

# Industry fund DIY option could sort franking credits

## SMSFs

Tim Mackay



In 2011 the Gillard Labor government introduced its Minerals Resource Rent Tax, a tax famous for the wrong reason. It was a "Claytons tax", the tax you have when you don't want to collect any revenue.

There is a strong chance that for self-managed superannuation fund (SMSF) investors, Labor's franking credit reforms will give the same result. A potential hole in Labor's reform through which you could drive a Mack truck could mean your super won't lose franking credit refunds.

The potential solution is industry funds. To be more specific, the industry fund DIY options.

Over the past decade industry funds experienced outflows as larger investors shifted to SMSFs. To combat this, industry funds introduced DIY options mimicking SMSF investors' ability to control their investing.

For example, AustralianSuper introduced Member Direct, Hostplus Choiceplus and Cbus Self Managed.

Within parameters, you can invest in S&P/ASX 300 shares and exchange traded funds (ETFs), just like an SMSF. You receive dividends and franking credits and franking credit refunds are paid to entitled DIY investors.

Within industry funds there is a massive pool of member accounts: some pay tax (in accumulation mode) and some do not (in pension mode). The fund is a single taxpayer paying tax at the entity level. As long as the overall fund has a big enough tax liability to soak up the franking credits, none are lost.

Assuming the industry funds don't change their internal accounting and attribution policy and based on Labor's announcements, the industry fund DIY options can continue to pay franking credit refunds.

So who benefits from this solution? For simplicity we divide SMSF investors into two main categories – those with \$1 million or less in their SMSF (lower balances) and those with



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more (higher balances). Those with lower SMSF balances can roll their Australian equity balance across to an industry fund DIY option.

Depending on how much of your SMSF your Australian equity exposure represents, you may no longer even need an SMSF. Because the cost benefits of SMSFs reduce as your balance reduces, it may be in your best

interests to roll the entire balance across.

Those with higher SMSF balances could consider planning to roll at least part of their Australian equities (for example, bank shares) to a DIY option. You can set up an account at minimal cost and it in effect gives you a call option on a potential solution should Labor be elected.

Who will dislike this solution? Fund managers will hate it because their funds aren't included in the investing options of the DIY options. The SMSF industry clearly won't appreciate material outflows to industry funds.

I admit most advisers won't like this solution either. It may be in your best interests to roll your Australian

equities to a DIY option, but if industry funds don't recognise the adviser and deny them access to your account, it's difficult for an adviser to run their business.

However, there are things to be wary of with this solution.

You can't in-specie transfer current investments into the DIY options. Funds have told me they are working on this (they know a wave of money is coming), but you must sell investments (a capital gains tax event) and re-buy them in the DIY option.

They restrict how much of any single investment you can hold (for example, 20 per cent of your balance). Most cap how much of your balance (for example, 80 per cent) you can invest in shares and ETFs. You must invest the rest in their pre-mixed or sector options (for example, Australian equities).

They may have a cap per trade (for example, \$250,000) and require a minimum cash balance. Most also have a minimum total account balance (for example, \$50,000).

My advice is not to rush to action. After the election, there is a good chance that you will be able to move your funds to an industry fund DIY option, retain your franking credit refunds and move on with your life.

So Chris Bowen, the ball is in your court. I suspect if elected you will negotiate a cap on franking credit refunds (perhaps \$10,000 to \$15,000) so a hostile Senate passes your reform. However, there is a good chance in a few years we'll discover you have gifted SMSFs another Labor "Claytons tax".

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