SMSF jargon buster!

A quick guide to some technical SMSF terms

Secure, Build, Succeed.

Self-managed super funds (SMSFs) have become extremely popular in Australia, with more than half a million SMSFs now in existence, and they're still growing.*

You probably already know that superannuation terminology can be convoluted at times; SMSFs are no different.

Here are some terms you may come across if you decide to join the million people already operating as SMSF trustees.

Of course your adviser can also assist if you happen to run into a wall of jargon!

Trustee: An SMSF trustee is one of up to four people who can be members of an SMSF. Trustees can be individuals or companies (where fund members are company directors, again with a maximum of four).

A trustee is responsible for ensuring the SMSF is maintained for the sole purpose of providing retirement benefits to members. They are also responsible for drafting and

reviewing
the fund's investment strategy and making investments, accepting contributions and paying benefits, appointing an approved auditor, keeping fund records and lodging annual returns with the Australian Taxation Office (ATO).

Investment strategy: As a trustee, you'll need to design and implement an investment strategy that:

- protects members' retirement benefits;
- minimises the risk of irresponsible/incompetent investments; and
- meets your stated SMSF investment objective.

By law, all SMSFs, whether they have individual or corporate trustees, must have a written investment strategy. The strategy should also consider issues like risk, diversification, liquidity, solvency and the insurance of members.

Arms-length provision: Any investments or leasing arrangements with related parties (see below) must be entered into under normal commercial terms.

In-house assets: Loans to, investments in, and leases with a related party. These are restricted to 5% of your self-managed super fund's assets.

For example, if your SMSF invests in a related company or unit trust, it can only do so if its value is less than 5% of the total value of the fund's assets. There are exceptions to the in-house rule, such as business real property owned by the SMSF and leased to a related party.

Related parties: A member of the SMSF or a person somehow related to a member, including other members, family, business associates, related companies and related trusts.

Generally a fund is not allowed to buy assets from related parties. Exceptions are assets such as listed securities (e.g. shares or bonds, traded at market price), managed funds (traded at market price), a business real property bought at market value or 'in-house assets' (see explanation above).

Sole purpose test: This must be met in order for your SMSF to receive concessional tax treatment.

The SMSF (and its assets) must be seen to have as its 'core purpose' paying benefits when members retire, or to their beneficiaries after their death.

Generally, you can't receive any other benefit from the assets owned by the fund. For example, if the fund owns shares, you wouldn't be allowed to receive any shareholder discounts you'd receive if you owned them personally.

Binding Death Benefit Nomination: A Binding Death Benefit Nomination is a notice given by a member of the SMSF to the trustee of their SMSF (even though this is generally the same person) requiring a death benefit to be paid to the member's nominated dependant(s) and/or legal personal representative.

Without a valid nomination, when you pass away, the remaining trustee(s) will, for better or worse, determine what happens to the assets in your SMSF in accordance with the Superannuation legislation and your fund trust deed. So in short, if you want to be sure who inherits your super (and any insurance), it is generally recommended that you put a binding death benefit nomination in place.

Trust Deed: The SMSF is governed by the Trust Deed, which makes it an important document. It sets out the rules of the Fund. The Investment strategy will be in alignment with the Trust Deed, setting out specific investments that the SMSF can make. Information that may be documented in the trust deed includes the powers of the trustee and any restrictions on investment vehicles.

Cash-Management Account (CMA): A CMA allows you to earn higher interest than you would from your regular debit or savings account. There are hundreds of cash management accounts available for SMSF investors.

CMAs will vary in the interest rates they offer and will also have different fees and features. Unlike an online savings account, where it can take days to access your funds, CMAs generally have faster or immediate accessibility. However, they may not offer the highest rates of online accounts.

Investor Directed Portfolio Services (IDPS): An IDPS is a custodial, transactional and consolidated reporting service that is often referred to as a wrap account.

A wrap account allows you to manage and retain control of your investment portfolio, plus have access to a wide range of managed funds, shares and term deposits through one service provider, with the advantage of consolidated tax, transaction and performance reporting.

A limited recourse borrowing arrangement (LRBA): If an SMSF borrows money to purchase a single asset (usually property), or a collection of identical assets that have the same market value, the trustees receive the beneficial interest in the purchased asset, but the legal ownership of the asset is held on trust (the holding trust).

The SMSF trustees have the right to acquire the legal ownership of the asset by making one or more payments.

Any recourse that the lender (or other party) has under the LRBA against the SMSF trustee is limited to the single fund asset (including rights to income).

In summary, the only way that you can borrow money to buy an asset such as an investment property through your self-managed super fund, is by using an LRBA.

In-specie transfer: This is the process of transferring the ownership of managed funds or shares from one owner to another or from one wrap account to another. For instance, as a member of a SMSF you can make a member contribution by 'in-specie' shares or managed funds that you hold personally into your SMSF. Also some wrap accounts allow you to 'in-specie' transfer shares and managed funds to/from a wrap account you hold with another provider.

Benefits of in-specie transfers include potential savings on buy and sell costs, and being able to remain in the market while the transfer is going through.

Many retail super funds do not offer in-specie transfer, whereas it's generally possible with self- managed super funds.

Listed Investment Companies (LICs): LICs are a subset of what the Australian Stock Exchange calls listed managed investments. They enable you to invest in a diverse and professionally managed portfolio of assets, including shares, property and interest bearing deposits.

In Australia, LICs primarily invest in Australian or international shares and they are bought and sold on the market just like an ordinary share. You can decide whether the investment style and underlying investment portfolio of a particular LIC suits your own investment objectives.

Exchange Traded Funds (ETFs): ETFs are a simple way to create a diversified portfolio. They are traded on the Australian Stock Exchange (ASX) in the same way as shares.

ETFs allow you to diversify your portfolio without having a large amount of money to invest. The broad investment exposure helps you to avoid concentration risk which can occur if you don't diversify across and within asset classes.

An ETF generally invests in a basket of shares that represents a particular index. You can also choose to invest in ETFs that focus on currency or commodities.

Franking credits: Shareholders receive 'franked' dividends paid from company profits that have been taxed at the Australian company tax rate.

Franked dividends have a franking credit attached to them which represents the amount of tax the company has already paid on those profits. Franking credits are also known as imputation credits.

Where an SMSF receives 'franked' dividends the SMSF is entitled to receive a credit for any tax the company has paid on those profits. As the tax rate of the SMSF is generally less than the company's tax rate, the ATO will refund the difference to the SMSF.

We are ready to help.

There are lots of advantages to managing your super and retirement savings via a self-managed super fund, but there can be complicated areas and considerations that are best addressed with SMSF-specialist advice.

We are equipped with the knowledge and expertise to help you get the most out of your SMSF, by showing you how to set up and develop a sound investment strategy that reflects your needs. We can work with other professional services to create and manage a super fund that puts you on a clear path.

Talk to your SMSF financial adviser for specific information related to your SMSF needs.

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