AUSTRALIAN INVESTORS ASSOCIATION

Email Bulletin

Investors Helping Investors

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SELF MANAGED SUPER FUNDS

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INTRODUCTION

By Pauline Hammer

Happy New Year to all AIA members!!

I hope you are all well rested following the Christmas and New Year holiday period. Unfortunately for many around the country, floods have devastated families, homes, businesses and livelihoods. Our thoughts and prayers go out to all those affected and we hope to see a speedy recovery in all aspects of their lives.

In this edition, SMSF Education discusses the distinction between SMSF as an investment and as an investment vehicle.

Grant Kai-Fong discusses the benefits of a corporate trustee for SMSF. He provides a useful step by step process to assist trustees who may consider changing from individual to a corporate trustee.

Dan Butler and Nathan Papson outline some practical tips and traps related to investing in both related and unrelated unit trusts.

Pauline Hammer CFP SSA Dip SA Fin Sub-Authorised Representative, Investment Strategists Pty Ltd, Corporate Authorised Representative of Professional Investment Services Pty Ltd AFS Licence 234951 Premium Adviser Rating and Self Managed Superannuation Fund Professionals Association of Australia (SPAA) Specialists Adviser.

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SUPERANNUATION AS AN INVESTMENT OR AS A VEHICLE FOR INVESTMENT

What this distinction means from a practical perspective

Superannuation is a well established vehicle for Australians to save for retirement. Virtually every working person will have a Super account into which their employer will place at least the equivalent of 9% of their gross income. Despite this, there continues to be a common misconception that superannuation is an investment.

We can probably attribute this misconception on a general lack of engagement with Super as a savings vehicle. Our contributions go into a fund, and even if we bother to change the investment option the fund chooses as its default, we often don't incorporate these savings into our planning. It's as though because it is locked away we don't treat it as though it is ours. It becomes a number we look at once a year when we get our annual statement, but we don't think about the process that is going on behind the scenes. There is nothing wrong with this approach per se, but it tends to lead to Super being viewed and described as a singular asset rather than the collection of assets that actually make up the account. Thus we get statements about whether 'superannuation' had a good or bad year, whether 'super' is doing well or is worthwhile. We become passive observers rather than active participants.

This singular focus distracts us from the fact that Superannuation is not an investment in its own right, any more than a company or family trust is an investment. We don't generally look at the stock market and say, 'Company' has done well this year. We know and acknowledge that there are all types of companies doing all types of things, and it is the things that they do which will drive their individual performance. So it is with Superannuation. Super is nothing more than a vehicle through which investments are made. A tax structure, nothing more, nothing less. It is an enormously powerful tax structure given the concessions bestowed upon it, effectively offering Australians a legal tax haven for their retirement. But it is not an investment.

The Cooper review recently noted that a healthy level of engagement with superannuation savings was generally a good thing when it came to understanding what was driving performance, and what changes could be made. They found this to be a positive for SMSFs and there is a very good reason for this. The SMSF trustee is required to make the decisions about the running of the fund, and part of this is the decision as to the investments held. By its very nature, an SMSF forces a member/trustee to 'look under the hood' and acknowledge the difference between the structure itself and the investments that lie within. However, you don't need to have an SMSF to do this.

What should this change of focus accomplish? Firstly, your focus will shift away from what an investment industry is doing (and the goals that it may have set for itself) and toward what your individual goals are. What is it that you are trying to achieve? When you ask yourself this question, spend some time to come up with a meaningful answer. For example, "to have a comfortable retirement" may be your goal but it is not very helpful in formulating a plan. You need to be more specific than that. What does comfortable mean to you? An example of a meaningful goal might be 'to accumulate sufficient superannuation by age 58 to pay a lump sum of $100,000 and to support an annual income of at least $50,000 indexed to inflation to my age expectancy plus 5 years'. You now have a true measure of success and a way of judging progress that is meaningful. Each Superannuation decision should be made to further that goal.

You can then look at where you are positioned right now compared to your goal. There is likely to be a gap. A gap that needs to be filled through a combination of investment returns and saving capacity/effort. You can now work out a strategy that should lead to an investment style that you are comfortable with and include an assessment of the asset classes you will focus on, and the degree to which you will commit capital to each of these. This is an active and individual process. An investment institution cannot do this for you even if they cared to.

Once you have a strategy in place, you can then choose your individual investments. In an SMSF the choices here are very wide and you have a far greater level of control over where your money is placed. However in virtually every fund the investment options available will let you tailor your asset class exposures to some extent. What investments do you choose? The answer is the investment that takes you closer to your goal with a level of risk that is acceptable to you. The one tried and true rule of investment is that where there is higher return, there is higher risk. People who tell you otherwise are just trying to sell you something. Approach skeptically. Once you have worked out the return you need to achieve your goals, judge your investment options based on the risk associated with them, whether this is for an individual investment or an asset class.

You may also look to reduce the unforeseeable risks by taking out some insurance. So now Super isn't just about investment, it is also a method of tax effectively mitigating risk. Again this is an active process that needs review as your circumstances change.

As soon as you individualise your Super by becoming involved, the 'superannuation' performance you hear talked about endlessly in the media and by industry protagonists will have little or no relevance to you. Your performance will hopefully be relevant to your circumstances and you will be more engaged with the decision making process. Super will become an active part of your financial planning, which can't be a bad thing.

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

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CHANGING FROM INDIVIDUAL TRUSTEES TO A CORPORATE TRUSTEE IN A SMSF

By Grant Kai-Fong

There may be times in the life of a Self-Managed Superannuation Fund ("SMSF") where it is deemed more beneficial to have a corporate trustee for the fund rather than an existing set up with individual trustees. The very nature of a family SMSF means that members and trustees over time may come and go from the fund. For this reason it may be considered more beneficial to have a corporate trustee rather than individual trustees, as when there is a change in membership of the fund with individual trustees there is additional administration required (compared to a fund with a corporate trustee) to transfer the assets held by the super fund into the new trustee(s) name.

To change the trustee in an SMSF however, is not always a simple process. Where individual trustees wish to change to a corporate trustee structure, change of trustee documentation is required, which will be governed by the trust deed for the fund and the *Superannuation Industry (Supervision) Act 1993* ("SIS Act"). There may also be directors of a corporate trustee being appointed during this process. If this is the case relevant documentation (as outlined in the company constitution as well as the Corporations Act) will need to be prepared.

The documentation required to be completed in changing from individual trustees to a corporate trustee in a SMSF will vary from case to case (depending on the terms of the fund trust deed), however the following is a general step by step procedure of the processes that needs to be completed.

(1) Check the Trust Deed Rules

The rules for documenting changes of trustee are contained both in the fund's trust deed as well as in the SIS Act. There are many SMSF deeds out in the market and each deed has different methods and rules for changing trustees. Some trust deeds may require the consent of another party other than the trustees (such as a founder, principal or employer sponsor) before the trust deed can be changed. Others only require the consent of either the members or the trustees. Some trust deeds actually require the deed to be varied in full if there is a change from individual trustees to a corporate trustee.

Basically, you first need to check the existing trust deed to see what documentation and consents are required to be executed. This documentation will include the minutes recording the change in trustee and the appropriate trust deed variation.

(2) Choose a Corporate Trustee

The members need to decide on a company that they wish to use as the new corporate trustee of the fund to replace themselves as individual trustees. This may be a company already in existence or it may be desired that a new company is incorporated for this purpose. If an existing company is going to be used it is important that all members of the fund are directors of the company and each director of the company is a member of the fund.

A dedicated corporate trustee can be set up with the sole purpose of being the corporate trustee of the SMSF, in which case the annual ASIC review fees are currently only $41 per year.

(3) Obtain Directors Consents

All members of a SMSF are required to be a director of the trustee company.

The SIS Act provides that a person is not eligible to be appointed as director of a trustee company of a super fund unless the person has consented in writing to the appointment. If any director of a trustee company has not consented in writing to their appointment, they are not eligible to hold that office.

(4) Report Changes to the Australian Tax Office

From 1 July 2007, the trustee of a SMSF must notify the Australian Tax Office ("ATO") within 28 days of changes in the:

- fund membership;
- fund trustees;
- fund address;
- name of the fund;
- contact details;
- directors for the corporate trustee (where applicable).

Therefore the new corporate trustee of the SMSF needs to be notified to the ATO. This notification is completed on an ATO form "NAT 3036".

(5) SMSF Trustee Declaration

From 1 July 2007, all new trustees and directors of corporate trustees of a SMSF must sign a declaration, in the approved form, stating that they understand their obligations and responsibilities as a trustee of a SMSF. This declaration is made on the ATO form NAT 71089 and contains information about:

- general trustee duties;
- investment restrictions;
- sole purpose test;
- record keeping; and
- reporting and lodgment obligations.

The declaration must be signed within 21 days of becoming a director of the corporate trustee. Although the form is not required to be lodged with the ATO, the declaration must be retained for at least 10 years and made available to the Commissioner on request.

(6) Fund Asset Administration

All changes in trustee must be notified to all relevant share registries and banks to reflect the new ownership in assets on behalf of the fund. The new corporate trustee will only have to be notified to the relevant security registers at this point in time (provided the fund continues with a corporate trustee), as any membership changes in the future will only result in a change of directorship of the corporate trustee which is already recorded as the asset holder.

Conclusion

There are a few steps that need to be completed in the process of changing from individual trustees of a SMSF to a corporate trustee. As such there is a legal risk in completing all the necessary documentation should anything be omitted or completed incorrectly during the process.

It is generally recommended that a reputable legal document service firm with appropriate legal backing and professional associations is used if you are looking at doing anything like changing from individual trustees to a corporate trustee in a SMSF. This will ensure that complete and correct documentation is executed during the process.

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SMSFS INVESTING IN UNIT TRUSTS

Daniel Butler, Director and Nathan Papson, Lawyer, DBA Lawyers

Introduction

This article outlines some of practical tips and traps related to investing in both related and unrelated unit trusts.

Can further units be acquired in a pre-1999 unit trust?

If a trust is related (eg, greater than 50% owned) then the 5% in-house asset ('IHA') limit applies. We generally recommend that SMSFs should keep this 5% limit as a safety buffer just in case of an oversight. Further, the Cooper review has recommended the 5% IHA limit be phased out for SMSFs.

However, if the trust is not related there is no limit on the amount of investment. This is because the IHA limit applies to an investment in a related trust. Three independent SMSFs holding one-third of a geared unit trust each does not invoke the IHA rules.

What documents should have been in place for the 30 June 2009 deadline?

It is crucial that the relevant steps and documents were completed prior to 30 June 2009 to ensure the investment satisfied the 30 June 2009 reinvestment deadline. Broadly, an SMSF could previously reinvest distributions back into a pre-1999 related geared unit trust up to 30 June 2009.

In particular, the unit trust deed usually prescribes how to issue units. This generally requires a number of discrete steps including a valuation of each unit, an application for units, directors' approval, updating the unit register and the issue of the new unit certificates. Thus, no investment is typically made until each step has been completed.

Further, only amounts received before 30 June 2009 could have been reinvested into the unit trust and these had to have been reinvested prior to 30 June 2009 to ensure that they were exempt from being IHAs under the 30 June 2009 IHA transitional rules.

Must distributions be paid by 30 June?

Broadly, the ATO considers that an unpaid present entitlement ('UPE') is a 'loan' by the SMSF to a unit trust if it is not paid within 12 months of the end of the relevant financial year. Otherwise, the ATO state that a UPE could result in a breach of the IHA rules, the arm's length rules and the sole purpose test.

In particular, SMSFR 2009/3 states that a UPE will be an IHA to a related trust if a consensual agreement for the provision of financial accommodation has been reached or can be inferred between the parties.

Accordingly, SMSFs should ensure that any UPE from a related trust is paid to them in a timely manner; otherwise it will be considered a loan by the ATO.

Conversion of a geared unit trust to a non-geared unit trust

Many SMSFs that had acquired units under the transitional rules for pre-1999 unit trust investments now have the problem of how to acquire or invest in further units in the related unit trust without it breaching the IHA rules.

One option appeared to be for the unit trust to be converted to a non-geared unit trust ('NGUT') provided each and every requirement in SIS reg 13.22C was satisfied (eg, no borrowings or charges, no business nor could the unit trust have any investment in another entity such as BHP shares). This option was generally considered as a viable strategy after the unit trust paid off its borrowings. The proposal was for the SMSF to then buy units in a unit trust that subsequently qualified as a NGUT at market value without any IHA limit.

However, the ATO has recently stated that a unit trust is precluded from relying on the NGUT exception if the trust has breached a requirement in reg 13.22C after its introduction in mid 2000. In particular, the ATO stated that a new borrowing by a unit trust in 2001 would preclude the previously geared unit trust converting to a NGUT. This ATO view has only recently been released and is causing considerable concern.

While DBA Lawyers does not agree with this ATO view, the ATO are willing to test its view in the courts. This ATO view provides little flexibility for pre-1999 unit trusts seeking further SMSF equity injection after the 30 June 2009 deadline.

A pre-1999 unit trust may however still be capable of satisfying the NGUT exception if all the requirements in reg 13.22C have been complied with since mid 2000. This may still be possible if the unit trust still maintained borrowings provided these had not been increased after mid 2000.

Should the unit trust be a fixed trust?

Unless the unit trust deed qualifies as a fixed trust, any trust distributions received by an SMSF may be treated as non-arm's length income taxed at 45% (this 45% tax applies even if the SMSF is in pension mode).

Note that a unit trust does not automatically qualify as a fixed trust. We are aware of numerous definitions of fixed trust including for trust loss and franking credit purposes, for distribution purposes, for land tax purposes (eg, NSW and Victoria have special land tax provisions) and for general trust law purposes.

Broadly, a trust is a fixed trust for superannuation purposes if all the entitlements to income and capital are fixed and cannot be taken away from the unitholders. Many unit trust deeds provide non-fixed entitlements and some provide discretionary or hybrid units with variable distributions. Further, under many deeds a majority of unitholders may be able to take away the income or capital rights of the minority. Naturally, these unit trust deeds are not appropriate for SMSFs.

Will the unit trust be taxed as a company?

A unit trust can be taxed as a company (ie, a public trading trust 'PTT') if both of the following tests are met:

- SMSFs hold at least 20% of the units in the trust; and
- the unit trust carries on activities beyond mere land ownership for the purpose of deriving rent and other passive investments such as investment in shares, units, loans, certain other financial instruments, etc.

Broadly, there is a safe harbour provided if at least 75% of the trust's gross revenue is derived from rent.

If a unit trust is a PTT, it is broadly taxed as a company rather than as a trust, ie it is taxed at the company tax rate and distributions are taxed like franked dividends. For example, where a unit trust develops a property and sells it (rather than holding it for long-term rental) and SMSFs own

more than a 20% unitholding in that unit trust, it would be taxed as a company at a 30% tax rate on any net income.

What are the current trust issues under ATO scrutiny?

The ATO has recently released Taxpayer Alert 2010/5, which strikes at SMSFs seeking to invest in an unrelated unit trust to avoid the usual SMSF investment restrictions (particularly lending to members and related parties).

The scheme the ATO attack in TA 2010/5 involves SMSFs investing in an unrelated unit trust that then on-lends a similar amount to a member or related party. The ATO see this as a blatant indirect breach of the super fund investment rules.

We should all consider the wider issues of this ATO alert. Similar concerns may be raised where an SMSF has invested in a related unit trust that provides a loan (eg, an extended UPE) or other investment that would not be permitted if undertaken directly by the SMSF — for example, the unit trust lending to a member, relative or related party. This is because the ATO generally looks through unit trusts to apply the usual super fund investment rules.

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Note: DBA Lawyers hold quarterly SMSF seminars at venues all around Australia. For more details or to register, visit http://www.dbalawyers.com.au or call Marie on 03 9092 9400.

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