



SMSF STRATEGIES NEWSLETTER

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SMSF Reserves – the new “old kid on the block

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Reserves have had a long history within the insurance and superannuation industries. Used by trustees of employer superannuation funds to self insure, smooth investment returns, pay temporary incapacity pensions and even hold onto surplus contributions they have become a mainstay of industry based superannuation funds. Long the preserve of life insurance companies reserves were determined each year by actuaries as surplus to the needs of the insurance company to meet all potential claims given the mortality and other risks of its policy holders.

Self managed superannuation funds (“SMSFs”) have also been in the reserve game since 1994 when these small mum and dad controlled superannuation funds were first introduced into Australia. But it is with the introduction of the Simpler Super regime in 2007 that SMSF reserving strategies have become important for tax and estate planning purposes.

What is a superannuation fund reserve?

A reserve in a SMSF is simply an amount or an asset or assets in the fund to which no member is presently entitled. In old superannuation talk it was an amount that was not vested in any member until the happening of a specific event – say the member turning age 65, retiring, becoming permanently incapacitated or commonly, on the death of a member. In modern day SMSFs, the trustee of a fund may create a surplus – say out of the earnings of a fund and allocate it to a reserve. When a specific event happens the trustee may allocate from a reserve to a member account or to a member’s dependant beneficiaries.

“The SMSF Strategies trust deed has long been at the forefront of SMSF reserving strategies providing trustees with a strong, secure platform for creating, building, maintaining and allowing the trustee to allocate from reserves.”

SMSF reserve case study



The Smith family SMSF has two members – George and Janet Smith with George's member's balance sitting at \$500,000 and Janet's - \$450,000. In the last income year the trustee earned \$50,000 on its investments. Normally the trustee of the fund allocates these earnings to George and Janet's member's account on a fair and reasonable basis. However this year the trustee has decided to implement a reserving policy in the fund. Instead of allocating earnings to fund members, the trustee instead decides to allocate the \$50,000 to an anti-detriment reserve in the fund (more on this reserve later). Alternatively the trustee could have allocated the earnings to a number of reserves including an investment or self insurance reserve.

The importance of the SMSF Trust deed

SMSF reserves can be used for a wide variety of purposes. Some reserves are also very tax effective thereby increasing the long term capital and strategic value of the SMSF. However before considering reserve strategies the trust deed of a SMSF must be updated to:

- ★ Allow the creation of a reserve
- ★ Specifically allow a reserve type such as an anti-detriment, pension, investment or self-insurance reserve
- ★ Enable the trustee of a fund to provide a purpose and rules around a reserve
- ★ Provide for a means of allocating to a reserve
- ★ Detail when amounts may be allocated from a reserve to a member's superannuation account, another reserve or a member's beneficiaries.

"An allocation from a reserve may be treated as a concessional contribution – however there are a number of important exemptions where we can ensure that the application of the concessional contributions tax will not arise."

The SMSF Strategies trust deed has long been at the forefront of SMSF reserving strategies providing trustees with a strong, secure platform for creating, building, maintaining and allowing the trustee to allocate from reserves. If you are using a SMSF Strategies trust deed already there is no need to upgrade your trust deed simply contact us to see how reserves may be used for your fund.

Types of SMSF Reserves

Examples of some reserve accounts that may be created under the Superannuation Laws and the SMSF Strategies trust deed include:

- ★ **A Pension Reserve** – where current superannuation pension liabilities such as a guarantee to pay an agreed rate of return on a pension may be met.
- ★ **An Anti-Detriment Reserve** - where a bonus or additional payment is made directly from the fund to a dependant of a deceased member or the deceased member's legal estate to compensate the deceased member's estate for any contributions tax paid by the deceased member.
- ★ **A General Reserve** – where the trustee can allocate earnings of the fund - from this reserve the trustee can populate other reserve accounts or make member superannuation benefit payments.
- ★ **A Self Insurance Reserve** – where the trustee can fund temporary and permanent incapacity payments to members as well as death benefit payments to dependants and/or the legal estate of deceased members.
- ★ **An Expense Reserve Account** – where the trustee can use the reserve account to fund general and specific expenses of the fund.
- ★ **An in-house assets Reserve Account** - where the trustee can use the funds to lend to members, related parties, acquire artwork, and any other activity that would be classified as an in-house asset and allows the trustee to monitor the 5% threshold; and
- ★ **A Contributions Reserve Account** – for short term warehousing of contributions for a term no greater than 28 days after the end of the month in which the contribution was made.



"The most popular reserving strategies of the moment are the use of an anti-detriment and self insurance reserve. There are also strategic advantages of using a contributions reserve at year end."

Anti-detriment Reserve

As was noted earlier, many of the Reserves have tax benefits for the trustee of the fund and its members if structured and used properly. For example, looking back on the Smith family SMSF with George Smith holding \$500,000 in superannuation benefits in the fund – there is a distinct advantage for the fund to create an anti-detriment reserve for George. Having done its sums the trustee determines that the current anti-detriment benefit payable to George's dependents to compensate them for the trustee paying contributions tax on contributions made on behalf of George is \$75,000. This amount may be built up slowly or if there are earnings of the fund set aside to populate the anti-detriment reserve.

If George dies suddenly and a \$75,000 anti-detriment benefit is paid by the remaining trustees of the fund from the reserve then the trustee of the fund will be entitled to a tax deduction = $\$75,000 / \text{SMSF tax rate } (0.15) = \$500,000$. This tax deduction can be used to offset any current capital gains, assessable income as well as future capital gains, assessable income and contributions tax of the fund - a great strategic tax initiative for the remaining members of the fund including his spouse Janet and any children that may join the fund before or after George's death.



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"Our firm has extensive experience in dealing with SMSF reserves. Contact us now to see how SMSF reserves are now a must for your fund."
