Investment strategy must be all inclusive

Managing your retirement funding through a Self Managed Superannuation Fund (SMSF) requires trustees to operate the fund according to the rules of the SMSF's Trust Deed.

Sometimes included with the deed that establishes the SMSF is an investment strategy.

Most investment strategies supplied with an SMSF trust deed are very general in their approach, sometimes requiring little input by trustees in relation to its operation.

This document should be given some detailed attention to be sure that it meets the requirements of the trustees and fund members.

The investment strategy provides the rules by which the investment of the SMSF may occur; much in the same way as the trust deed dictates how the SMSF is to be run.

Ideally, an SMSF's investment strategy should provide for the trustees of the fund to undertake any non-traditional investments (e.g., investments in unlisted entities). Otherwise, the fund risks breaching one of the investment covenants contained in S.52 of the SIS Act, being that the fund must undertake its investments in accordance with the investment strategy.

However, it is important to remember that an SMSF cannot be rendered non-complying simply because it undertakes an investment that is outside its investment strategy, although this is not advisable and may subject the fund to further scrutiny by the ATO.

It should also be noted that trustees should also ensure that the investment strategy specifically provides for the fund to make investments into assets such as business real property and warrants.

Regular review

Once you have determined that your investment strategy covers all the investment types you wish to include, this should not be the last time you look at it because an investment strategy should be regarded as a 'fluid' document.

More specifically, trustees of an SMSF are entitled to make amendments to a fund's investment strategy to reflect the changing investment needs of the members, or the changing investments of the fund.

A good time to do this is at the same time you review the fund trust deed.

With the requirement now (as from July 2013) that a trustee regularly review the investment strategy, and given the regularity that change takes place in superannuation, it would make sense to do this at least annually.

Claiming deductions for personal super contributions

A taxpayer must satisfy the '10% rule' before they are entitled to claim a deduction for any of their personal superannuation contributions.

A taxpayer will satisfy the 10% rule where their assessable income from employment plus 'Reportable Fringe Benefits' and 'Reportable Employer Super Contributions' are less than 10% of their overall income (for these purposes).

Assessable income includes income without the deduction of any expenses and includes:

- Salary and wages;
- Business income;
- Distributions from trusts;
- Investment income (rent, interest, dividends);
- Foreign source income; and
- Net capital gains

It should be noted that Reportable Employer Super Contributions generally includes salary sacrifice contributions, but it does not generally include any superannuation guarantee contributions made on behalf of the member.

Tip – An employee's Reportable Fringe Benefits and Reportable Super Contributions are recorded on the annual payment summary they receive from their employer(s).

Unfortunately, many taxpayers hoping to claim their personal superannuation contributions fail to take account of one of the aspects above. Most commonly they:

- Don't take into account any Reportable Fringe Benefits; or
- Don't take into account salary sacrifice arrangements made for super contributions.

Making sure you meet the '10% rule' requires careful tracking throughout the financial year, especially where income is variable and you are hoping to make use of the full deductible amount.

This should be monitored with the help of your accountant to make sure that you meet all the required criteria to be able to claim your deduction.

Personal Insurance now part of the SMSF investment strategy

From 1 July 2013, it became a requirement for trustees of an SMSF to regularly review the members' need for personal insurance as part of the fund investment strategy.

This requirement is a result of the Cooper Review into the Australian Superannuation System and hopes to equalise the SMSF market with corporate plans that are required to provide a basic level of insurance for its members.

Statistics that support the need for such a step are:

- Currently Australians are underinsured by approximately $10.6 Trillion; and
- Only 13% of SMSFs have included insurance as part of their arrangements.

How do I review this?

The need for personal insurance can be established in this way:

- *Life insurance* should be sufficient to pay final expenses, repay any debts, meet any special requriements (such as education for children) and provide the surviving family members with an ongoing income.
- *Total and Permanent Disability Insurance (TPD)* should be able to help meet expenses for ongoing medical treatment, repay any debt and provide an ongoing income.
- *Income Protection* insurance can also be provided to help meet the ongoing income needs in the event of a TPD payment – normally up to 75% of pre-disablement income from personal earnings (i.e., it doesn't cover investment earnings and other "unearned" income).

It is important to note that a fund is not required to undertake an insurance policy in the fund with respect to a member 'if the cost of the insurance inappropriately erodes the retirement income of beneficiaries'.

Therefore, an assessment of the costs and benefits associated with the fund entering into an insurance policy with respect to a member must be considered.

Why have cover in super?

Life insurance and TPD premiums aren't generally tax deductible when held in our personal names, but premiums for these covers may be deductible for an SMSF (the type of TPD policy will determine how much of the premium is deductible).

Provided that the benefits are intended for beneficiaries of the member, any payment from a super fund due to death or disability can be tax free to a dependant beneficiary.

There are estate planning benefits by adopting this strategy also; benefits payable to a dependant under a "Binding Death Benefit Nomination" effectively bypass an estate and are paid directly to that beneficiary.

A review of your needs in this area should be part of a regular review of your fund and how it has been structured.

Plan ahead to maximise your contributions

With contribution limits now set for after tax ('non-concessional') contributions, maximising your position at retirement takes some careful planning.

Several years ago there were no limits on after tax contributions, but with legislation changed to remove limits on the amount that could be withdrawn from super at retirement, limits on contributions were imposed.

The limit for these 'non-concessional' contributions is now $150,000 per year, and if aged less than 65 there is no requirement for a member to be working to make such a contribution.

Bring Forward' Rule

The $150,000 limit can be exceeded with the use of the 'Bring Forward' rule. This rule allows a taxpayer to contribute up to three years' contributions in a single year.

However, once this limit is reached, no further contributions can be made in that three year time frame with excess contributions tax being payable (generally at 46.5%).

This means that a fund member may make a contribution of up to $450,000 in a single year, but then not make another contribution within 3 years.

Such an allowance provides flexibility where a client's situation arises that they wish to make a contribution above the $150,000 cap limit.

The 'Work Test'

The 'Bring Forward' rule generally applies when the member is under the age of 65.

After attaining age 65, to make non-concessional contributions to a super fund it is a requirement that the member meet the 'Work Test'.

This test measures the member's work activity, requiring them to work for forty hours over a thirty day consectutive period during the financial year.

If they meet this requirement they can make a non-concessional contribution for that year but they may not be entitled to take advantage of the 'Bring Forward' provisions.

However, where a member is 64 years old, they can at that time still make use of the 'Bring Forward' rule and make up to three years contributions in that year.

It is important to note that a person can trigger the bring forward rule before turning 65 years old and take advantage of it once they turn 65 years old. Please speak to your accountant for more information.

Maxing your contributions

With the above points in mind, as a member approaches retirement they could use non-concessional contributions to maximise their superannuation position as they approach age 65:

- Age 63 – contribute $150,000 (a single year's contribution)
- Age 64 – contribute $450,000 (three year's contributions brought forward')

Given also that these contributions could be made in June and July respectively (i.e. in separate financial years) a fund member could contribute $600,000 to their superannuation fund within the space of two months.

Excess Contributions Tax

The timing of these non-concessional contributions and making the amounts within the limits is vital to ensure that you do not mistakenly attract excess contributions tax; particularly where utilising the full amount of the 'Bring Forward' rule.

Any excess contribution above the non-concessional cap amount will generally be taxed at 46.5%.

To ensure you do not exceed your cap limits we recommend you speak to your accountant on this issue to discuss any plans you have for making non-concessional contributions.