I ❤ SMSF | THE STRATEGIST
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Top 5 SMSF and Family SMSF Strategies for 2018/2019

Welcome to the very first edition of **"THE STRATEGIST"** - an I LOVE SMSF members only publication. This takes me back to June 1996 when I typed my first ever "Strategist" newsletter. I remember it so well, 12 pages going out each month with the latest strategies, ideas and tactics for accountants and financial planners to use for the benefit of their clients. And of course, show their skills to prospective clients.

In those days, SMSFs were very much the new kid on the block. I remember doing Australia's first ever SMSF video in 1995 and I think we did 100 copies. To be truthful the larger retail superannuation funds and company super funds treated them as a joke. I was pushing a heavy barrow up a big mountain, particularly with financial planners who were being paid good commissions on company and retail super.

But SMSFs took hold amongst the more business minded financial planners who could see the commercial sense in dealing with high-net-worth clients. In addition, and more importantly for the overall longevity of the SMSF industry, accountants started to move into SMSFs in a BIG way for three reasons:

1. The SMSF was a great tax vehicle and aligned well with their client base of small business owners who could use SMSFs to acquire business property using bank finance via a wholly-owned unit.

2. SMSFs provided a good long-term fee income for the accountant as administration and audits were required each year. In the early 1990's SMSF accounting fees were substantial where 50 SMSFs could add $150,000 in revenue, year after year. Plus, with many accountants having financial planning arms through groups like Count and Professional Investment Services, additional revenue streams opened up.

3. Accountants found converting existing clients to an SMSF very easy and with no licensing or advice requirements, plus very few laws, it was an exciting new area to build. With every new SMSF adding another $3,000 or more of income, SMSFs were "happy days" for accountants.

Of course, there were the naysayers particularly from the retail funds management industry who argued against SMSFs along the following lines[1]:

1. Some of these arguments are used by the SMSF industry now to throw cold water on Family SMSFs — shame on you!

- It is all too hard, too much paperwork to do and lots could go wrong;
- There is no diversification in such small funds and the members retirement incomes will suffer greatly;
- Mum and Dad trustees don't have the skills or temperament to run retirement investments successfully.

Like any new idea, such as SMSFs were in the mid 1990's, traditionalists who hate change get left behind with the early adopters reaping all the benefits. I often ask SMSF Trustees who have been in their SMSF since the 1990s and have accumulated $ millions in super benefits what their best financial decision ever was and they emphatically state "it was my SMSF."[2]

Anyway, here we are in 2018 and I have come back into the SMSF fray to build, grow and strategise around the new wave of SMSFs – the **"Family SMSF"**. Now I am not abandoning the "common or average SMSF" but there are just so many more tax, family, financial and estate planning strategies in a multi-generational or blended family fund than in a one or two-member SMSF that is going to die when the last surviving member dies.

What a shame, pity and well, if you ask me, really poor planning!

So, let's start strong with my top five SMSF and Family SMSF strategies for 2018/2019:

Strategy One: Upgrade SMSFs to a Family SMSF

Family SMSFs are not SMSFs with more than two members. For those that think they are you are in for a big shock! They are magnificent strategic structures that stand the test of time, family circumstances and well I can go on and on. Let me give you a very simple case study to show the power of a Family SMSF in a family-owned business. This is post 1 July 2019 when six members in a SMSF are allowed.

Family SMSF Leading Member John aged 70[3] and his spouse Sally aged 66 are in the Smith Family SMSF. They were working graziers but have transferred the farming business to their son Mathew, aged 40 who is also a member of the Fund. The property sits in the Family SMSF for the benefit of John and Sally who are both retired, have pensions with reversions to each other, then to Mathew upon their death to ensure the property is transferred to the son working the farm.

Mathew has two children, Ben aged 17 and William aged 13 at boarding school, runs the business through the Family Trust and still employs John and Sally, paying them $70,000 each pa by way of a super contribution. John and Sally have more than $500,000 in dividend-paying stocks in the Fund and these are used to cover their contributions tax and

2. And now I ask those who have been in a Family SMSF for a few years, what was the best family financial decision they ever made and guess what, that's right it is the "Family SMSF."

3. In the upcoming I Love SMSF Family SMSF trust deed where bloodline membership and benefits are chosen, the key bloodline member is known as the Leading Member. This is much like the Appointor in a Family Trust but with a lot more powers.

that of Mathew, plus deductible Family Trust contributions made for Ben and William who do vacation work on the farm. John and Sally's daughter, Marie is also a member of the Fund but has her own investment strategy. John and Sally use part of their pension benefits to pay a school allowance directly to Ben and William to cover boarding and school fees. In their SMSF Wills, apart from the property to go to Mathew, a lump sum is payable to Marie with the grandchildren also paid a benefit, as an income stream or lump sum. At this point in time, John and Sally have been advised that their grandchildren are their financial dependants, while Marie and Mathew are not.

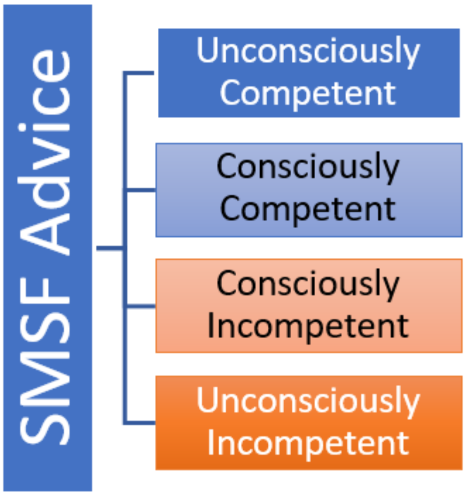
Now there is a lot more in this case study to flesh out but that is the exciting part and challenge for the adviser using Family SMSFs to their fullest. For those who cannot wait until 1 July 2019 for the six-member Family SMSF, you can start a four-member fund immediately and set in place two provisional members.

But can I be candid with you. Since I have been preaching about the strategic and more important, value of a Family SMSF to a family, the chatter in the mainstream SMSF press is that they don't work because:

- The kids might take over the Fund and leave mum and dad at a disadvantage;
- The adult children are at a different stage of life so their investment strategy should not be that of the senior members of the Fund;
- The administration and accounting for the Fund is a lot more complex.

This sounds a lot like some of the arguments by the mainstream financial press against SMSFs in the 1990's. Now here's the deal. At the recent I Love SMSF Family SMSF Adviser accreditation course we looked at the following diagram which highlights the skill and competence level of an SMSF adviser:

Diagram One: Skills and Competency Levels

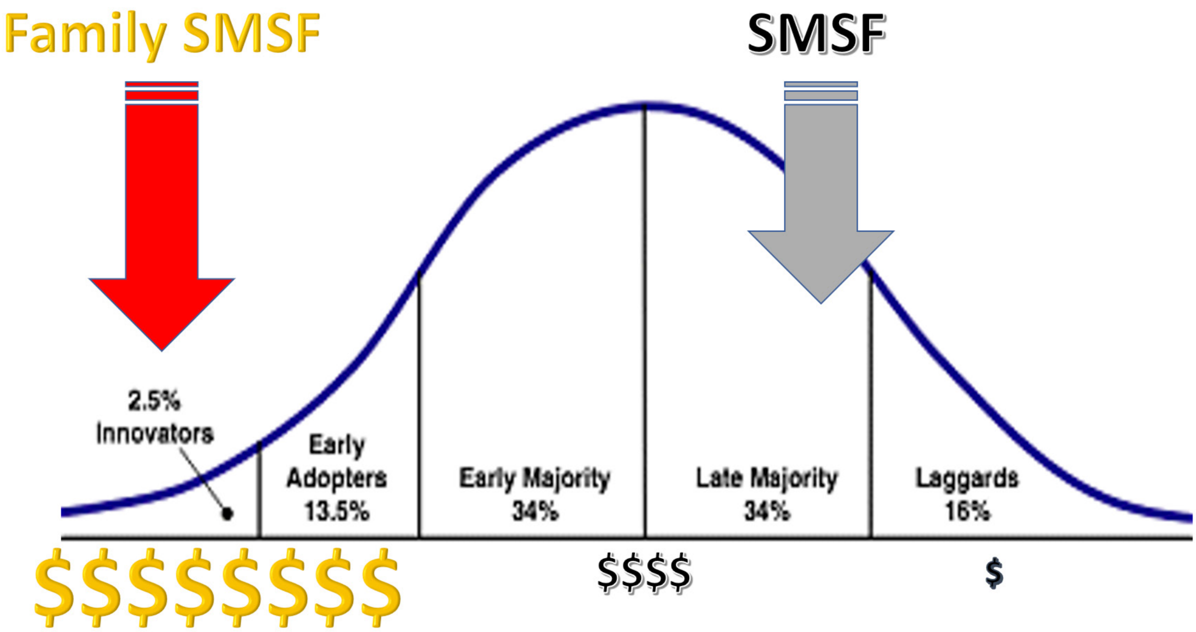


Where are you on this chart and even if you are not an adviser but a SMSF Trustee, as many of our Scholar members are, where are you in terms of your SMSF knowledge? Turning our attention to Family SMSFs and the anti-Family SMSF chatter by SMSF advisers and commentators, where would the naysayers fit on the above skills competency chart?

Well there are two answers. *Best case.* For the professional who is already giving SMSF advice it shows that they are consciously incompetent. They know there is a problem but have no clue on how to address the issue. More often than not, their solution is that it is better to not discuss Family SMSFs with clients as things might get a wee bit messy.

Worst case. From a Family SMSF perspective, the adviser is unconsciously incompetent. They don't know what they don't know. They can't fathom the subtlety and nuance of a Family SMSF and without that basic understanding, any Family SMSF issue is off limits. Even though an SMSF Trustee may beg and plead for an upgrade of their Fund to a Family SMSF, it is way beyond the skills level of the SMSF adviser. Now that is not a bad thing as it means we are at the start of a new advising curve, where innovation and early adoption is the key. Like SMSFs when they first started, the first advisers end up with the most client and business growth — all the spoils.

Diagram Two: The new Family SMSF Advisers to Cash in



Quite simple really. So for those that take the opportunity and do the hard yards, exciting business growth awaits. And I know from research that I Love SMSF has done on SMSF Trustees, where after watching a five minute video of Grant Abbott discussing the ten benefits of a Family SMSF over a common SMSF that 90% would like to upgrade to a Family SMSF. If you ask me, and if you are an adviser reading this, jump in full throttle while you have the chance to be a leader in the new Family SMSF industry.

"If someone offers you an amazing opportunity and you're not sure yo can do it, say yes — then learn how to do it later." *—Richard Branson*

Anyway, enough business motivation from me, let's go back to the Family SMSF set up. It is different, radically different from an SMSF and it has only been in the past year that I have really got my head around it. Of course, I have had the opportunity of being in more than three Family SMSFs for over 20 years and one of them a blended family, so I have seen it in action.

This radical difference means a new way of thinking, all the way up and down the spectrum from investments, investment strategies, family contributions, insurances, multi-generational benefits, internal lending and so much more. But to stick this all together you cannot use an SMSF deed. Like an SMSF, the strategic foundation and strength of the Fund is the trust deed. So with a Family SMSF, the foundation is a strategic multi-member deed, with or without bloodline controls or coping mechanisms for blended families.

So for the past three months I have been solidly at work creating Australia's and for that matter the world's first ever Family SMSF trust deed and governing rules. It is unlike anything in the SMSF market. And I should know having reviewed more than 90 SMSF trust deeds in my career.

The best way to describe it is there is a foundational mothership where trustee powers, procedures and systems are held. This includes Trustee meetings, deed and rule variations, setting up reserves, accepting contributions, making investments, creating pensions and paying lump sums are detailed. But the real kicker and exciting thing for adviser is that each member of the Fund, up to six members from 1 July 2019 and four until then, has their own sub-fund or account. That sub-fund deals with them and them only. It details and describes:

- Any SMSF Will they have put in place;
- Any SMSF Living Will in the event they become incapacitated;
- The various superannuation benefits that they have including, but not limited to, an accumulation account, a retirement accumulation account and multiple pension accounts (with or without reversions);
- Their enduring power of attorney and their rights as a Replacement Director of the Corporate Trustee. As an aside a Family SMSF NEVER has individual trustees;
- One or more specific investment strategies for the member as a whole or for each or a selection of their superannuation benefits. They may have units in a pooled investment strategy or investment in the Fund;
- Their Executor and Replacement Director of their Corporate Trustee in the event of their death; and
- Their replacement member in the event of their death.

Now when first starting the Fund and the founding members of the Fund, a lot of the above is for future consideration and advice but ultimately a well-constructed Family SMSF will cover all of the above for all of the members of the Fund.

And here's the kicker the whole lot, the mothership and member sub-funds are all within the primary deed providing security and efficiency as each change or update to any of the circumstances of the members means an auto-upgrade of new rules for the mothership. This would have been impossible before but with the advent of our new robotic processing automation platform it is a simple task to create a fluid, flexible strategic offering that is utterly bespoke for the clients.

Importantly, and this is the key, control of the mothership rests with the Leading Member of the Fund, much like the Principal in many Family Trusts. It is that person who controls membership and whether the Fund is bloodline, bloodline with exceptions or non-bloodline. And with each sub-fund transaction only being voted upon by the member or the member's Replacement Trustee, the issue of control fades. It moves from a common SMSF collective to empowered individualism.

Of course, there is a lot of work and continuous upticks as family circumstances vary and change, investments are bought and sold, and superannuation benefits commenced or terminated. But that is the beauty of a Family SMSF adviser and once you have done one, you become consciously competent and after 20 or so, unconsciously competent.

With the new Family SMSF deed system we are building at I Love SMSF which includes a Family Document Vault, building all of the above is child's play.

Strategy Two: Making Deductible Contributions Now!

First, let me give you two rules of contributions law:

- ALL employer contributions are deductible, plus ALL individual contributions can be deductible at the choosing of the individual. Deductions mean less tax outside and adjustments to PAYG if someone is on salary. Not a bad start-up strategy for profitable or high salary and wage-earning clients if put in place from 1 July;
- Deductible contributions are called taxable contributions and form part of the assessable income of the Trustee of the Fund and after deducting any deductible expenses, the resulting taxable income is subject to tax at a rate of 15%.

Knowing this, but subject to the tax rules in relation to excess concessional contributions (added back to assessable income and taxed at marginal tax rates less 15%) and excess non-concessional contributions (to be withdrawn from the Fund to fight another day), we should be contributing as much as we can in July, by way of cash, short term promissory notes or in-specie contributions to get the tax benefits.

That leaves us a whole year to maximise Fund deductions to offset taxable contributions, build up franking credits through wise investments and look at Early Stage Innovation Companies where the government provides a 20% tax offset for capital invested. Now that is super smart. Plus, there are the added benefits of:

- Contributions being invested in a concessional tax environment now;
- The Trustee of the Fund not having to lodge its tax return until March 2020, a long, long way off. This also includes the adjusted marginal tax payable on any excess concessional contributions.

Strategy Three: Set in place GFC 2 Pension Measures

Look I am no investment guru and if I could accurately pick the market I would make a fortune. But what I do know is that GFC2 is around the corner. It looks from all the chatter a lot of money is being taken out of the market around the world. And if GFC 1 was all about leverage and asset bubbles, then GFC 2 is that

and much more. And will measures like quantitative easing work as well this time around? Who knows.
But what I do know is when the market goes down pension accounts will be reduced. In fact, last time pension members were so desperate to retain their capital that the government was forced to reduce the minimum pension drawdown factor by 50%.

Now the problem in the current transfer balance system when a pension is commenced a credit to the member's personal transfer balance account ("TBA") arises. Importantly once the pension commences, any increase or decrease to the account will not impact the amount standing in the member's TBA. This is great if the pension has increased from $1.6M to $3M. But not the best if it has gone, thanks to GFC 2 from $1.6M to $1.2M. Particularly if the member is running a retirement accumulation account. This is where strategy kicks in.

Simple example. James Earl has a $1.8M accounts-based pension which was originally tested at $1.6M. He also has a $400,000 retirement accumulation account from the surplus pension amount rolled back on 1 July 2017. The GFC hits and his mainly share-based investment strategy in the ABP results in a reduction of the ABP to $1.2M. In contrast the $400,000 in cash in the retirement accumulation account remains the same.

But here is a strategy that you will want to put in place for clients with pension and retirement accumulation accounts. It should be done now just in case GFC 2 hits.

What it requires is an addition to the ABP pension rules for James Earl such that in the event of the ABP account balance being reduced by more than 5% (excluding any pension payments and fees) the pension is to be automatically commuted, subject to the Trustee's discretion, and rolled back to the member's retirement accumulation account. This means that when his pension account hits $1.71M it is rolled back to the retirement accumulation account. This creates a debit in James' Transfer Balance Account of $1.71M. Importantly debits are not limited to $1.6M but carry the full weight of the rollback or commutation amount. If his balance in the ABP was $3M and rolled back then a debit of $3M sits in his ABP enabling up to $3M of accumulation monies to be transferred to a new pension without any breach of the TBA caps.

After six months in GFC 2 James now has $1.6M (see above) in his retirement accumulation account – the $400,000 cash plus the $1.2M that the pension rollback is now. He can now commence a new pension with $1.6M. As his TBA is $1.71M, the credit of $1.6M means he still has a further $110,000 to be applied to a new pension if he makes further contributions. GFC 2 has soaked the retirement accumulation account into his ABP. Legally plus given him more capacity.

Hint: Some of you have clients with much bigger rollback amounts than James. Put the GFC 2 rollback strategy in place now for them. Just watch the tax and taxable components but if you are consciously competent you will know how to handle that. If not contact our offices or put a question on the www.ilovesmsf.com forum.

Strategy Four: Commute or use Retirement Accumulation Account Proceeds to Re-Contribute to the Spouse

This is a variant of the above. Let's say James' spouse, Betty has $800,000 in an ABP, is aged 61 and has only $700,000 tested for TBA purposes. She has plenty of family TBA capacity.

As such the best strategy is for James to withdraw $300,000 from his ABP as a commutation payment. This results in a debit to his TBA which will release further capacity from the accumulation account for the benefit of a new pension. Naturally he could withdraw from his retirement accumulation account as it is cash reserves. A lot will depend on the components of his pension and the accumulation account. The best is to withdraw from the account with the least tax-free component.

The $300,000 can be used as a spouse contribution by James. It will be under her non-concessional cap and when it goes into her fund is a tax-free component. The strategy is to commence a tax-free component pension before there is any growth in Betty's accumulation account which has the result of:

- Ensuring the pension is all tax-free (any growth would be taxable component in the accumulation phase);

- Limit the credit to Betty's TBA to $300,000 giving capacity for a further $300,000 in three years' time when she turns 64.

And don't forget that in a Family SMSF it is not only the spouse that may receive the contribution. Adult children and grandchildren can also be contributed on behalf of. But a warning, any contributions made on behalf of another are taxable contributions into the fund with the exception of contributions for minors. For adults James would need to put it into his children's bank account and then they contribute. If they don't contribute, then there is a family issue but for pension members with large pension or retirement accumulation accounts the strategy is something to run past your clients.

With a Family SMSF nothing is off the table.

Strategy Five: Running separate Investment Strategies

At the Family SMSF adviser accreditation course we must have gone through at least 20 strategies within the first two hours. So it is hard coming up with my Top Five SMSF strategies. One that I could not forget to mention is the importance of members making a choice in relation to their investment strategy. And this may be not only for all their superannuation benefits but even separate superannuation interests such as a tax-free ABP, a taxable ABP and a retirement accumulation account.

Now we are not talking about segregated exempt pension assets as, for many clients, these may be ruled out due to the fund paying a pension and one of the member's having exceeded their General TBA. And in any case the large majority of SMSFs and Family SMSFs use in the

the proportional basis, as determined by an actuary, for calculating their exempt tax component relative to fund pension assets.

As noted earlier the new I Love SMSF Family SMSF trust deed, to be released on 1 October 2018, will enable members to build their investments and investment strategies into the deed itself. Ordinarily this would be messy however with ILS robotic processing automation, the task got so much simpler.

Here are five of my top benefits of running separate investment strategies in a Family SMSF[4]:

1. Growth on a superannuation interest if based upon the investments in that interest. We saw above in relation to James Early, he had share based investments in his ABP post TBA and cash in his retirement accumulation account. This is good for when the market is going up as it means growth is directed to his post TBA pension account and not proportionately across the two superannuation interests.

2. By their very nature an ABP which has hit its member's personal TBA provides retirement income for the member. This means cash flow and for many Australian SMSF members, franked dividends with tax refunds from the government[5] On the other hand, retirement accumulation accounts are surplus to the member's needs where maximum TBA has been achieved. It can be used for family emergencies and aged care Refundable Deposits but for the most part it is estate planning directed and should form an important part of a member's SMSF Will. Generally members want to transfer as much as possible to their family and so a low income, growth strategy is suitable. The cash investment strategy being run by James for his retirement accumulation account does not fit with an estate planning strategy unless he is sitting waiting for growth opportunities post GFC 2.

3. One of the silliest comments I have heard against Family SMSFs by the uninformed is that the investment strategy of older members of the fund will not be suitable for younger accumulation members, the adult children. I don't think I need to say anything more. Separate investment strategies cover this false issue well.

4. Where there is a borrowing in the fund and an LRBA is part of a pooled asset investment strategy, recent legislation requires the member to include portion of the liability in their TBA. Not so if a separate investment strategy is put in place. However, if there is a borrowing fund that relates to a property in a member's separate investment strategy due regard must be had to cash flow issues

4. There are so many of them when using a Family SMSF and half as much for a common SMSF but if you want to know further come to a Family SMSF accreditation course.

5. An important side strategy: If the Labor party get in and put the kybosh on franking credit refunds this may hurt the sectors driven by annual franking credit policy hard. However, a smart Family SMSF adviser will teach the senior Family SMSF members and particularly the Leading Member how younger members can absorb the franking credits. And if the Fund makes internal adjustments amongst member accounts for use of the franking credits so be it.

by that member and the impact on other member balances. Not a big deal but one that must be discussed nevertheless.

5. Switching of assets. This is really one for a face-to-face encounter so I can show you how it works. But let's say that we have an asset in a retirement accumulation account, that by all accounts is set to go high growth. It makes sense to transfer it to a superannuation pension interest that has already reached its TBA, remember growth post TBA is not tested. The mechanics of the process and tax side of the strategy is again a face-to-face discussion, but certainly worth it.

And in the End

There you have it — my top five SMSF and more importantly Family SMSF strategies. And you would have seen in each of these there are also another five. This is the beauty of Family SMSFs, dealing with up to six members gives an adviser and their family client so many options, strategies and more importantly, fee--paying advice.