

SELF MANAGED SUPER FUNDS

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INTRODUCTION

By Pauline Hammer

Welcome investors.

Well, it's less than a month before Christmas and we expect the next few weeks to be extremely busy as people tie up loose ends prepare for festivities. This will be our last edition for 2010.

We sourced an article from MLC Technical which highlights the benefits of establishing a corporate trustee instead of individual trustees and how the benefits can potentially outweigh the additional costs.

It is important that you are aware of the traps associated with estate planning and SMSFs. Nathan Baker of SMSF Education provides us tips on what to look out for before encountering an estate planning event.

We would like to extend our best wishes for a safe and happy Christmas and New Year to all AIA members and, of course, a peaceful and prosperous 2011.

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TIPS AND TRAPS OF SMSF ESTATE PLANNING

There is no doubt that superannuation is a highly effective tax vehicle within the Australian savings landscape. There is also no doubt that within the superannuation landscape, SMSFs are the most tax effective superannuation vehicle. However, when it comes to estate planning, there remain a number of stings in the tale, so to speak, and it is important that you are aware of these before encountering an estate planning event. Afterwards it's usually too late.

Question - When is a pension not a pension?

Answer - After the death of the member.

We all know that a SMSF enjoys tax free status for assets that are backing a pension. This tax exemption applies to income earned on assets, and capital gains on asset sales. But what happens to this tax exemption upon death? The ATO has clearly stated that they believe the pension ceases when the member dies and if the pension has ceased then so has the tax exemption. What this means is that if a death benefit needs to be paid out of the fund, and assets need to be sold to fund this payment (if assets are transferred out in-specie then a deemed sale will occur on the transfer) this sale will give rise to a capital gain or loss. Your fund will be taxed on this.

The best way around this problem is not to die with unrealized gains in your fund. This requires quite a bit of forward planning. The next best method would be to get an actuary to certify the proportion of the year the fund was tax free, as this would reduce your tax bill. Finally, and you'll see why below, the very best solution is to not die with money left in superannuation.

Question - When are death taxes alive and well?

Answer - When death benefits are paid to non-tax dependents.

A superannuation fund can only pay death benefits to dependents of the member or to their estate. So for example a SMSF can pay a benefit to an adult child of the member as a child is always a dependent for superannuation purposes. The problem then is not that a member's benefits can't get to the people you would want it to go to.

The problem is that the definition of dependent within the superannuation legislation is not the same as the definition in the taxation legislation. So while a benefit could be paid to your adult children, that child may have to pay tax on the benefits they receive. The tax payable will be between 15% if received through the estate, up to 31.5% if the benefit is sourced from an untaxed component within the fund. Any tax free component is always received tax free.

The real anomaly in this situation is if you are over 60 years of age and retired, you could take 100% of your superannuation benefit as a tax free pension or lump sum and then your kids would receive this money tax free as part of the estate. But die with that money in super and your beneficiaries pay tax. So again, the best solution is to withdraw all your money out of the fund prior to death. Great if you know that death is imminent but this is not always the case.

Another very useful strategy is to maximise the proportion of your member benefit that is tax free component. For a retired member over the age of 60 this may include using withdrawal and re-contribution strategies prior to age 65. If not retired, you may look to withdraw the maximum allowable pension each year, even if this is more than you need, then re-contribute it as a tax free member contribution.

Question - When can insurance cost a lot more than planned?

Answer - If the benefits go to a non tax dependent.

Insurance within an SMSF is a very useful tool in providing for beneficiaries in the event of a member's death, or ensuring that an investment strategy stays intact when a member dies. An added advantage of insuring through superannuation is that the premiums for life insurance are a tax deduction for your fund, and if premiums are funded from tax deductible contributions, this means that you have effectively made your life insurance premiums tax deductible.

A problem can arise however, if the SMSF has claimed a deduction for the premiums and an insurance claim is made. If the recipient of the proceeds of that claim is not a tax dependent of the member the insurance proceeds are treated as coming from an untaxed source. What this means is that the benefits they receive are taxed at the much higher rate of 31.5%. If the proceeds go to a tax dependent, then even though they are from an untaxed source, they are received tax free. As you can imagine, if you thought you had enough insurance to cover your needs, losing almost 1/3rd of them in tax could be a very unpleasant surprise.

So it is important to know who is likely to receive any insurance proceeds from your fund. It is particularly important if you have binding nominations in place, as the trustees may not have the discretion to transfer funds to the least taxed individuals. If non- tax dependents are involved it may be necessary to adjust the level of cover you hold to allow for the tax that is payable. Alternatively, plan who will receive what, and outline this very clearly so that there can be no mistake as to what was intended. You may even look to change your Will so that the different beneficiaries receive benefits from different sources to what you planned.

Summary

Estate planning is one of the most complex areas of SMSF operation. This article dealt with only 3 situations where what you have planned could be thrown into disarray because of the fund having to pay more taxes than you may have thought. However there are many ways that your careful planning could come unstuck, whether it be because of taxes, the actions of trustees, or the demands of potential beneficiaries. Estate planning can be quite simple, but the more control you want, the more complex it can become.

This article was provided by SMSF Education www.smsfeducation.com.au.

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SMSFS: INDIVIDUAL VS CORPORATE TRUSTEES

While it can be simpler and cheaper to have individual trustees of a SMSF, the benefits of establishing a corporate trustee can potentially outweigh the additional costs.

Background

To meet the definition of a self-managed super fund (SMSF) and qualify for certain tax concessions, the fund must have a trustee.

The trustee can be two or more individuals or a company (known as a corporate trustee). With both these options, a range of conditions need to be met and some important issues need to be considered when deciding which option to use.

Key conditions

With individual trustees, generally all members must be trustees and every trustee must be a member. If the SMSF is a single member fund, then the sole member cannot be the only trustee.

In this situation, a second individual (who is not an employee of the member, unless related) must be appointed as a trustee, but they don't have to be a member of the fund. Anyone over the age of 18 can be an individual trustee of a SMSF, unless they are a 'disqualified person' under section 120 of the SIS Act (SISA). A disqualified person is someone who at any time was convicted of an offence involving dishonesty, has been subject to a civil penalty order under SISA or are an insolvent under administration (eg an undischarged bankrupt). Minors are considered to be under a legal disability and are unable to be a super fund trustee, however, a parent or guardian can be a trustee in their place. Where a corporate trustee is appointed, all members must be directors of the trustee company and all directors must be members of the fund.

If a single member fund has a corporate trustee, the member can be the sole director of the trustee company or there can be another director (who is not an employee, unless related).

A company is not permitted to act as trustee if:

- a responsible officer (including a director, secretary or executive officer of that company) is a disqualified person – see above
- a receiver, official manager or provisional liquidator has been appointed to the company, or
- action has commenced to wind up the company.

Key considerations

Can the fund pay lump sums?

If a corporate trustee is used, the fund is regulated using the Corporations power of the Constitution. Conversely, if individual trustees are appointed, the fund is regulated under the Age Pension powers of the Constitution and the fund's sole or primary purpose must be the provision of old age pensions.

While some argue a SMSF with individual trustees must therefore pay pensions at retirement, the ATO has confirmed the trust deed may also permit (but not compel) benefits to be paid as a lump sum.

Change of membership

When a new member is introduced to a SMSF with individual trustees, that person is required to become a trustee.

As trust assets must generally be held in the trustee's name(s), this will require the transferring of title to all assets (eg property, managed funds and listed securities) to include the new trustee.

This could result in significant time and effort, as well as transaction costs. The same administrative issues can arise when a member leaves a fund upon death, retirement or for any other reason.

In contrast, when members are admitted or cease membership of a SMSF with a corporate trustee, they only need to become, or cease to be, directors of the trustee company. ASIC must be notified of the changes within 14 days and the legal title to all assets remains with the company, which continues to act as trustee. A corporate trustee can therefore save considerable time and effort, particularly where fund assets are significant.

Note: Where SMSF assets are held by a custodian, it may not be necessary to change the titles if there is a change in the individual trustees.

Trustee protection from litigation

If individual trustees are subject to litigation (eg a personal liability action in relation to a property of the fund), the trustees are joint and severally liable and, therefore, 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.

Single member funds

If a person is the only member of the fund and wishes to act as personal trustee, then another person must be appointed, as a sole member cannot be the sole trustee. This means another person is involved in the fund's decisions. However, a sole member is able to be the only director of a corporate trustee and will have total control of the fund.

Succession issues

As a company and SMSF can continue indefinitely, a corporate trustee can provide greater certainty over control of the fund in the event of the death or incapacity of key members.

Cost

The cost of establishing and running a corporate trustee may not be significant if a suitable company already exists. However, if a new company is established, the additional costs will include:

- an up-front establishment and ASIC registration fee (approx. \$800 plus)
- an annual ASIC review fee (approx. \$41 pa), and
- annual accounting costs (which should be minimal, unless the company undertakes other activities).

Family company vs dedicated trustee company

If your clients have a family company, it can also act as trustee of their SMSF, so long as the company's other roles are kept separate. This ensures the assets of the fund are protected (eg if the trustee goes into liquidation or bankruptcy, the assets of the fund are not available to creditors).

However, a dedicated trustee company can provide a clearer separation of assets and director interests. This can further reduce the chance of error (eg mixing up fund assets with other company assets) as well as reducing possible trustee conflicts of interest. The family company directors must be restricted to the SMSF members. These restrictions may not be appropriate for the family company (eg they may want more directors than the maximum four members allowable in a SMSF).

Voting rights and decision making

Having a dedicated trustee company can allow clients to better control voting powers when compared to equal voting rights. If all directors are able to cast one vote each, then the majority has control over fund decisions. However, this may not be appropriate if there's not an even distribution of fund assets among member accounts.

For example, a member with the greater majority of benefits can be out voted on important issues such as distribution of fund reserves or determination of death benefits by other members or directors with minimal benefits. One way to overcome this issue is to give directors voting rights based on the account balance of the member they represent (usually themselves). This gives those with higher balances more control and can make trustee resolutions smoother if there is an even number of votes, or there is a relationship breakdown among trustees (eg divorce). Those with smaller balances should consider whether this approach is acceptable and trustees should seek specialist legal advice in relation to these matters.

Death of a director

On the death of a director of the trustee company, it's possible under SISA (subject to the company's constitution) to appoint the executor of the deceased member as a director up until the time death benefits are paid from the fund. Careful consideration should be given to the company's constitution to see if it allows this to happen and, if so, under what conditions. Otherwise control resides with the surviving directors. It's also possible to include a provision in the company's constitution to allow the automatic appointment of the executor. This may be attractive in the case of complex family arrangements (eg multiple marriages) to prevent disputes.

Incapacity of a director

A person's legal personal representative, or a person who holds a member's enduring power of attorney, can take the place of an incapacitated member as director of a corporate trustee. The company's constitution should allow for a legal personal representative to stand in the place of a director in circumstances such as where the member is a minor, incapacitated, overseas or deceased. In these instances, the legal personal representative can be appointed to represent the members' interests.

This article was sourced from MLC Technical.

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