AUSTRALIA'S LOVE AFFAIR WITH SMSFS CONTINUES

Establishing a self managed superannuation fund (SMSF) offers a variety of benefits, chief among them being the unparalleled control and flexibility this type of fund can afford its members over their retirement savings. This control extends to the ability to tailor investment strategies to personal financial goals, risk tolerance and preferences, with access to a broader array of investment options than those typically available in retail or industry super funds. Such options include not just traditional stocks and bonds but also direct property, precious metals and even cryptocurrencies, allowing for a highly diversified investment portfolio.

Beyond investment choices, SMSFs provide significant tax advantages. Members can employ strategic tax planning to minimise liabilities and enhance their retirement nest egg, benefiting from the ability to manage the timing of tax events and utilise imputation credits. In addition, SMSFs can offer enhanced estate planning flexibility, enabling members to specify how their assets are distributed upon their death, which can be particularly beneficial in complex family situations.

The pooling of resources in an SMSF, which can include up to six members, allows for increased buying power, making it easier to invest in assets like real estate that might otherwise be out of reach for a single individual. Additionally, the direct ownership of investment assets through an SMSF can provide a sense of security and personal involvement not found in other superannuation arrangements.

It is perhaps no surprise then that in the latest data released by the ATO, the number of SMSFs in Australia continues to grow as more people seek to take advantage of all the benefits offered. In the 5 years to 30 June 2023, the ATO estimates that there were on average 24,000 establishments and only 13,800 wind-ups of SMSFs, leading to an overall growth rate of 9%. As at 30 June 2023, there were 610,000 SMSFs holding roughly $876bn in assets, which accounts for around 25% of all super assets.

However, taxpayers seeking to establish SMSFs should also be aware of the challenges and considerations that can significantly impact this type of fund’s suitability for individual retirement planning. One of the primary concerns is the complexity and responsibilities involved in managing an SMSF, as trustees must navigate a maze of financial, legal and tax regulations to ensure compliance with the ATO. This complexity is compounded by the potentially high costs associated with setting up and running an SMSF, including auditing, tax advice, legal advice and investment fees, which can erode investment returns, especially in funds with smaller balances.

The autonomy in investment decision-making, while a key advantage, also introduces significant investment risks – trustees' lack of experience or knowledge can lead to poor investment choices. It should also be noted that not all investments are created equal. SMSFs need to meet the sole purpose test, which means the fund’s investments are required to be for the sole purpose of providing retirement benefits to the fund’s members. The sole purpose test may be contravened if a related party to the fund obtains a financial benefit (directly or indirectly) when making investment decisions. The SMSF will also fail the sole purpose test if it provides a pre-retirement benefit to an individual, for example, if one of the members engages in personal use of a fund asset.

In addition to these potential drawbacks, there is the time commitment required to research investments, monitor fund performance and stay updated on regulatory changes; liquidity challenges for funds investing in real estate or other illiquid assets; and in most cases, more expensive or complex insurance (ie life, total and permanent disability [TPD], income protection) access to consider when starting an SMSF. Taxpayers thinking about starting an SMSF should carefully weigh these potential drawbacks against the benefits, and consult relevant qualified advisers for further advice where required.

CONTACT

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