EUREKA*report*

Superannuation Q& A

By Andrew Quinn
September 9, 2009

This week:

- Death of an SMSF trustee.
- Investment property and SMSFs.
- SMSFs and property borrowing.
- How to set up an SMSF.

A matter for trustees

We are upgrading our will and have a couple of questions regarding trustees and enduring powers of attorney. Is it true that upon the death of a trustee member of a self-managed fund, the person given enduring power of attorney for the deceased can act as substitute trustee to co-manage the super fund, thus maintaining the fund. If this is so, to what degree and for how long? Can a super fund have a trustee who is not an active member of the fund? What documentation is required if a trustee member wishes to resign and have their balance transferred to another fund?

This is more of a legal than financial question, so I would recommend that you seek expert advice from your solicitor to ensure that your particular circumstances are taken into account. The broad rule under section 17A(3) of the Superannuation Industry Supervision Act is that if a member dies, then their legal personal representative – generally the executor their estate – takes over the member's powers until the death benefit is paid.

However, this is not necessarily an automatic appointment and the SMSF trust deed will need to be reviewed to determine who has the power to appoint a replacement trustee. The issue of who receives the death benefit will primarily depend on whether the deceased has signed a binding death benefit nomination. Where such a nomination has been made, and it is valid at the time of death, the trustees must pay the benefit to the recipient stated in the nomination (you can find out more about binding death benefit nominations **here**).

Without a binding nomination, the trustees have discretion in distributing the death benefit as long as it is in accordance with the trust deed, trust law and the superannuation legislation. Enduring powers of attorney can be used where the trustee becomes legally incapacitated but will cease when the trustee dies.

Bayside conundrum

I am a 64 year old self-managed super retiree and have $300,000 in a managed fund, an SMSF of $700,000 shares and $650,000 in term deposits, and a holiday house worth $500,000 which I don't rent. I have converted to pension mode recently. I would like to buy a townhouse in Brighton, Melbourne, where I live. The area is increasing in value considerably – it has doubled in seven years and continues to boom. I plan to use all the funds I have in term deposit and rent it out for approximately 10 years and maybe live there when I wish to scale down. I currently live in a home that belongs to my partner and I pay no rent. Would it be better to purchase the townhouse in the name of the super fund as the income would pay no tax, or in my own name so as to not pay capital gains when I or my beneficiaries sell it?

There are several issues that need to be considered in your case. The first is to highlight that self-managed super funds must satisfy the sole-purpose test at all times. This means that they can only be used to provide retirement or death benefits to their members. While SMSFs are permitted to acquire residential property from non-related parties on an arm's length basis, it must be done for an investment purpose and you will need to transfer it out of the fund if you wish to live in it yourself at a later date.

You will also need to work out how the fund will acquire the property. Do you have enough cash or liquid assets in the fund already to complete the purchase? Are you eligible to contribute money to the super fund so that it can buy a property? Likewise, you will need to assess whether the purchase of one large asset like a townhouse is a suitable asset when the members of the fund are close to retirement and whether it is consistent with the fund's investment strategy.

The answer to your question on capital gains tax will depend critically on when you sell the property, who your beneficiaries are and whether or not they are dependants. These are complex issues that should be discussed in more detail with a qualified adviser.

Property dreams

I'm aged 50 and want to acquire a residential property as an investment using 90% debt (so that the interest paid is tax-deductible) and progressively move that property into an SMSF. As far as I know the SMSF rules don't allow me to borrow against assets, so I can't acquire the property from within the SMSF. Separately, I understand that I am now restricted as to how to move the property to an SMSF as I can only place up to $25,000 a year into the SMSF. Over time I expect the property to increase in value, and therefore expect to pay CGT. Is there a definitive tax office formula to work this out? Also, how would I adjust the proportion of rent paid between my own taxable income, and the SMSF income?

SMSFs can borrow for residential and commercial property investments using products and borrowing arrangements that qualify as instalment-warrant-style borrowings. However there are important rules that need to be met to satisfy the conditions contained in section 67(4A), 71(8) and 71(9) of the Superannuation Industry Supervision Act.

There are several lenders that specialise in arranging SMSF loans and you should speak to them or your accountant for further guidance. You should also be aware that this is an evolving area of the law and the ground rules on how these loans should be structured is still being clarified. For example, the tax office is yet to give definitive guidance on critical aspects such as the use of guarantees, whether this constitutes a contribution, and the boundaries of the "limited recourse" requirement.

Super head start

I am contemplating setting up my own super fund, but lack the knowledge and or the confidence. What I understand is that you ultimately benefit you in the tax you pay on the investment capital in your superfund. I am 62 years young and I want to be in charge of my selling and buying of shares without the penalty of paying tax more than necessary.

My question is that I don't know which SMSF to go for? My accountant, of course, recommended I use him (with an annual fee of $4000). On the other end of the scale, I found Esuperfund with an annual fee of $599. Can you give me some clarity as to what the basic benefits are for an SMSF.

SMSFs offer their members a range of important benefits, the most obvious one being direct control over the fund's investments. SMSFs can also provide members with great flexibility in terms of managing their super. This applies at all stages in the process, not just investing. There are several estate planning, investment, gearing and tax strategies that are either much easier or only possible within a self-managed fund.

Lower fees are another motivating factor. With retail funds, wrap accounts and master trusts typically charging 1.5–2% per annum in fees, it doesn't require a very high account balance before the pros and cons start to favour the SMSF option. It is hard to give a precise guide on accounting fees but SMSFs with good administrative records should not generally be paying $4000 per annum, even if you have a corporate trustee.

As you have noted, there are many firms around which will do the job at a fraction of this cost. Of course, there is often a trade-off between price and flexibility. Many lower-cost firms will require you to use a specific bank account or online broker to do all your trading, or have restrictions on the number of investments or transactions permitted each year.

Others will allow greater flexibility but charge slightly more. But the decision to establish an SMSF is not one that should be taken lightly because the law places many compliance obligations on trustees and can impose severe penalties if the rules are not followed. You should therefore seek further advice before making any final decisions.

Andrew Quinn is a director of the Melbourne-based ***Wren Investment Advisers****.*