

## Managed versus self managed superannuation funds: is DIY better?

With property a long-term investment and super a long-term vehicle, the two seem like an ideal partnership – but are they?

Julia Nekich discovers that you need more than property expertise to run a self managed super fund with direct property.



REI Super CEO Mal Smith



Julia Nekich

It's estimated that the superannuation market in Australia will soon be worth a trillion dollars. While managed super funds make up the market's largest share, self-managed super funds (SMSFs) are the industry's fastest-growing sector. Figures released by the Australian Taxation Office (ATO), show that in June 2005 around \$165 billion worth of assets was held in more than 300,000 SMSFs.

Mums and dads are drivers of the SMSF industry, according to Graeme Evans, superannuation specialist at Taxpayers Australia, an organisation that educates the public on tax and super. "65% are two member funds and there are 2000 new registrations each month," he says.

Industry experts believe SMSFs are growing because they offer benefits that managed super funds don't – flexibility, greater control, reduced rates of tax, and lower fees. In a managed super fund, management fees are, on average, 2% of your fund balance, and the fund manager makes the investment decisions. SMSFs can invest in any type of asset – including direct property.

### The attraction of direct property

Unlike managed super funds, self managed funds can hold direct residential and commercial property. Mal Smith, CEO of REI Super, says he is aware of

a number of real estate agents who have set up SMSFs with direct property. "A very common model is that around 10% of principals are members of Rei Super, some are with retail funds, and then a large proportion has self managed funds,"

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he says. "It's usually suggested to the agency principal by their accountant, who administers the fund. However, the principal, as fund trustee, is ultimately responsible for its compliance."

Holding property in super can be a better estate planning tool and capital gain asset than gearing. "In the accumulation phase, the tax on earnings is a maximum of 15%.

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If the property is held for more than one year, the capital gains tax is just 10%," says Robert Turner, director at Dixon Advisory and Superannuation Services, a financial advisory company.

"When you sell the property on retirement, or if the fund is paying a pension, then tax is zero on earnings and zero on capital gains." Turner says he believes this is a huge attraction for people choosing direct property as a super asset.

sell property directly into your self-managed fund – you can't do the same with residential property," says Michael Davison, superannuation policy adviser at CPA Australia.

According to 2003-2004 figures released by the ATO, 11.5% of SMSFs invest in business real property, while just 0.5% invest in other property, suggesting that the former might be the reason SMSFs with direct property are a popular choice. "Another reason they're a popular choice is that the super fund can lease business real property back to the member," says Evans.

#### **Beware of putting all your eggs in one basket**

"A key message is diversification. It's risky to put 100% of your super in direct property," says Davison. The property market could well be in a slump when you retire, while markets for shares and other assets are doing very well. "You also need to balance out the tax benefits with the illiquidity of direct property," Davison says.

Smith says managed super funds are easier to withdraw from. "The day you want to withdraw, another investor is willing to invest, so there are no liquidity constraints. In addition, self-managed funds often have inadequate death and disablement cover. The significant advantage of a collective arrangement is

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that a managed super fund can offer much better deals on insurance".

#### **Managing SMSFs**

SMSFs are regulated by the ATO. Trustees need to comply with the Superannuation Industry (Supervision) Act 1993 and other legislative and administrative requirements. As a trustee, you also need to develop an investment strategy.

**"If you are going to buy property to have for retirement, why not buy it in the name of your fund?"**

"Real estate agents could also use this knowledge as a marketing tool. They can find a different type of client and sell more property – as an investment for retirement."

There is another form of direct property that can also be included in SMSFs. "The fund can actually invest in your agency premises. This is called business real property. It's the only case where you can

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These require time, effort and regular record-keeping.

Penalties such as fines, loss of tax concessions, imprisonment or being barred as a trustee can be imposed on trustees in breach of regulations. A survey of 100 SMSF trustees carried out by CPA Australia in October 2004 showed that one-third did not recognise themselves as trustees, and one-third did not have an investment strategy.

**If you decide to reduce your risks by investing in a mix of asset classes, more time will be needed to manage the fund.**

According to Turner, monitoring direct property in an SMSF, however, is no different to personal property investments. "If you have already decided to invest in direct property, then why not do it in this way? It takes no more work to monitor the investment in a super fund."

But if you decide to reduce your risks by investing in a mix of asset classes, more time will be needed to manage the fund. This is where you might decide to hand over the compliance – and even the management – side to your accountant or a superannuation specialist.

#### Taking the SMSF route

The first step "is to first decide if a self-managed fund is for you," says Evans. "Get informed. See a licensed financial adviser, then maybe an accountant. Then identify suitable trustees – you must be one. To make it cost-effective, you need at least \$200,000 worth of assets in your SMSF," he says.

While you can't purchase the direct property through a loan – you need the money upfront – if you have a substantial amount of money in a super fund, it can be rolled over into an SMSF and then used to buy property.

Davison warns trustees that the property must only provide benefit on retirement. "You can't use a residential property as a holiday house, for instance."

But with super and property both long-term investments, "self-managed super funds are not a bad option," Evans says. "If you are going to buy property to have for retirement, why not buy it in the name of your fund."

The ATO provides comprehensive information about SMSFs and their compliance obligations at [www.ato.gov.au](http://www.ato.gov.au). Taxpayers Australia offers a 'DIY Superannuation' manual. Call 1300 657 572 or visit [www.taxpayer.com.au](http://www.taxpayer.com.au). ■

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#### DIY SUPER FUNDS – SOME IMPORTANT CONSIDERATIONS:

- Each fund must have one to four members.
- Each fund member is a trustee.
- The trustee can be a corporate entity.
- No member of the fund can be employed by another member of the fund, unless those members are related.
- No trustee can receive remuneration for their trustee duties.
- SMSFs must be registered with, report to, and be regulated by, the ATO.
- An SMSF is audited every year.
- Potential for litigation, fines and imprisonment rest with the fund members.
- There must be a succession plan for trustees in the event of death, loss of capacity or disqualification, otherwise a government authority may take over the running of the fund.
- The trustees are required to prepare and implement an investment strategy for the fund.