Advantages of SMSFs

Why a PAF?

# SEPTEMBER 2014 CLIENT NEWSLETTER

## Welcome…

to The Enterprise Sanctuary's 2014 September Quarter newsletter. As a firm that is passionate about helping clients creating wealth and build dreams I am excited to discuss the advantages of having a self managed superfund and the benefits of setting up a private ancillary fund. Read on!

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# SELF MANAGED SUPERFUND

The advantage of self managed superfund (SMSF) is based on four main elements – control, flexibility, taxation benefits and costs.

The main difference compared to managed funds is that the members of an SMSF have control over the fund, which also means they are fully responsible for all the administration and compliance tasks. This can provide advantages for:

- investment decisions;
- control over the operation of the fund;
- fees and charges may be minimized;
- greater tax effectiveness; and
- estate planning.

The level of funds need to make a SMSF cost effective depends on the individual circumstances. The general view is that an SMSF with a balance less than $200,000 is not cost-effective. The reason is that operating a SMSF has many fixed costs (eg audit, accounting fees, supervisory levy) which do not necessarily relate to the account balance. These costs are estimated to average $2,000 per annum (hence 1% of $200,000 estimate). Therefore, the higher the balance the lower is the percentage that the fixed fees represent. In contrast, fees in managed funds are generally charged as a percentage of funds invested although some tiering of fees may apply to give discounts for larger balances.

<u>Investment decisions</u>

The major reason for establishing an SMSF is the control you have over the investment decisions. This may be due to a desire to make the decisions or the belief that they can achieve a better result than fund managers.

Many trustees of SMSFs prefer to invest directly by purchasing shares, interest bearing securities and property as they believe the decisions they make can produce better returns or outcomes than professional superannuation fund managers.

Members may also have opportunities to invest in assets that are not available through managed funds. SMSFs are in a unique position as they can acquire certain investments from members which are not available to other funds. For example, an SMSF can acquire business real property from members and other related parties. This can provide a number of taxation advantages for a client who is able to transfer property they own to the SMSFs.

**Warning** — Careful regard must be given to the different investments of the SMSFs.

SMSFs with non-traditional investments must ensure that they are fully aware of all relevant matters associated with their investment choice, including risk/return, diversification, liquidity, etc.

SMSFs with investments in “collectables” and “personal use assets” must comply with rules prescribed in the SIS Regulations with respect to the holding, maintenance and realising of these assets.

**Tip** — Members who run their own business may gain asset protection and cash flow advantages by transferring business real property into their SMSF instead of having ownership of these assets in their own names.

Tax effectiveness

SMSFs are treated for tax purposes in the same way as other superannuation funds.

However, the way that the tax rules are used in the administration of the fund (eg control over investments and the accounting methodology) may provide tax efficiencies for an SMSF. For example:

- ensuring that all tax deductions and franking credits are directly allocated against tax liabilities of the member to reduce contributions tax (some retail funds including wrap accounts and insurance-only retail funds may also provide these advantages)
- deferring the sale of underlying investments until members have moved into the pension phase to eliminate liability to capital gains tax
- the ability to choose investments with high levels of franking credits
- using tax deductions on insurance payouts to offset future tax liabilities in the fund
- the use of reserves within an SMSF.

**Please contact us at The Enterprise Sanctuary if you would like to talk about this topic in more detail.**

# PRIVATE ANCILLARY FUND

A private ancillary fund (PAF) is a special type of Trust that is specifically designed to encourage private charitable giving. It provides private entities, including business, families and individuals, with a flexible way to set up trusts for philanthropic purposes. With a private ancillary fund you can structure your giving and be more strategic and effective in how, where and what you give.

**Benefits**

- PAFs can make invaluable contributions to social/community programs that are carried out by DGRs. DGRs particularly value longer term funding commitments, as they enable the DGR to have certainty of cashflow for projects.

- A PAF allows people to establish a philanthropic legacy in their own lifetime, and can thereby perpetuate the name of an individual or family. Most PAFs are set up to survive into perpetuity.

- A PAF can provide a valuable tool for intergenerational bonding to assist parents foster in their children their own philanthropic values and financial responsibility.

**Tax and compliance benefits**

- All gifts to a PAF are tax deductible. This can be particularly useful in an income year where a large capital gain has been realised by the donor. Gifts to the PAF can be in the form of cash, shares or physical goods such as real estate.

- The income of a PAF is normally exempt from income tax.

- A PAF is entitled to cash refunds of franking credits it receives.

- PAFs are comparatively simple and inexpensive to establish compared to other structures. They operate in a similar manner to Self-Managed Superannuation Funds.

- The PAF structure gives trustees considerable control and flexibility by enabling them to determine the PAF's philanthropic objectives, to adapt those objectives to meet changing needs.

- The trustees can control how the assets of the PAF are invested. Donors are able to have as much or as little involvement in the PAF as they wish.

Finally, please note amongst other things a PAF is required to distribution $11k a year.

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