of non-compliance from the ATO usually has devastating tax consequences. These include:

- The market value of the SMSF as at the end of financial year before it become non-complying less the value of any undeducted contributions is included in the assessable income of the SMSF in the year in which the SMSF became non-complying (Income Tax Assessment Act 1997 (Cth) ('ITAA 1997') s 295-325).
- The rate of tax payable in respect taxable income of the SMSF is the highest marginal tax rate (currently 45%), rather than the usual 15% (Income Tax Rates Act 1986 (Cth) s 26(2)).

The pension exemption is not available.

General interest charge is also usually payable on the above. The interest accrued can be substantial where the ATO issues the notice of non-compliance in respect of a financial year that has long past.

Consider the following case study.

In 2007 financial year, Joey made a \$1 million undeducted contribution to a brand new SMSF. By 30 June 2008 the market value of the SMSF has grown to \$1.7 million. On 1 July 2008 the SMSF commences using all of its assets to pay Joey a pension. During the 2009 financial year, the SMSF receives \$100,000 of interest payments.

The amount of tax payable by the SMSF if it continues to be a complying superannuation fund with 100% of its assets in pension mode is as follows:

Income from assets set aside to meet current pension liabilities: \$100,000

Less adjustment for 'pension exemption'	(\$100,000)
Total assessable income	—
Taxable income	—

Tax payable (ie, taxable income x 15%)	—

However, if the SMSF received a notice of non-compliance in respect of the 2009 financial year, the amount of tax payable is as follows:

The market value of the SMSF as at the end last financial year	\$ 1,700,000
Less undeducted contributions	(\$1,000,000)
Income from assets set aside to meet current pension liabilities:	\$100,000
Total assessable income	\$800,000
Taxable income	\$800,000

Tax payable (ie, taxable income x 45%)	\$360,000

A general interest charge would also apply and this could in some cases result in almost double the amount payable if five or more years have elapsed since the breach occurred.

Process of being rendered non-complying

Many SMSFs are rendered non-complying pursuant to the following process.

Firstly, the SMSF's auditor lodges an auditor contravention report ('ACR'). (ATO publication NAT 11299 contains a handy summary of the ATO's views on when ACRs need to be lodged.)

The ATO mails 'notification of audit for your action' to the trustee (usually care of their tax agent) asking for more information within say one month. This outlines, amongst other things, the ATO's aim to complete an audit within a given period (eg, three months).

Subject to the information received from the trustee, the ATO might form the view that a contravention did occur. Assuming that the SMSF met the definition of 'Australian superannuation fund', the ATO has a discretion on whether to issue a notice of non-compliance.

If the ATO are considering issuing a notice of non-compliance, they generally send a position paper explaining their reasons. The ATO typically provides the trustee the opportunity to submit reasons why the fund should not be made non-complying.

Subject to the response received, the ATO will either issue the notice of non-compliance and then amended assessments will follow or accept the reasons (but invariably request further evidence to support of a trustee's reasons).

Broadly, the trustee may request a review of the decision or may appeal to the Administrative Appeals Tribunal. Note, the ATO's decision to issue a notice of non-compliance is reviewable and an income tax assessment then follows. Thus, both a request for a review of the ATO's decision and an objection against the assessment are generally required. Trustees must act swiftly as they only have 21 days to request a review but 4 years to lodge an objection. In practice, a request for an extension of time is invariably required due to this short time frame.

ATO's discretion

Just because a contravention has occurred, does not necessarily mean that the ATO will issue a notice of non-compliance. As set out in ATO Practice Statement Law Administration 2006/19 at paragraph 12, the ATO have many options where a contravention has occurred, including:

- making the SMSF a non-complying superannuation fund by giving the SMSF a notice of non-compliance;
- accepting an undertaking from the trustee to rectify the contravention;
- disqualifying individual trustees and prohibiting them from acting as a trustee of an SMSF or as a responsible officer of a corporate trustee of a superannuation fund;
- suspending or removing the trustee;

- as part of an investigation, freezing the assets of the SMSF if there is a risk of the members' benefits being eroded; and
- seeking civil and/or criminal penalties through the courts.

One notable exception to the ATO's discretion is where the SMSF has failed to meet the definition of Australian superannuation fund in s295-95(2) of the ITAA 1997. If an SMSF fails to meet this definition, the ATO must issue a notice of non-compliance and there is little point in objecting against such an assessment or seeking a review by the AAT as the legislation provides no discretion, ie, if a fund fails the definition of Australian superannuation fund the tax liability automatically applies: see s295-320 ITAA 1997.

This was illustrated in the recent AAT decision of CBNP Superannuation Fund and Commissioner of Taxation [2009] AATA 709. In this decision the SMSF's auditor lodged an ACR regarding a perceived contravention of the 'in-house assets'. Upon investigating, the ATO appeared to disregard the in-house asset breach but had detected that the SMSF was not a resident superannuation fund (note that from 1 July 2007 the concept of a resident superannuation fund has been replaced with Australian superannuation fund). As the ATO had no discretion on this point, the ATO issued a notice of non-compliance, which the taxpayer requested review by the AAT. The AAT found that although the SMSF member's situation was 'most unfortunate', the notice of non-compliance had to stand because the SMSF did not satisfy the definition of resident superannuation fund.

Factors the ATO consider in deciding to exercise their discretion

The ATO consider a number of factors in deciding to issue a notice of non-compliance. As set out in ATO Practice Statement Law Administration 2006/19 at paragraph 34, these factors include:

- The behaviour of the trustee in relation to the contravention. A contravention resulting from recklessness or intentional disregard for a regulatory provision is likely to be considered more serious than a contravention resulting from an honest mistake.
- The extent to which the contravention affects the SMSF's assets. The greater the proportion of the SMSF's assets affected by the contravention, the more serious the contravention is likely to be.
- The extent to which the SMSF's assets are exposed to financial risk and whether there is any loss to the value of the SMSF. The greater the proportion of the SMSF's assets exposed to financial risk and the greater the loss suffered by the SMSF, the more serious the contravention is likely to be. However, a contravention may still be serious if a significant proportion of the SMSF's assets has been put at risk, even though the SMSF has not suffered any actual loss.
- The number and duration of contraventions over a period of time. A single contravention on its own may not be considered serious, but a number of contraventions taken together may make the situation more serious. In addition, the longer a contravention continues without any attempt to rectify it, the more serious it is likely to be.
- The nature of the contravention in the overall scheme of the legislation. For example, a contravention involving an artificial arrangement intended to undermine a regulatory provision is likely to be considered a serious contravention.

In light of the first factor above in particular, whenever a contravention occurs, the trustee should always endeavour to rectify any contravention as soon as possible. Thus, if an ACR must be lodged, it is ideal if it can also confirm that the contravention has already been rectified.

If the contravention is not rectified when the ACR is lodged, the trustee should consider offering a written undertaking to the ATO. When and if a written undertaking is accepted by the ATO, it becomes enforceable. If the Trustee breaches a term of that undertaking, the ATO can apply to a court for an order in relation to the breach. Acceptance of an undertaking by the ATO may be an alternative to the fund being rendered non-complying. The authors have had success with

numerous breaches in which the enforceable undertaking was instrumental in obtaining the ATO's exercise of discretion.

However, it is important to note that just because an undertaking is offered, does not mean that ATO will necessarily accept it. As set out in ATO Practice Statement Law Administration 2006/18 at paragraph 19, in determining whether to accept an undertaking offered, the ATO will consider the following:

- Can the contravention be rectified? For example, a contravention of the in-house assets rules can be rectified by the fund disposing of relevant assets. If a contravention cannot be rectified, then an undertaking is not appropriate.
- Does the contravention give rise to criminal consequences? Where there are criminal consequences it is not appropriate to accept an undertaking. This reflects the principle that a person may not contract out of criminal liability.
- Past behaviour of the trustee. It would be appropriate to accept an undertaking where the behaviour indicates that the trustee is likely to comply with it. However, it may not be appropriate to accept an undertaking if the trustee has contravened the provisions which they had previously completed an undertaking to rectify.
- The nature and seriousness of the contravention indicates that it is inappropriate to accept an undertaking. For example, 100% of superannuation contributions, when received, are immediately lent to members.

Another major factor that the ATO take into account is the time frame offered in any undertaking. The longer the time frame offered, the less likely the ATO is to accept it. This was illustrated in JNVQ and Commissioner of Taxation [2009] AATA 522. In this matter more than 95% of the SMSF's assets had been lent a related party. In the first undertaking offered (made in February 2008) the trustee proposed to have the loan fully repaid by 30 June 2010 (approximately 2.5 years). The ATO rejected this. In the second undertaking offered (made in June 2008) the trustee proposed to have the loan fully repaid by 30 November 2008 (ie, 5 months). This very short time frame was also rejected by the ATO. The AAT noted that:

The [ATO] declined each proposal. As appears from the [ATO]'s reasons for refusing these offers, the [ATO] considered the timeframes were set too far into the future.

Conclusions

When contraventions are identified, they should be rectified immediately or as soon as possible. If an ACR needs to be lodged, it is ideal if the report can detail a 'happy ending' (eg, yes a contravention occurred, but the trustee diligently rectified and have taken the following steps to ensure that it never happen again ...).

If it is not possible to rectify before the ACR is lodged, an undertaking should be offered to the ATO detailing how the contravention will be fixed in the shortest possible time frame.

If it is not possible to offer an undertaking, then a suitable request should be made which seeks to position the fund in the best light and to obtain the ATO's favourable exercise of discretion.

If a request for review and an objection is required, the trustee should ensure they have all grounds and supporting information covered and seek to co-operate with the relevant ATO officers to preserve the fund's complying status.

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Note: DBA Lawyers, will be presenting at SMSF seminars at venues all around Australia in February, May, September and November 2010. For more details or to register, visit www.dbalawyers.com.au/index.php?p=DNW or call Marie on 03 9092 9400.

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CAN A BDBN SPECIFY HOW A DEATH BENEFIT IS PAID?

By Bryce Figot

Many wish to enforce not just to whom their super benefits are paid upon death, but also how those benefits are paid. This wish is common in clients with spendthrift spouses. Often such clients are concerned that if their spendthrift spouse receives a death benefit lump sum, those benefits will be quickly spent leaving the spouse financially unsupported. Such clients often seek to ensure super death benefits will be paid out as a 'drip-feed' pension.

It is well accepted that a binding death benefit nomination ('BDBN') can specify to whom death benefits are paid. However, many are unclear as to whether a BDBN can specify how benefits are to be paid.

Subject to the SMSF's governing rules, a BDBN can specify how benefits are to be paid. However, there are some niceties that trustees, members and their advisers should bear in mind.

Context: what is a BDBN?

A BDBN is a nomination made by the member of an SMSF that is given to the trustee of the SMSF. Receipt of the BDBN binds the trustee to pay the member's benefits upon death as specified in the BDBN.

However, not all SMSFs allow members to make BDBNs. In order for a member to be allowed to make a BDBN, the SMSF's governing rules must allow for the BDBN. These rules are typically contained in the trust deed of the SMSF.

General law

The general law position is that, if the governing rules of any trust — including an SMSF — require the trustee to follow a direction etc, the trustee must comply. This is due to principles articulated in the decision of *Armitage v Nurse* [1998] Ch 241. Accordingly, at general law, if an SMSF's governing rules specify that members may give trustees BDBNs detailing how super death benefits are to be paid, this is valid and binding.

How the super legislation modifies the general law

The super legislation modifies the general law position somewhat. Section 59(1) of the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA') provides that the governing rules of a super fund *other than an SMSF* must not permit a discretion under those rules to be exercisable by a person other than the trustee. However, there is an exception to s 59(1). This exception is contained in s 59(1A).

Section 59(1A) provides that — subject to a trustee of the fund complying with the conditions contained in the super regulations — the governing rules of a super fund may permit a member to give a notice to the trustee that binds the trustee to pay any super death benefits to persons mentioned in the notice.

The super regulations specify that the notice must meet certain conditions such as:

- it must be in writing;
- it must be signed, and dated, by the member in the presence of two independent, adult witnesses; and
- it can not last for more than three years.

Naturally, such a notice is a BDBN.

The exception in s 59(1A) makes it clear that a BDBN can specify to whom super death benefits are paid. However, the exception is silent on whether a BDBN can specify how super death

benefits are paid. Because the exception is silent, the original prohibition in s 59(1) applies to this aspect. However, the original prohibition never applied to SMSFs!

Therefore, there is a well accepted view in the industry that the exception and the conditions contained in the regulations have no application to SMSFs. This is why — although non-SMSF super funds may only have BDBNs that last for three years — the Commission of Taxation has released a determination stating that SMSFs may have BDBNs that last indefinitely (SMSFD 2008/3).

Accordingly, there is nothing stopping an SMSF's governing rules from allowing a BDBN to specify how benefits are to be paid.

However, there are certain risks that must be considered.

Firstly, despite the Commissioner's determination, the view that the requirements in the regulations do not apply to SMSFs is not universally accepted. The recent case of *Donovan v Donovan* [2009] QSC 26 considered the validity of an SMSF BDBN. The judge was aware of the Commissioner's determination, but nevertheless left the door open to the possibility that even SMSF BDBNs must conform to the super regulations.

Secondly, the most popular type of SMSF pension (including death benefit pensions) is an account-based pension. Account-based pensions can generally be commuted (ie, exchanged for a lump sum) at any time. Furthermore, there is generally no limit on the size of account-based pensions annual payments. These characteristics can be sought to be addressed by having the BDBNs also add extra rules as to how pensions are paid (eg, with a cap of maximum pension payments, without the ability to be commuted etc). In order to achieve this, the SMSF's governing rules would need to specify limitations and in so doing ensure that there is no conflict with the super regulations. Moreover, in order for these limitations to be irrevocable, the SMSF's governing rules would need to contain special provisions to preclude the surviving spouse from opting out. This type of strategy has yet to be tested in court.

Thirdly, remember that the members of the SMSF must also be trustees (or directors of the trustee company). This means that members also can write the SMSF's cheques! Consider an example where dad fears that mum is a spendthrift and will quickly dissipate any super death benefits. Accordingly, dad makes a BDBN that specifies that upon his death, mum (as the surviving director of the SMSF's corporate trustee) must pay herself a pension. If mum truly is a spendthrift, she may well 'rip' the money out of the SMSF and waste it. Although an action could then be brought against the trustee in the supreme court, this would not help in achieving the goal of ensuring that mum is financially supported.

Practical methods to deal with these risks

To overcome the first risk, some advocate inserting provisions directly in the SMSF's governing rules. However, this does little to address the second or third concern.

Another technique is for the client to accept these risks. The client can merely accept that by using the super environment, tax efficiency is being achieved but this comes at the cost of being able to fully control super benefits from the grave.

The final technique can be split into two 'sub-techniques'.

The first sub-technique is to make a BDBN specifying that upon death super death benefits be paid not to the spouse, but rather to the deceased's estate. The terms of the deceased's estate (ie, the will) can then specify that the surviving receive an annuity of \$x per annum as increased for inflation each year. Naturally, an independent third party would be the executor of the estate and the trustee of any trust that arises under it. However, the first sub-technique opens the door to the new risk of the estate being challenged.

Therefore, the second sub-technique should be considered. This is to withdraw benefits from the SMSF during lifetime and then put the benefits in an inter vivos trust (eg, a family discretionary trust). The governing rules of the inter vivos trust can specify that the surviving receive \$x as increased for inflation each year and an independent third party would be the trustee. For

completeness, note that in New South Wales the 'notional estate' provisions can mean that technique this is also subsequent to a challenge against the estate.

Both these sub-techniques involve a loss of tax efficiency.

Conclusion

If the SMSF's governing rules so allows it, a SMSF BDBN can allow members to specify not just to whom super death benefits are paid but also how. However, if the client wants to go this path, they must understand that they are bearing risk and that there is a trade off between the tax efficiency of keeping money in an SMSF and the ability to control how it is paid.

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THE COOPER REVIEW – STATISTICAL ANALYSIS OF SMSFs

By Bruce Brammall

This article was first published in *Eureka Report* on January 13 2010.

PORTFOLIO POINT: The Cooper review of superannuation has produced probably the best, and most fascinating, statistical analysis of SMSFs yet compiled.

So, how exactly do you and your SMSF compare to the 410,000 other funds out there? Are you an average SMSF member, with a taxable income of about \$92,000? Or is yours one of the 30% of SMSFs that managed a positive return in 2007-08, during what was one of the worst years for investing?

Despite the offer of help all around (including us here at Eureka Report), the duties and responsibilities that come with being a DIY super operator can be quite isolating.

Trustees are, by choice, electing to run their own super fund. They can't have more than four members – and more than 90% have only two – so there aren't too many trustees to consult directly with. The cost of bringing in an accountant (who can't give investment advice) or a financial adviser for every decision would be expensive and, in some cases, self defeating – and that's not why people get into running their own fund.

For years, people have moaned about the lack of quality of statistical data available for SMSFs. Well, finally, something reasonable is here, thanks to Jeremy Cooper's super review.

It is, at least, the best compilation of data on SMSFs published to date, and offers trustees a guide to whether their fund is above, at or below average across a number of fields.

Cooper's *A Statistical Summary of Self-Managed Superannuation Funds* covers a lot of ground, including growth in the SMSF sector, member demographics, member income, fund balances, investment performance, asset allocation, operating expenses and compliance.

Where possible, it compares SMSFs and their trustees to the rest of the super industry and their members.

For instance, SMSF assets grew at an average rate of 20% during the five years to June 2009, while the rest of the industry grew at just 8%. The average SMSF member had a taxable income of \$92,000, while the average non-SMSF member earned just half that, about \$47,000.

The peak earning years for Australians is between the ages of 35 and 60. The report shows that SMSF trustees between those ages earn an average of \$106,000 versus about \$55,000 for non-SMSF members.

The flow of contributions is weighted heavily towards SMSFs, which accounted for between 20% and 41% of all contributions during the four years of statistics. The peak of 41% was during 2006-07 when the temporary \$1 million non-concessional cap was in play, as reasonable benefit limits were being removed.

To further demonstrate where SMSF contributions are coming from, during the five years to June 2008, member contributions outweighed employer contributions \$3 to \$1. As a result of the massive inflow of money into SMSFs, between 2004 and 2008, SMSFs moved from controlling about 20% of the super fund market to 30%. In dollar figures, SMSFs went from holding \$132 billion to \$332 billion.

For SMSFs, the average combined employer and member contribution for 2007-08 was \$68,156, while the median was \$26,475. This suggests that a large number of members used the various maximums (\$100,000 and \$50,000 for concessional and \$150,000/\$450,000 for non-concessional contributions) to help bring up the averages.

Performance

SMSFs beat larger APRA-regulated funds in the financial years ending in 2006, 2007 and 2008. SMSFs scored returns of 12.6%, 16.9% and -6.1%, while the whole of industry average was 12.2%, 13.3% and -7.8%.

It is probably no surprise that the larger SMSFs performed better than the smaller funds given some of the fixed costs (fees, accounting and audit) involved in running an SMSF. But the effect this had on returns was truly remarkable. Funds greater than \$2 million outperformed those with less than \$50,000 by 14-19% between 2006 and 2008.

In 2007-08, 70% of SMSFs had a negative year. In the previous two years, those figures were just 19% and 14% respectively.

Demographics

At the end of 2008-09, 23% of SMSFs had just a single member and 67.9% had two, 4.5% had three members and 4.6% four.

Two-thirds (67%) of SMSF members are aged over 50, while in other superannuation sectors, the over-50s make up just 22% of the member population. It's even starker when you look at members over the age of 65: in SMSFs, the share is 19.4%, while in non-SMSF super it's just 3%.

Just 5.5% of SMSF members are aged 35 or less, while that age group makes up 43% of the overall superannuation market. But in the setting up of new SMSFs, as expected, it is younger Australians who are looking to take advantage the freedom of SMSFs.

About 22% of all members in SMSFs are on a super pension, while about 27% of all SMSFs were fully or partially in pension phase.

Member balances

The differences are nowhere more obvious than in super balances. The average member balance inside SMSFs is \$456,000, more than 18 times the average non-SMSF member's balance of approximately \$25,000.

The common wisdom, based on the level of costs associated with running an SMSF, has been that \$200,000 should be the minimum balance to set up a fund. And the average fund size did rise considerably between 2005-06 and 2007-08. The proportion of small funds (under \$200,000) fell, while mid-sized funds (\$200,000 to \$1 million) stayed steady and larger funds increased by proportion.

Interestingly, those who open an SMSF don't necessarily roll all their super into it (or have some trapped in defined benefit funds). Of those who had money in both, the average balance inside the SMSF was \$272,000, while they had another \$78,000 in super outside their SMSF.

Operating expenses

The average cost of running an SMSF has declined by 20% between 2006 and 2008 – from 0.86% of the average balance to 0.69% – while the average for all super funds is about 1.2%. However, in dollar terms, the average operating expense cost rose from \$5500 to \$6500 over the same period.

Economies of scale are quite evident in the size of SMSFs. Funds with less than \$50,000 tend to pay 5–6% of fund assets in expenses, while the largest super funds pay 0.36%.

Other findings

Some of the other findings do not differ at all, or differ little, from data we have covered previously in Eureka Report, including that SMSFs tend to be more overweight Australian shares and cash than APRA funds, which have higher allocations to international shares and fixed interest.

Other interesting findings include:

- 71% of SMSFs have individual trustees, while 29% have corporate trustees.
- 86% of trustees said greater control of investments was one of the reasons for setting up their fund.
- 46% said greater control was the primary reason for doing so.
- The average super fund has been in existence for eight years.
- 64% have been established for more than five years.
- 38% have been established for more than 10 years.
- Only 15% are less than two years old.
- When setting up their fund, 72% said they consulted an accountant, 42% said they consulted a financial adviser and just 3% said they consulted no professionals.
- Approved auditors qualified the accounts of 3.8% of super funds in the 2008 financial year.

The information was compiled by Cooper's review team because there was a frustration with the lack of overall information available on SMSFs, the fastest-growing sector of the superannuation industry.

Let's hope that someone – perhaps the taxman – picks up this ball and starts producing these results annually.

Bruce Brammall, for Eureka Report, is director of Castellan Financial Consulting and author of Debt Man Walking.

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