



Institute of  
Chartered Accountants  
Australia

super**optimised**

# National SMSF Conference 2013

16 – 17 September 2013, Melbourne

**M11**

**When SMSFs aren't the right solution  
– Using a small APRA fund to optimise and  
protect your client's position**

Presented by:

Julie Steed  
Technical Services Manager  
Australian Executor Trustees

---

### **Disclaimer**

This paper represents the opinion of the author(s) and not necessarily those of The Institute of Chartered Accountants in Australia (the Institute) or its members.

The contents are for general information only. They are not intended as professional advice - for that you should consult a Chartered Accountant or other suitably qualified professional.

The Institute expressly disclaims all liability for any loss or damage arising from reliance upon any information in these papers.

---

## Overview

In this session we will look at the features of both types of small superannuation funds, self-managed superannuation funds (SMSFs) and small APRA funds (SAFs) and consider instances where a SAF may provide a solution for optimising client outcomes. We will also review a number of unique SAF estate planning opportunities.

## SMSF features

The popularity of SMSFs continues to rise as superannuation members look to increase their involvement in their retirement savings. Control and flexibility are generally cited as the two major reasons why people turn to SMSFs. In an SMSF, all members are trustees (or directors of the corporate trustee) and they are responsible for all aspects of running the fund. Being a trustee and running an SMSF requires time, skill and knowledge. Trustees are required to understand and attend to trustee duties, superannuation compliance and record keeping.

Most trustees will handle their duties competently, often with the assistance of other professionals, however, some people are not suited to being a trustee, or may be unable to be a trustee. For these people, the other type of self-managed super, a SAF, may provide an optimal solution.

## SAF overview

A SAF is essentially an SMSF that has a professional licensed trustee which is responsible for all of the legislative, compliance and administrative responsibilities.

SAFs are an alternative for clients looking for the flexibility of a self-managed superannuation fund but without the burden of being a trustee, the commitment and time involved with administration of the fund or the associated compliance risk.

SAFs provide significant investment flexibility with a wide investment menu, including property and collectables. SAFs provide all of the legislative advantages afforded to SMSFs, without the risks associated with being a trustee and of breaching legislative compliance requirements.

As at June 2013, there were over 503,000 SMSFs and approximately 3,250 SAFs<sup>1</sup>. The SMSF sector is generally recognised as the fastest growing sector of the superannuation industry and has been for some time. Clearly SAFs are not as prevalent in numbers as SMSFs and in many instances this is due to a lack of awareness of their existence and benefits.

---

<sup>1</sup> APRA Quarterly Superannuation Performance March 2013

The main characteristics of SAFs and SMSFs are outlined in the table below:

Feature	SAF	SMSF
Less than five members	Yes	Yes
Trusteeship	Professional licensed trustee	Members
Regulator	APRA <sup>2</sup>	ATO <sup>3</sup>
Responsibility for compliance	Professional licensed trustee	Trustee members
Acquisition of business real property	Yes	Yes
Member directed investments	Yes (trustee may have restrictions)	Yes
Superannuation Complaints Tribunal	Yes	No
Disqualified persons as members	Yes	No
Non-resident as a member	Yes (may not be able to contribute)	No
SIS <sup>4</sup> legislation	Applies	Applies

## SAF compliance

In an SMSF, the compliance risk is borne by the trustee/members. The ability to manage effective compliance and investment management plans requires skill, expertise and time. Many SMSF trustees will perform their compliance responsibilities soundly, often with the aid of professionals, however, a number of trustees will be unaware of the full extent of their responsibilities or simply have insufficient time to dedicate to their responsibilities.

In a SAF, the compliance risk is borne by the professional licensed trustee whose core business is the provision of trustee services. The licensed trustee can reasonably be expected to be skilled and experienced and what are common breaches of legislative requirements for an SMSF would be avoided or minimised. The licensed trustee will also issue a Product Disclosure Statement and annual member statements which are tools that will often assist members with their understanding of how their superannuation works.

In addition, if a SAF is in breach of superannuation law, any penalty imposed by the Australian Prudential Regulation Authority (APRA) may be mitigated by applying a 'culpability test'. This test helps protect arm's length members who were not involved in the decision making that gave rise to the breach of superannuation law. Generally, it is difficult to apply this concession to an SMSF due to the mutuality between members and trustees.

<sup>2</sup> Australian Prudential Regulation Authority

<sup>3</sup> Australian Taxation Office

<sup>4</sup> Superannuation Industry (Supervision) Act 1993

## SAF administration

The administration of SMSFs can vary dramatically between funds, with a poor quality of service often provided by smaller/non professional administrators. SMSF administration is typically 'after the event' administration which relies heavily on the trustee/members providing timely and accurate information. There is often limited access to real-time information.

The administration of SAFs is generally performed by professional administration organisations appointed by the licensed trustee and are often controlled by the licensed trustee. There is likely to be a consistent compliant approach to administration with common compliance breaches unlikely to occur. The administration will record all fund transactions on behalf of the licensed trustee including collection of fund income, payment of expenses and asset purchases and sales. Record keeping will generally be timely and complete since the licensed trustee controls custody of all assets and receives all information and transactions directly. Generally members will have online access to account information with daily portfolio valuations.

## Common administration issues

Common administration issues that can lead to loss of tax concessions rarely occur in a SAF. The trustee will closely monitor and report on factors including:

- excess contributions
- conditions for claiming a tax deduction for personal contributions
  - commencing a pension
  - timeframes for lodging 290-170 notices
- payment of minimum pensions
  - no loss of exempt current pension income
- investment strategy monitoring.

## Investments

The investment universes are technically the same for both SMSFs and SAFs, however different licensed trustees will have different requirements for the approval of assets to be held in a fund and these are likely to be less generous than those approved by individual trustee/members in SMSFs. Conversely, SAFs are likely to have access to wholesale managed funds and investment strategy monitoring tools. In addition, common investment related breaches such as the purchase of assets from related parties are unlikely to occur in a SAF.

Investments are also likely to be highly automated with daily updating of investment transactions and access to online corporate actions.

## Establishing a SAF

A SAF can be established by rolling over from a retail, industry or corporate fund, in the same way that an SMSF can be. The rollover from the existing fund is a capital gains tax (CGT) event - capital gains are crystallised and any losses cannot be carried forward.

One of the common criticisms of a barrier from moving out of an SMSF which is found to be an inappropriate arrangement for a particular person is that the move to a retail, corporate or industry fund arrangement will result in CGT being incurred. The imposition of CGT is however entirely avoided if clients move from an SMSF to a SAF by retiring as trustees themselves and appointing a licensed trustee. Greater knowledge of this option would perhaps result in a smaller number of trustees who have concluded that they are not suited to the obligations of being a trustee continuing in the role. This can be particularly beneficial for SMSF

trustee/members who were skilled and committed in their younger years but who have become less interested and able as they age.

## Trusteeship

Trustees of a superannuation fund are responsible for the prudential management and conduct of the fund. Trustee duties are primarily sourced from trust law, the trust deed, SIS legislation<sup>5</sup> and various state based Trustee Acts. The SIS legislation codifies the covenants that all trustees must comply with and sets minimum operating standards, the breach of which could lead a fund into non-compliance and the imposition of penalties on its trustees.

SAF trusteeship is provided by an APRA licensed trustee which is a professional trustee company. The licensed trustee will invariably be very familiar with the fund's trust deed and with superannuation legislation. In addition to reducing compliance risk, the use of a professional trustee may provide cost reductions through economies of scale in respect of the provision of professional services.

Trusteeship of an SMSF may cause difficulties for a number of clients including those facing bankruptcy and non-residents.

## Disqualified persons

A disqualified person is an individual who:

- has been convicted of an offence involving dishonesty, or
- is an undischarged bankrupt, or
- has been disqualified by a Regulator of a civil penalty

A disqualified person is unable to be a trustee and is therefore unable to be a member of an SMSF. It is also not possible for a disqualified person's legal personal representative to act as trustee of an SMSF. There are no legal issues with disqualified persons being members of a SAF.

Once an individual is declared to be a disqualified person, they are no longer eligible to be a trustee of the SMSF, which also means that they are unable to be a member of that fund while it remains an SMSF.

If an SMSF trustee becomes a disqualified person, they are required to notify the Australian Taxation Office (ATO) immediately and make alternative arrangements for their SMSF within six months. If alternative arrangements are not made, the fund will fail to meet the definition of an SMSF and is therefore not entitled to concessional tax treatment. An amount equal to the market value of the fund's total assets (less any contributions the fund has received that are not part of the taxable income of the fund) will be included in the fund's assessable income. This amount is taxed at 45%.

In addition to the risk of tax penalties, civil and criminal penalties may also apply. A disqualified person acting as a trustee of a superannuation fund is a strict liability offence. If the facts are that the breach has occurred then penalties can apply, there is no requirement for the breach to be intentional or reckless. Penalties include imprisonment for up to two years and/or a fine of up to 60 penalty units (\$10,200).

It is also an offence not to notify the ATO in writing immediately upon becoming a disqualified person which is also a strict liability offence and a fine of up to 50 penalty units (\$8,500) can apply.

---

<sup>5</sup> Superannuation Industry (Supervision) Act 1993

## Residency

Superannuation funds are allowed certain tax concessions provided that they comply with a number of regulatory conditions, one of which relates to the residency status of the fund, and requires the fund to meet the definition of an Australian superannuation fund at all times.

A superannuation fund is an Australian superannuation fund if:

- the fund was established in Australia, or any asset of the fund is situated in Australia, and
- the central management and control of the fund is ordinarily in Australia, and
- active members who are Australian residents hold at least 50 per cent of the fund value.

Provided non-resident members don't contribute (or contributory resident members hold greater than 50% of the fund's assets), SAFs can generally meet the requirements of the definition.

### Central management and control

For clients who are trustees of SMSFs, the residency test is particularly important. As the trustee is responsible for the central management and control of a fund, their physical location is very relevant.

In a SAF, retail, corporate or industry fund environment, the trustee will invariably be a body corporate, incorporated in Australia, with the business of the fund being managed from Australia. As a result, the central management and control test is generally easily met.

The central management and control of a superannuation fund is ordinarily in Australia at a time even if that central management and control is temporarily outside Australia for a period of not more than two years.

Prior to 1 July 2007, fund trustees were able to be absent from Australia for two years, however, by returning to Australia for a period of 28 consecutive days, this two year time period was re-triggered. For example, trustees returning to Australia every second Christmas for a month were able to continue to meet the residency requirements. However, the 28 day provision no longer applies and trustees who are temporarily absent for more than two years will rarely meet the central management and control test.

### Active members

Active members are members who contribute, or for whom contributions are made to a fund. For the purpose of the residency test, contributions include rollovers to a fund.

### Power of attorney

In April 2010, the ATO issued an SMSF ruling (SMSFR 2010/2) relating to the definition of an SMSF and the use of legal personal representatives (LPRs) as trustees.

The issue of using an LPR has been somewhat difficult in the past as many State Trustee Acts limit the amount of time that an LPR can act in their capacity as a trustee (of any trust), typically to 12 months. The ATO has addressed this issue in the ruling by clarifying that the LPR is not acting in the capacity of trustee. Instead, the member retires as trustee and the LPR is formally appointed in their place as trustee (or director of the corporate trustee).

As with any new trustee appointment, the LPR needs to complete the ATO new trustee declaration. The member can then have no ongoing high level involvement in the decision making and operation of the fund. All decisions must then be made by the new trustee.

Only an LPR appointed under an enduring power of attorney can be appointed as a trustee. It is also important that the trust deed of the fund allows a person to be a member of a fund without the requirement that they be a trustee. It is fairly common for trust deeds to require all members to be trustees.

## **Penalties**

SMSF trustees and members must ensure that their SMSF complies with the central management and control test and the active member test at all times so that the SMSF is an Australian superannuation fund. If a superannuation fund does not meet the residency requirements at any stage of the year, the fund is not an Australian superannuation fund and therefore will not be a complying superannuation fund. Any discretion that the Commissioner of Taxation may normally have to treat a non-complying superannuation fund as a complying superannuation fund is not available for an SMSF that is not an Australian superannuation fund.

An SMSF that is not complying is not entitled to any tax concessions and will incur a significant tax penalty. An amount equal to the market value of the fund's total assets (less any contributions the fund has received that are not part of the taxable income of the fund) will be included in the fund's assessable income. This amount is taxed at the highest marginal tax rate. For every year that the fund remains non-complying, its assessable income is taxed at the highest marginal tax rate.

## **SAFs and non-resident members**

Provided non-resident members don't contribute (or contributory resident members hold greater than 50% of the fund's assets), SAFs can generally meet the requirements of the Australian superannuation fund definition and therefore provide a viable alternative for non-resident members.

## **Estate planning opportunities**

SAFs provide a number of unique estate planning opportunities regarding death benefit nominations, dealing with families with disabled children and protecting the assets of blended families.

## **Death benefit nominations**

Members of SMSFs and SAFs are able to incorporate certainty in the nomination of beneficiaries using a clause in the trust deed. Such a clause would typically state that:

- if a member nominates a valid SIS dependant, the benefit shall be paid to them
- if there is no nomination, or the nomination is invalid, the benefit shall be paid to the LPR.

SMSFs and SAFs are able to utilise this option as they are exempt from the provisions of SIS which prohibits fund trustees from being subject to a direction.

Unlike traditional binding nominations, member directed nominations never lapse and do not need to be witnessed. However, they still need to be regularly reviewed to ensure that the nomination remains appropriate.

Member directed nominations together with a professional and independent trustee in a SAF provides certainty in the death benefit nomination process. While SMSFs have the same legislative power, the ability of surviving trustees to access the cheque book may provide undesirable outcomes where there are family tensions.

## Disabled children

SAFs provide a unique opportunity for families with a disabled child. They can be used to protect the disabled child and optimise superannuation benefits. The parent's death benefit can be paid as an income stream to an intellectually disabled adult child providing a tax-effective outcome.

Invariably, superannuation death benefits are unable to be paid to a child over age 25 unless the child has a permanent physical or intellectual disability, has a substantially reduced capacity for communication, learning or mobility and requires ongoing support services.

It is difficult to provide the same level of protection in an SMSF because an intellectually disabled person cannot be a trustee. In addition to being unable to be a trustee, a person who lacks mental capacity is unable to appoint an LPR. The process of having the courts appoint an LPR can be extremely arduous.

There are no such difficulties in a SAF, the professional licensed trustee continues as trustee indefinitely, providing unrivalled protection.

The income stream is prevented from being commuted and is often paid to a protective trust and then distributed to the disabled child.

## Blended families

When clients marry for a second time they are often keen to ensure that their second spouse is well looked after in the event of their death. However, there is often a desire to balance this with leaving assets to children of the first marriage.

A member can arrange for their death benefit to be paid as a pension to their second spouse (pension beneficiary) throughout the spouse's life. Upon the death of the second spouse, the remaining capital is paid to the original member's estate or SIS dependants (remainder beneficiaries). This basically provides the second spouse with a life interest in the deceased member's superannuation.

The member determines how the pension benefit will be calculated and the spouse cannot commute the pension or rollover to another fund. If the pension beneficiary dies before the member, the arrangement is voided.

While these arrangements are available in an SMSF, the concern of many clients is that if there was friction between the second spouse and the children from the first marriage things may not go to plan. If the second spouse has the cheque book, they could disappear with the money. The children would have recourse for breach of the trust deed provisions, however locating the spouse and commencing legal proceedings could be a lengthy and expensive process.

### Binding determination

Members make a written binding determination to the trustee directing them to pay an income stream to the second spouse. The binding determination will also identify the remainder beneficiaries who are to receive any remaining balance following the death of the second spouse. The binding determination also includes the calculation method of the pension beneficiary's maximum pension benefit. The trustee formally agrees to the binding determination.

### Calculating the pension

The pension is calculated as a multiple of average weekly ordinary time earnings (AWOTE). AWOTE is currently \$1,396<sup>6</sup> or \$72,592 per annum. The use of AWOTE provides a strong indicator of purchasing power and provides clients with a sound basis for determining the future income needs of their spouse. AWOTE figures are issued by the Australian Bureau of Statistics (ABS) biannually as at May and November.

If a client wanted their spouse to receive an annual pension of \$100,000 they would currently select an annual pension of 72 times AWOTE (\$100,512 per annum). The annual pension payment will be adjusted as at 1 July each year to reflect the updated AWOTE figure. The multiple of AWOTE will not change. The only other determination in calculating the annual pension amount is that the minimum pension required by superannuation law must always be paid. If the multiple of AWOTE chosen by the member was less than the minimum annual pension required by superannuation law, the higher minimum would be paid.

### Variation to pension calculation

The pension beneficiary can vary the annual pension payment between the superannuation minimum annual pension amount and the amount previously determined by the member. However, the pension beneficiary cannot elect an annual pension payment above the amount pre-determined by the member.

The pension beneficiary cannot commute or rollover the pension payment however they can forfeit their benefit and have it pass to the remainder beneficiaries at any time.

### On the death of the pension beneficiary

The remaining balance is paid to the member's dependants (the remainder beneficiaries) which can include the member's estate. The remainder benefit is paid as a lump sum and any PAYG tax is deducted.

### Case study – Mark and Lucy

Mark and Lucy have been married for 3 years and they both have adult children from previous marriages. They have a comfortable lifestyle on an income of \$200,000 per annum. If one of them was to die they want the survivor to be able to maintain a comfortable lifestyle and remain in the same home. Upon the death of the second they want all four children to benefit.

Ten years ago Lucy's sister Rachel married Tom following the death of her first husband several years earlier. Rachel and Tom bought a house together and they also each had two children from their previous marriages.

When Rachel died a few years ago all her assets passed to Tom. Tom died just recently. It was the family's understanding that when Tom died the estate would be divided between all four children. However, sadly for Rachel's children this wasn't the case and Tom's children received all of the estate assets. Mark and Lucy are keen to ensure that they have secure plans in place to ensure that this can't happen to their children.

Mark and Lucy have the following assets:

Ownership	Asset	Value
Joint	Family home	\$1,500,000
Mark	Superannuation	\$2,600,000
Lucy	Superannuation	\$1,700,000
Total		\$5,800,000

<sup>6</sup> As at November 2012

After meeting with their accountant and estate planning specialist, Mark and Lucy make a number of changes to their financial arrangements. They have Wills prepared which include a lifetime right to reside in the family home. Upon the death of the second of them, all four children will share the proceeds of the sale of the family home.

Mark and Lucy convert their SMSF to a SAF and make binding determinations specifying each other as the pension beneficiary and their own children as remainder beneficiaries. They set the annual reversionary pension as a multiple of AWOTE, acknowledging that they can change the multiple any time prior to death if their lifestyle needs change.

Shortly thereafter Mark dies and their estate plans are activated. Lucy continues to live in the family home. Mark's superannuation death benefit is paid to Lucy as a pension at the pre-determined multiple of AWOTE.

Upon Lucy's death, her share of the house will pass to her two children and Mark's share of the house will pass to his two children. It is likely that the children will sell the house and receive a quarter of the proceeds each. The remainder of Mark's superannuation account is paid to his two children and Lucy's superannuation is paid to her two children.

## Summary

A SAF may provide a useful alternative to SMSFs for a number of clients. They can assist clients who require the flexibility of an SMSF without the compliance burden of being a trustee.

SAFs are also an alternative for clients who are ineligible to be a trustee of an SMSF. They offer the ability for clients to retain assets such as real property and collectables that are not able to be transferred to a retail superannuation fund. A SAF may also provide clients with a very tax-effective exit strategy from an SMSF.

A SAF can provide powerful estate planning tools that can optimise and protect superannuation that is difficult to match in an SMSF. This is particularly so for families with disabled children and blended families who wish to provide for a second spouse during their lifetime whilst maximising the opportunity to leave a residual estate to children from former relationships.