Savvy Gens X and Y join DIY baby boomer super surge

Stephen Brereton

It might traditionally be the preserve of baby boomers but there are signs that some technically savvy individuals from the more self-directed Generations X and Y are getting active in self-managed superannuation funds (SMSFs).

Generally speaking, the younger generations are ambitious and confident, viewing work as a means to fund their chosen lifestyle. They believe in personal advice and when partnered with a financial coach to guide them through a self-managed super portfolio, it provides them with the wealth-creation opportunities they are often seeking.

The Australian Taxation Office's latest SMSF statistical report — with information about who is behind the explosion in SMSFs, asset allocation and quarterly establishment rates, reveals that 32,875 funds were established in the year to June 30, 2011.

Taking control: More young people are opting for DIY funds.

At the end of June 2011, 44 per cent of SMSF members were aged 54 years and under. This number grew in the December quarter of 2011, with 9.8 per cent of new funds involving Gen Y (aged 25 to 34) and 67 per cent of all new funds being opened by those aged under 55.

By receiving good advice, young people can take advantage of the key benefits of an SMSF — most notably the selection of the types of assets fund members can invest in. The three most popular investment classes for SMSF trustees, regardless of the size of the fund, were: direct shares, cash and term deposits and directly held non-residential property.

By last June, these three main asset categories represented 75 per cent of all SMSF assets.

While control over their fund's investment portfolio can be preferable for many people, it is important to understand the commitment required to develop and maintain an appropriate investment strategy. This is where good advice is essential.

As with all investments, the overall asset allocation will have the biggest impact on the success of the strategy. It is only in the long term that the benefits can truly be seen.

Compared to the majority of managed funds, those with self-managed funds have more flexibility in their chosen investment strategy. Gearing into a property asset is popular for a younger generation that has time to see this asset grow, in a tax-efficient environment.

In its position as the regulator, the tax office has suggested a minimum of $200,000 in super savings would be sufficient to start a viable SMSF. Of course one can be created with fewer funds and costs but the effort and engagement will remain at a high level and the fixed costs need to be considered.

Mercer usually recommends $400,000 as a starting point. If you have a sizeable balance, fixed costs as a percentage of assets are reasonable.

The decision to have an SMSF should not be based solely on fees.

If you decide to outsource to a specialist provider you may have fees but the professional advice and peace of mind about your strategy can more than make up for it.

Stephen Brereton is a senior financial adviser at Mercer

It pays not to make mistakes with your nest egg

Monica Rule

As a self-managed superannuation fund (SMSF) auditor with 16 years in the industry, I have seen many people with SMSFs make critical errors, some of which have cost them their life savings. Let's look at some of the common mistakes.

An SMSF can only be established either under a structure with an individual trustee or a corporate trustee. You cannot have both. A single member SMSF under individual trustees' structure must have at least two trustees — the single member cannot be the sole trustee and member. If a person has been convicted of a serious dishonest offence or is bankrupted then they are a "disqualified person" and cannot be a member or trustee of a SMSF.

The flexibility of an SMSF can be a problem. People can be tempted to use money in their SMSF when they face financial hardship because they control the SMSF's bank account. However, there are severe penalties for illegally getting money from your SMSF for personal benefit. SMSF money and assets must also be kept separate from personal assets as trustees can be fined up to $17,000 for not doing so.

It is also not uncommon for trustees to make the mistake of acquiring residential properties for the SMSF from members. Although a SMSF can buy a business or commercial property from a member, it cannot buy a residential property from a member.

Incorrect borrowing structures are another common mistake. Too many borrowing structures have been established incorrectly, where only one holding trustee is established for several assets or incorrect names are recorded on the ownership and loan documents.

SMSF members need to keep a close watch on money going into their fund. The concessional contribution limit of $25,000 is often breached because members fail to monitor what their employer has paid into their SMSF throughout the financial year. Breaching the limit will result in SMSFs having to pay extra tax.

Making investments in a related entity is also fraught with danger. SMSFs can only invest up to 5 per cent of its total asset value in a related entity unless the related entity satisfies certain conditions including not investing in other entities or having borrowings. Trustees often invest more than this 5 per cent cap, without meeting the conditions, meaning the investment must be unwound.

Finally, and perhaps most importantly, all members of the fund are equally responsible. Most SMSFs are established by husbands and wives. If one of the members makes a decision that breaks the law, the other member is held equally accountable. It is crucial that all members have some input in the decision-making of the fund and at least make themselves aware of their legal obligations.

The decider: Each SMSF member is equally responsible. Picture: Getty Images

Monica Rule is the author of The Self Managed Super Handbook — Superannuation Law for Self Managed Superannuation Funds in Plain English
www.sunshinepress.com.au

Be careful with gearing strategy

John Kavanagh

Trustees of self-managed superannuation funds (SMSFs) are turning increasingly to gearing strategies to acquire assets, particularly property, for their funds.

But they will have to be careful how they go about it — the Australian Taxation Office has seen a rise in illegal arrangements.

The tax office, which regulates the SMSF fund sector, says if trustees do not meet their obligations under superannuation law their investment and gearing arrangements might have to be "unwound", trustees might be disqualified, and the fund might have to pay penalties.

Borrowing to acquire assets in a super fund is still relatively new.

A 2007 amendment to the Superannuation Industry Supervision Act established the right of super funds to borrow to invest in any asset they would otherwise be allowed to buy outright.

Australia's 478,000 SMSFs have average balances of $963,000, according to the Tax Office.

They invest an average of 11.4 per cent of their assets in non-residential property and 3.5 per cent of their assets in residential property.

The head of technical services at AMP's SMSF administration division, Philip La Greca, says 15 per cent of AMP's SMSF clients have loans, half of which are used to fund property investments.

That number is likely to grow.

A mortgage market sentiment survey released by mortgage insurer Genworth showed 53 per cent of SMSF trustees found residential property "an attractive investment".

The tax office's concern is that trustees do not understand that a geared property investment in a super fund is a more complex financial transaction than taking out a standard mortgage.

For example, until the asset is fully paid for it must be held in a separate security trust.

Setting up the security trust adds to the cost.

The loan must also be limited-recourse, which means if the borrower defaults the lender can take possession of the asset used as security but no other assets of the fund.

One rule that causes confusion is that borrowed funds can only be used to buy what is called a "single acquirable asset".

A block of land is a single acquirable asset but if the land is subdivided, the subdivision would be treated as separate assets and the ATO would rule the trustee has breached the borrowing rules.

The technical director of the SMSF Professionals' Association of Australia, Peter Burgess, says in practice "this means alterations to a property cannot be made if they fundamentally change the character of the asset".

The acting commissioner of the tax office, Bruce Quigley, says the fine details are important and trustees need to be sure that the arrangement is legal.

Another no-no is acquiring a residential property from a member of the fund, which is a breach of the related-party rule. This is a confusing area, because an exemption allows SMSFs to buy the business premises of the fund's members.

Borrowing to buy property in a super fund has appeal.

The money that is paying off a property loan in a super fund has been taxed at only the 15 per cent contribution rate, compared with money taxed at the marginal income tax rate outside super.

Another positive is that if you retire and convert the superannuation account to a pension, once you reach the age of 60 you can sell the property without having to pay any capital gains tax.

Mr La Greca says the tax office is not saying there is anything fundamentally wrong with SMSFs using loans to invest in property.

"The (tax office) is highlighting issues of poor administration and documentation," he says.

"What people need to recognise is that if they want to get a loan and use it to buy a property for their super, they need to have the fund and any other necessary structures in place before they do the deal."