TRUSTEE TOOL:

How asset segregation could help your fund meet everyone's needs

Brought to you by SMSF experts you can rely on

If your SMSF brings together members with different interests and financial needs, asset segregation could be the solution to keeping everyone happy.

What is it?

Asset segregation simply means dividing the SMSF's assets up into separate pools. You can segregate assets:

- **At the fund level.** Splitting the fund into two or more pools with different features — for example, pre-retiree and pension assets.
- **Between individual members.** Giving each member ownership of assets that are especially important to them.

Asset segregation in action

Fund level segregation

Your SMSF

Pre-retiree assets
- Long term
- High growth
- Less liquid

Pension assets
- High income
- Secure
- More liquid

Member level segregation

Your SMSF

Member 2
- Business premises
- Managed funds

Member 2
- International shares
- Managed funds

Member 3
- Investment properties
- Shares
- Managed funds

Why do it?

Segregating assets can make sense if a fund has multiple members at different life stages, or with different risk appetites and investment interests. For example, if one member has a business whose premises are owned by the SMSF, they may have a particular interest in retaining ownership of that property.

Member level segregation can also be useful when spouses are separating, as a first step towards officially dividing the fund's assets.

Case study: One fund, two different life stages

Jason and Sandra have an SMSF with their children, Sophie and Scott. Jason and Sandra are just about to retire. They need security and a steady income from their investments, with some growth to keep up with inflation. Sophie, 28, and Scott, 31, have very different needs.

Their accountant suggests they divide the fund's assets into two pools: one designed to create a reliable pension income stream, the other designed to generate growth over the long term. That also makes tax planning and administration easier, since the fund pays no tax on gains made from the assets used to support Sophie and Scott's tax-free pensions.

How does it work?

Segregating assets is not hard to do, but there are a few issues to consider. Here's a step-by-step guide:

1. Review the fund's assets to ensure they can be effectively split. For instance, if the fund's main asset is a large property the members wish to keep, segregation may not be practical.
2. Check your trust deed to make sure it allows segregation.
3. Update your investment strategy to explicitly note the different requirements of each member or group of members.
4. Clearly document who owns each asset.
5. Talk to your accountant about administration, including setting up different general ledger accounts for each group of assets. You may also need to open separate bank accounts.

What are the negatives?

Segregating assets is not for everyone. It inevitably means spending more time and money on administration, so you need to be sure it will be worth it. You may also need to change your trust deed, creating more expense. And, as pointed out earlier, you may not be able to split large assets between members.

Note: As a result of the introduction of the super reforms, from 1 July 2017 some SMSFs are not permitted to use the segregated method for tax purposes. Generally, if a member of an SMSF has a total super balance exceeding $1.6 million as at 30 June prior, and that same member is receiving a super income stream (whether from the fund or another super fund), the SMSF will not be permitted to use the segregated approach when claiming the tax exemption on income derived from the assets which support the payment of that pension.

While an SMSF in this situation can still segregate its assets for investment purposes, the inability to use the segregated approach for tax purposes, introduces an additional layer of administration complexity and cost.

Who can help?

Your financial adviser can help you understand whether it makes sense to segregate your fund to satisfy the different investment needs of each member. Your accountant or fund administrator can also help you understand the potential costs, as well as finding the most efficient and cost-effective way to put your strategy into action.

Super Concepts