DO SMSFS HAVE A USE-BY DATE?

While much of the discussion focuses on when it is appropriate to establish a SMSF, we would suggest that many people remain in a SMSF too long. One important parameter that is often overlooked in the question of SMSF suitability is the relevance of where your client is at within their investment life cycle. This article explores this issue and the impact for your clients.

Self managed super funds (SMSFs) continue to enjoy huge popularity. While much of the discussion focuses on when it is appropriate to establish a SMSF, we would suggest that many people remain in a SMSF too long. One important parameter that is often overlooked in the question of SMSF suitability is the relevance of where your client is at within their investment life cycle. By this we mean that issues such as a change in investment focus to income style strategies, the willingness to commit the time required to manage the SMSF, advancing age, mental agility and health should all be important factors when considering the continuation of a SMSF.

We would suggest that SMSFs have their own lifecycle and in fact have a “use by” date

It is often said that one of the differences between a successful investor and a less successful one is knowing when to sell! Much the same could be said of a SMSF. Not all investment structures are suitable over your clients’ whole investment lifetime and knowing when to be “in” or “out” of a relevant investment structure can make a significant difference to their investment results. Remaining too long in a SMSF could end up costing the member’s estate tens of thousands of dollars.

This diagram summarises this hypothesis and forms the basis for the discussion below.
The first question is whether your client has enough assets to justify an SMSF - is it $100,000 or $200,000 or $500,000 worth of assets?

The answer will vary depending to whom you speak, but what is important is that before starting a SMSF, there needs to be significant assets accumulated. Prior to having this level of accumulation, one could consider a retail super wrap. Arguably these are just like an SMSF but with little compliance or accounting responsibilities.

The fee structures on modern super wraps are generally such that they can also be very fee efficient. Exactly how efficient is will be dependent upon the equivalent cost of an accountant or administrator in regard to a SMSF but there is little doubt that often a retail super wrap will be a better vehicle to accumulate an adequate lump sum to justify beginning a SMSF.

Once your client has accumulated enough assets, is an SMSF appropriate for them?

Having accumulated sufficient assets and being in a position to contribute to super, does not in itself justify the use of the more sophisticated SMSF structure. While SMSFs provide the ability to tailor highly specialized strategic planning and investment options for some people, we would suggest that they are not necessarily the panacea for all. Unless the investment strategies run to the use of physical property, integrating business real property options, gearing via limited recourse borrowing arrangements or other specialised lifestyle strategies, your clients should consider continuing using a retail super wrap. Obviously cost efficiency of an SMSF will need to be considered too.

The time will come to move out of a SMSF

If your client relies on an SMSF, it will probably remain an appropriate structure for many years – right through transition to retirement and for a large part of the client’s retirement. However, there comes a time for a variety of reasons where the SMSF may not be the best option. At that point provided the investments allow, your clients may be better served by rolling back to a retail super product, such as a super wrap platform.

There can be a number of reasons for this including:

- a move to have a passive income based investment strategy;
- changing lifestyle priorities that make SMSF management responsibilities less attractive;
- diminishing mental abilities that no longer allow you to discharge trustee responsibilities effectively; and
- an increasing focus on compliance issues with an escalating penalty regime, all at a time when they are least needed.

Finally, there is another benefit to rolling back to a retail super product – its ability to pay an anti-detriment benefit.

SMSFs find it nearly impossible to pay anti-detriment benefit to the deceased members beneficiaries

Where trustees pay a death benefit lump sum, they have a discretionary ability to increase that lump sum to a spouse, former spouse or child (including adult child) of a deceased member. On the death of a member, the trustees of a super fund can claim a tax refund on behalf of the member from the tax office. This refund equals the estimated tax previously paid by the member and is added to the death benefit lump sum payout to the eligible beneficiaries. Anti-detriment payment can increase the portion of the taxable element of the death benefit lump sum by up to 17.6%. So for a member with a taxable element of only $500,000 in their death benefit, there is the potential for an increased benefit of approximately $88,000 payable as an additional lump sum to the eligible beneficiary.

Due to the mechanics involved with claiming the tax refund, SMSFs find it nearly impossible to pay this anti-detriment benefit to the deceased members beneficiaries for a number of reasons. On the other hand, a retail super fund, such as a super wrap, has the capacity and ability to immediately make the payment to the dependents on the death of the member by virtue of the thousands of other members investing and contributing to the fund and generating taxable fund income allowing it to claim the refund.

Thus we have come full circle – start with a retail super fund to accumulate assets, such as a super wrap – use a SMSF to drive and build retirement asset and throughout retirement – in the twilight years roll back to retail super to shift onerous responsibilities away from aging members and trustees and increase death benefits via anti detriment.

To learn more about SMSFs and anti-detriment payments, the lifecycle of a SMSF and the business opportunities that may arise for your practice, stay tuned for netwealth’s upcoming webinar.

The quote

Remaining too long in a SMSF could end up costing the member’s estate tens of thousands of dollars.

FS Advice