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Finance

**Setting up your own nest egg**

WITH dismal performance figures from professionally managed super funds, increasing numbers of investors are taking retirement plans into their own hands with a self-managed super fund (SMSF).

DIY super is now the fastest-growing sector of the industry, with more than $330 billion in assets.

According to the Australian Taxation Office, there are now more than 400,000 SMSFs in Australia, with nearly 800,000 members.

One of the key attractions that has spurred the recent rush to DIY super is the ability of the funds to borrow and invest in residential or commercial property -- with tax breaks on the income.

However, there are plenty of pitfalls surrounding SMSFs, so they are not suitable for everybody. Indeed, it is such a tightly regulated area that an innocent mistake can result in the tax office seizing nearly half the fund's assets. But, used properly, these can be a godsend.

So, how do you go about it?

Getting started

FIRST, be sure you have enough money. Most experts say at least $200,000, preferably more, is needed to set up an SMSF, because fees and costs can be prohibitively expensive for smaller funds.

Set up costs can be $2500 or more, with ongoing fees of $1500 to $3000.

However, those with less in their super can still consider SMSFs, if they continue to make sizeable contributions each year and build up the fund's size over time.

The first step is to go to a specialist SMSF company to establish the fund's legal status and appoint the trustees -- the people who will make the investment decisions and who, crucially, are legally responsible for the fund.

The firm could be an accountant, a lawyer or specialist financial planner.

Anybody can set up an SMSF and each fund can have up to four members.

You can then either set up a company where all the directors are members and act as trustees of the fund, or have all the members as individual trustees.

``Generally speaking, we advise a corporate structure, because it is much less fiddly,'' said Peter Gribble, of Quantum Warrants, a specialist SMSF firm.

``If somebody dies or a new member joins, you don't have to change the ownership names on the holdings in the fund, as you would with individual trustees.''

Once the trustees are appointed and the SMSF is registered with the ATO (which regulates all SMSFs), a nominated bank account is set up to hold all money related to the fund.

At this point, members should contact their old super managers -- whether they are occupational funds or retail funds managed by the banks or insurance companies -- and ask for the super balances to be rolled over into the SMSF bank account, ready for investing in the SMSF.

By this time, if not before, trustees should have decided on an investment strategy. This is a legal requirement so that auditors can see what the investments were trying to achieve, and what type of assets the trustees favoured.

SMSFs are ideal for families to club together and build a family retirement fund. These can be set up by parents and children added to the membership whenever they come along, although children cannot be trustees until they are 18 years old.

``SMSFs should really be called family super funds,'' said Grant Abbott, of SMSF Strategies, the advisers.

``They are great for mums and dads to set up, and then the kids join when they get older. It's a great way to build an inter-generational retirement fund.''

Clearly, however, older members would most likely have a different risk profile to younger members, and require different things from their investments.

To cater for this, SMSFs offer the flexibility to run ``segregated'' accounts, so

that younger members can invest in an aggressive, growth-oriented portfolio while older members might choose a more conservative approach.

For many, however, the rule change in July 2007 that allows SMSFs to borrow to invest in property is the key to their appeal.

Investing in property

SINCE last year, SMSFs have been able to borrow to buy a property and, because of their tax-efficient treatment, the funds only need to pay 15 per cent tax on the rent income.

Better still, once you're 60, you can keep the property and pay no income tax, or sell the property and pay no capital gains tax.

``This has been an incredible boost to the market,'' Abbott said. ``Banks were slow to respond, but have now launched a range of mortgage products targeting SMSFs where the fund can put down a deposit of 20 to 25per cent and borrow the balance to invest directly in property.

``I know many people who are using their super balance as deposits and leveraging into property in this way. The tax benefits make it attractive and a great long-term investment.''

What else can they invest in?

SMSFs can invest in stocks and shares, whether directly or through managed funds, residential and commercial property and cash, whether through term deposit accounts or government bonds.

However, the weightings in these various asset classes will obviously vary, according to attitude to risk and age, with cash and property accounting for a greater allocation as members get older.

``I generally start off from a base of a third in equities, a third in fixed income and a third in property,'' says Gribble, ``but then tailor each element according to the investor's appetite for risk. Younger investors clearly have more in equities and property because these are the real growth assets''.

Fees and charges

IF you use a corporate trustee, there are fees to set up the company, varying from $1000 to $1700. Legally appointing the trustee costs $500 to $1000.

Depending on size of fund, annual accounting costs and administration such as the annual audit, will total $1500 to $3000 on average.

That will include somebody providing financial statements, completing member accounts and lodging the tax return.

The fund must be audited annually to ensure that it has adhered to all the rules and not broken any investment regulations.

Common mistakes

WITHOUT doubt, the most commonly broken rule is the ``sole-purpose'' test. This stipulates that the fund must be run purely for the member's retirement and nothing else.

There are stories of people dipping into their funds to buy cars, or even lend money to friends, but this breaches the sole-purpose test, and can result in the ATO taxing all the fund's assets by 46.5 per cent.

``That means that instead of the 15 per cent tax rate, if you had $100,000 in the fund the ATO might take $46,500 -- a very expensive error,'' Gribble says.

As with all super funds, you are not allowed to touch the money until you are at least 55, and even then only under certain conditions.

You must not use the money for any ``personal'' reasons, and investments in companies or projects you are involved in personally must not exceed five per cent of the fund's value.

The rest must be so called ``arm's length'' investments, in which you have no personal interests.