The Pros and Cons of an SMSF

Summary

A self-managed superannuation fund (SMSF) is a tax effective savings vehicle, which provides retirement and other benefits to its members.

The key attractions of a SMSF are the additional control and investment flexibility they offer. However, they are not right for everyone as it takes time and knowledge to manage the SMSF's investments and to ensure the fund complies with all the superannuation and taxation requirements.

When deciding whether you should use an SMSF the benefits and costs need be considered.

What are the advantages of having an SMSF?

The main reason people choose to use an SMSF is that they are able to do things that cannot be done in larger funds. These revolve around control, flexibility and timing of investment and taxation decisions.

Control

SMSFs allow members to exercise a high level of control over fund issues, such as fund membership, structure of the portfolio and timing of investments. They are generally suited to people who like to invest directly and make their own decisions about when and where to invest.

Trustees may seek guidance from investment professionals such as financial planners, accountants, and lawyers from time to time. Ultimately they are responsible for any decisions that are made for the fund, along with the other trustees or directors of a corporate trustee.

Flexibility

Trustees of an SMSF can consider a greater range of direct and indirect investment opportunities. Many of these investments are unique to SMSFs and generally are not included in the portfolios of the larger funds.

Investments may include assets that are connected to a member's business, such as commercial property, or a collectible investment like artwork or antiques.

Holding a commercial property within a SMSF that is leased by a business owned by the members may be advantageous as any rent received by the fund may be tax deductible to the business.

There are additional benefits of including business assets in an SMSF like asset protection and estate planning benefits, particularly relevant to sole traders, partners in partnerships and small business enterprises.

It may also be possible to make contributions to the fund by transferring or selling certain investments that are owned personally to the fund. While there are restrictions on some types of investments that can be transferred, direct shares, managed funds and commercial property may be able to be transferred or sold to the fund.

An SMSF can acquire certain assets from members and other parties related to the fund. This could be used as a strategy to free up capital for the member or to build up the fund's assets. Any acquisition must comply with the fund's investment strategy.

Timing of Investment and Taxation Decisions

An SMSF can be used to accumulate assets during your working life and to provide income during retirement. This places you in a position to plan the buying and selling of fund investments to obtain maximum tax efficiency.

On retirement there is no requirement to sell down investments when commencing an income stream to fund the pension payments. This allows investments to be sold in a more tax effective way when capital gains may be tax-free.

Other factors to be considered?

Do you have the knowledge and time available to manage a SMSF?

It takes time and knowledge to:

- manage the investments of the SMSF
- achieve an overall outcome that is better than that which can be achieved from a retail or industry superannuation fund
- ensure that the SMSF remains compliant with all superannuation and taxation requirements.

Where any of the superannuation or taxation requirements are breached, significant penalties may apply.

The administration and compliance requirements of an SMSF can be time consuming. The trustees must decide whether they take on this responsibility themselves or seek assistance. Either way, the trustees still remain responsible for any decisions made.

Will the benefits of the SMSF outweigh the cost and time involved?

Whether running an SMSF is more cost effective than using a retail superannuation fund depends on the:

- level of assets held in the SMSF
- extent to which the management of the SMSF is outsourced

When trying to quantify the cost of an SMSF compared to other types of superannuation funds, consider the amount of work involved and the time devoted to running the SMSF.

Most fees and charges involved in running an SMSF are fixed. This means the cost can be the same for a fund with $100,000 as it can be for a fund with $1 million. Therefore, as the fund balance grow over time in an SMSF the cost of running the fund decreases as a percentage of the fund balance.

Other considerations would include the potential additional cost of insurance premiums. SMSFs may not have access to conditions that are available to the larger funds. This may include larger funds having access to group premiums and automatic acceptance.

Estate planning goals may be achieved effectively by using an SMSF, however, there may be difficulties with accessing some tax concessions such as the payment of anti-detriment payments where a member has died.

Advantages and disadvantages of running an SMSF

Advantages	Disadvantages
Control Members/trustees control the decision making process	**Time and Knowledge** May require time and knowledge to manage investments and comply with the law
Flexibility Investment options that may not be available within a retail superannuation fund	**Estate planning** Payment of 'anti-detriment' death benefit payments may be problematic due to funding difficulties
Timing The trustees can decide when investments in the fund are bought and sold	**Timing** Decisions about investments may be made on an ad hoc basis and not consistent with investment principles
Insurance Insurance policies held within an employer sponsored superannuation fund are generally not portable	**Insurance** Group rates for insurance and automatic acceptance may be offered in employer sponsored superannuation funds
Cost May be cost effective for larger SMSF balances.	**Cost** May be relatively expensive for smaller SMSF balances