Self Managed Super

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The investment strategy

The Tax Office (ATO) recently wrote to 17,700 SMSF trustees that borrowed to invest in one asset and asked them to review their investment strategy. In this article, we revisit the 'investment strategy' requirement for SMSFs and discuss the implications of the ATO letter.

INFO–SMSF trustees may seek advice from professionals about their investment strategy. However, trustees remain ultimately responsible for preparing, implementing and regularly reviewing the fund's investment strategy.

Background – Why does an SMSF need an investment strategy?

Individuals often establish an SMSF to exercise control over their super investments. However, along with this freedom of choice, trustees have a responsibility to ensure that the fund invests in line with a properly considered plan – called an 'investment strategy'.

The rationale behind requiring SMSF trustees to develop an investment strategy is to ensure that trustees think about the most appropriate mix of investments to help them build retirement savings – taking into account their financial situation, needs and goals.

Having a properly considered investment strategy means that the fund invests with purpose instead of choosing an investment on a whim or because of the high returns that may be on offer.

Specifically, the super laws require trustees to take the following into account when preparing, implementing and regularly reviewing their investment strategy:

Item	What needs to be considered?
Member circumstances	Each member's circumstances including their age, financial situation, retirement needs, investment and behaviour biases.
Risk and return	How risky the fund's investments are, taking into account the income and capital returns they are likely to generate.
Diversification	The extent to which the fund has 'all its eggs in the one basket', or whether the fund has 'diversified' by investing in a range of different asset types.
Liquidity	Liquidity of the fund's assets – i.e., how easily the investments can be converted to cash to pay costs and benefits.
Ability to pay costs and benefits	The ability of the fund to pay its expenses and benefits (e.g., pension payments) to retired members.
Insurance	Whether insurance cover should be taken out for one or more fund members.

HIGHLIGHTS

THE INVESTMENT STRATEGY

The ATO recently contacted SMSF trustees about their investment strategy

ATO UPDATE

The ATO is clamping down on SMSFs that have overdue tax returns

TRUSTEE Q & A

My fund owns a property which I'd like to move into as part of my sea-change. Can I live in it while the fund owns it?

INFO–Once the strategy is drawn up, the SMSF needs to implement it, and review it regularly. Reviewing the strategy recognises that circumstances change, particularly as members get older (e.g., they may be inclined to make less 'risky' investments).

How does my SMSF develop an investment strategy?

The Australian Securities and Investments Commission (ASIC) recently advised that trustees should consider the following factors when developing an investment strategy:

1. The needs of all members – for example, their ages and retirement savings goals;
2. The need for regular investment income to cover the expected costs and benefit payments to be made;
3. The extent to which the fund needs to preserve its assets (i.e., protect them from loss);
4. The level of capital growth required and the risk associated with achieving that level of growth;
5. The ability of the fund's assets to be converted to cash (liquidity) if the income received by the fund is not enough to cover the fund's costs and benefit payments;

The investment strategy – continued

6. The need for the fund's assets to be spread over different asset classes – such as fixed interest, shares and property ('diversification');
7. The individual investment and behavioural biases of members – for example, whether a member is conservative or more aggressive in terms of their investment preferences; and
8. Excluding certain assets that are too risky when taking into account the member's appetite for risk.

INFO–Younger members may prefer a high-growth investment strategy. However, this is likely to change as members grow older and move towards retirement – the investment strategy will generally become more conservative.

ATO targets 17,700 SMSF trustees about their investment strategy

As Regulator of SMSFs, the ATO recently wrote to around 17,700 SMSF trustees. The ATO letter specifically targeted SMSFs who had:

- Invested more than 90% of their retirement savings in one asset or asset class (which in 99% of cases, was property); and
- Borrowed to buy the asset.

INFO–The ATO revealed that 180,000 SMSFs have invested in one asset or one asset class. The ATO only directed its letter to a small pool of SMSF trustees who had one asset **and** borrowings.

Why did the ATO send the letter to those SMSFs? The ATO was concerned that the investment strategies of these funds had not adequately considered the risks of 'putting all their eggs in one basket'.

The ATO did note that SMSF trustees have the freedom to choose to invest 90% or more of their retirement savings in one asset (or asset class – such as property).

However, the ATO also said that investing in only one asset or asset class (combined with borrowings) means that substantial retirement savings may be lost if the investment fails.

Borrowings magnify the risk because the fund could lose value on the asset, **and** the members could lose money if the fund defaults and the financier calls on any personal guarantees provided.

INFO–As noted above, the super laws require fund trustees to consider the 'diversification' of their investments. A 'diversified' investment portfolio can help to reduce risk because there is less chance that all asset classes will fail at the one time.

What did the ATO ask trustees to do? The letter asked trustees to review their investment strategy to ensure the rationale behind their investment decisions is documented.

Further, the ATO asked for trustees to provide this documentation to the SMSF's auditor. The auditor will assess whether the fund meets the investment strategy requirement as part of the yearly audit.

INFO–Trustees need to think about why investing in one asset is appropriate. For example, the members may plan on making a non-concessional contribution in the current year to build up cash reserves to diversify the fund's investments.

What does the ATO letter mean for SMSF trustees in general?

The ATO letter has led to trustee concern about what it means for investment strategies in general – especially for funds with investments in a single asset or asset class (e.g., shares).

Ultimately, the ATO is reminding trustees that the investment strategy is a fundamental responsibility of being an SMSF trustee. Further, trustees should document their thought process and reasoning behind their investment choices – taking into account the factors noted above.

"Trustees need to think about why investing in one asset is appropriate."

ATO UPDATE

From 1 October 2019, the ATO is clamping down on SMSFs that are more than two weeks overdue on lodging their annual tax return, and have not arranged with the ATO for an extension of time to lodge.

The ATO will change details of these funds on 'Super Fund Lookup' to 'Regulation details removed'. Normally the details would show as 'complying'.

This means that APRA funds cannot roll over member benefits to the SMSF and employers cannot make super guarantee payments for SMSF members. Google 'QC 60128' to read more.

The ATO has advised that SMSF members who have exceeded their $1.6 million transfer balance cap may have liabilities that fall due over the Christmas/New Year period. Google 'QC 60428' to learn more about this update.

SMSF trustee Q & A

Question

I am a member of an SMSF, aged 72. My fund owns a property which I'd like to move into as part of my sea-change. Can I live in it while my fund owns it (as I am retired), or do I have to transfer the property out of the fund?

Answer

You cannot live in the property whilst the fund owns it – even though you are retired. However, you can either sell the property to yourself, or transfer it as a lump sum benefit payment as you have met a full condition of release.

Living in the property while the fund owns it is likely give rise to numerous compliance breaches for the fund. For example, the sole purpose test is likely to be contravened where the fund provides post-retirement benefits to a member other than by way of a lump sum or a pension payment.

You could, however, transfer the property to yourself as follows:

- Sell the property to yourself at full market value; and/or
- Transfer the property to yourself as a lump sum benefit payment – either from your pension or your accumulation interest.

Note that the fund cannot transfer the asset by way of pension payment. That is, the super laws only allow a lump sum (but not a pension payment) to be paid by transferring an asset.

Also, a transfer or sale of the asset by the fund to you will trigger a CGT event for the fund – which could result in tax payable by the fund.

TIP–Any stamp duty and land tax consequences for your State or Territory should also be considered.

Question

Our SMSF has changed from individual trustees to a corporate trustee. Do we need to change the name of the fund's bank account?

Answer

Yes, you need to amend the name of your fund's bank account to reflect the new trustee.

Assets owned by an SMSF must be recorded in such a way that clearly show that the fund owns the asset. For the fund's bank account, this means including the details of the fund trustee 'As Trustee For' the SMSF. For example, J&Q Pty Ltd ATF J&Q Family SMSF.

In your case, changing the individual trustees to a corporate trustee requires the ownership details to be updated for each asset owned by the fund – including the fund's bank account.

Key dates and reminders

1 December 2019

Due date for payment of the fund's income tax where one or more prior-year tax returns were outstanding as at 30 June 2019. Lodgment of the 2019 tax return for these funds was due on 31 October 2019.

28 Jan 2020

Quarterly TBAR due for SMSFs with a member over the $1m threshold with a reportable event.

28 Feb 2020

Due date for new SMSFs, unless the ATO advised the fund upon initial registration that it had a due date of 31 October 2019.

Recent law changes affecting SMSFs

The following measures have recently been legislated and are now law:

- Rules that apply a 45% tax rate to income from arrangements involving SMSFs that incur expenses below market rates. The changes apply from 1 July 2018.
- Affected members of SMSFs that enter into limited recourse borrowing arrangements from 1 July 2018 may see their total super balance increase. A member's total super balance is used to assess eligibility to various super concessions (e.g., an individual's non-concessional contributions cap).

Contact Us:

1 Somerville Street
Bendigo VIC 3550
invest@360pw.com.au

Ph: (03) 5443 8888
www.mgr.com.au
www.360pw.com.au