Common SMSF Trustee Stumbling Blocks

Trustee Mistakes are Constant

SMSF trustees are prone to making a variety of mistakes including some specific to the changes to the superannuation system in 2017, according to experts.

The legislative changes, which span everything from a new transfer balance cap and a new total superannuation balance cap to death benefits, were introduced in the 2015/16 Federal Budget, with many laws taking effect from 1 July 2017.

Trustees tend to make mistakes around everything from not documenting information properly to not adhering to investment standards.

Breaching Investment Standards

SMSF Association head of technical Peter Hogan explained that some of the common errors that trustees will make are around breaching the investment standards.

The investment standards, which are a part of the *Superannuation Industry (Supervision) Act 1993*, are a set of rules that apply to investments and investment decisions that trustees make (ATO 2016).

"SMSF investors need to be very careful around making sure that there is a genuine long-term retirement reason for the investment," Hogan said.

"The general sole purpose test… that superannuation is for retirement purposes, is reflected in the context of self-managed super funds and in the decisions that SMSF investors make as to whether there is a long-term retirement purpose for the investment decisions they make or not."

Using SMSFs As A Short-Term Overdraft Facility

Hogan highlighted that another common mistake includes people with SMSF's treating superannuation assets as if they are freely available.

"Perhaps they might try and use a self-managed super fund as a short-term overdraft facility — something that's clearly not allowed under the rules. But it is very tempting for some people to say, 'I'll just help the cash flow of my business a little bit by borrowing a little bit of money from my fund. Then I'll make sure I put it back in again'", he said.

"That can be common, particularly in poor economic times when cash flow is tight, and so on, and availability of funds get tight."

Buying Investment Property

SuperConcepts' executive manager, SMSF technical & strategic solutions, Philip La Greca, explained that sometimes people do not understand that when a superannuation fund trustee buys an investment property, their name — as opposed to a relative's — must be on the contract. Similarly, if a fund has a corporate trustee, then it is the corporate trustee's name that must appear on the contract because that is the name that will appear on the property title.

The other common error is that people do not always ensure the superannuation fund pays for an investment property.

"You buy property in a super fund because it's part of your investment strategy. You don't buy a property and then say, 'Gee, I think I want to put that in my super fund'," La Greca said.

"Even little things like who pays the deposit has to come from the fund's bank account. If it comes from the client's bank account, the fund can't give you the money back. You have to treat that as a contribution."

Buying Residential Property

"There are some assets that trustees simply can't buy for themselves. Probably the most prominent one of those is residential property," Hogan said.

Hogan added that it is not possible for an SMSF trustee to acquire a residential property from a related party, nor is it possible to lease it.

"If you were to buy a residential property from a third party, then you couldn't lease that back to a related party either — very tight parameters," he said.

However, Hogan qualified that one acceptable investment is to acquire business real property from a related party. A trustee can also lease business real property back to that related party.

Further, Hogan emphasised that some of the rules do not make sense from an investment perspective.

"They're examples of the types of rules that an ordinary investor would not even think about. They're not something that's been decided in a linear sort of fashion or a fashion that flows in terms of the rules," he said.

'Related party' of a fund

A 'related party' of a fund includes:

- All members of the fund
- Associates of fund members, which include:
- The relatives of each member
- The business partners of each member
- Any spouse or child of those business partners
- Any company the member or their associates control or influence
- Any trust the member or their associates control.
- Standard employer-sponsors, which are employers contributing to a person's superannuation fund for the member's benefit, under an arrangement between the employer and the fund's trustee.
- Associates of standard employer-sponsors, which include:

- Business partners and companies or trusts the employer controls (either alone or with their other associates)
- Companies and trusts that control the employer.
- A relative of a member means any of the following:
- A parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the member or their spouse
- A spouse of any individual specified above. (ATO 2016)

Recent Changes to the Law

Changes to Australia's superannuation and taxation laws took place on 1 July 2017.

A year later, SMSF experts and advisers are beginning to see the effects — including the problems that SMSF trustees and members have been encountering as a result.

Confusion Over Recalculating

La Greca recounted that clients had been asking SuperConcepts questions about what they are allowed to do after the balance cap amounts in the pension phase of superannuation changed.

Before the changes, people could, for instance, have $2 million in their pension account — there was no limit. Now they can only have $1.6 million in their pension account, an amount that will change in line with the consumer price index (ATO 2018).

For people who had more than the $1.6 million saved in their retirement income stream, under the changes, they had to roll some of their investments that were in pension phase back into the accumulation phase, or take it out of the superannuation system.

"Your minimum pension level falls, so you'd have clients who would have then decided, 'What do I actually need to live on? Do I still need 5% of $2 million or can I live on 5% of $1.6 million? Then if I do still need the 5% of $2 million, well, it's not in my pension account. I've only got $1.6.' So then you have questions about, 'Where am I taking the extra from?'" La Greca said.

"We've seen a lot of issues around that where people weren't necessarily doing, not so much the wrong thing, but they hadn't really thought where was the best place to take the extra from. They might have thought, 'I'll just keep taking it from my pension account, but I've also now got this accumulation account sitting over there. Should I be accessing that instead?'"

Hogan pointed out that for people who have already satisfied a condition of release of superannuation — so that they can cash preserved benefits or restricted non-preserved benefits — the question they need to answer, and many are still trying to answer, is, do they leave that extra money in superannuation and pay tax of 15% on the investment earnings on that part of their portfolio inside their SMSF?

Difference between the two $1.6 million caps

Transfer balance cap of $1.6 million

The transfer balance cap of $1.6 million is the new limit on the amount of superannuation that can be put into the retirement phase.

“What that says is you can only have capital that supports a pension of up to $1.6 million which has tax-free earnings. Anything else above $1.6 million needs to be held in accumulation phase where the earnings are taxed at 15% in most cases,” the SMSF Association’s head of policy, Jordan George, said earlier in 2018.

Note: This is the capital that is used to commence a pension. The value of your pension can grow, and the growth, above $1.6 million, can remain in the pension and remain entitled to tax-free earnings. You just cannot contribute any further capital to a pension.

Total superannuation balance of $1.6 million

A superannuation balance is calculated by adding up:

- The accumulation phase value of your superannuation that is not in the retirement phase.
- If an individual has a superannuation income stream in the retirement phase, their transfer balance.
- Rollovers in transit between superannuation funds.

Personal injury or structured settlement contributions that have been paid to an individual’s superannuation then need to be subtracted. (ATO 2017)

Once their total assets in superannuation reach $1.6 million, an individual can no longer make non-concessional contributions.

“That was a rule the [Federal] Government brought in to try and make the system more sustainable. So, basically saying once you have $1.6 million in super, the Government doesn’t accept that you need to keep putting post-tax money into super to be sheltered in a concessional tax environment. They’re saying that we think you’ve already got enough out of the system,” George said.

Estate Planning

Under the changes, SMSF investors have one pension account and one accumulation account. La Greca observed that it has been difficult for them to determine what rules apply for estate planning regarding both accounts.

Hogan says one change specific to people with more than $1.6 million in their pension are adjusting to is that once they die, money held in the accumulation phase must be paid out as a death benefit lump sum (ATO 2018a).

Additionally, paying out the benefit also depends on how much any surviving spouse has.

“That’s again something that I think many members of self-managed super funds, in particular, are just starting to understand: that there are some implications around

death benefits which also changed on 1 July 2017 that are not as well known," Hogan said.

"A lot of people are saying, 'Oh, yes, I'm alive and I can leave this money in superannuation' — and that's a pretty good deal."

Hogan added that, however, when a trustee dies, this money will come out of the fund, and it could be quite substantial.

"We might be talking about a very large fund. We might be talking about several million dollars that might have to be paid out on their death," he said.

Hogan encouraged people to restructure their arrangements before they die, "rather than leaving a bit of a mess for their spouse to sort out after they pass away with all the other things that obviously need to be sorted out when that event happens".

The Right Fit?

La Greca emphasised advisers should not recommend that clients enter into SMSFs if they are not suited to such investment vehicles.

"This is why this whole issue about raising standards across the adviser industry becomes important because we really need to have a uniform approach that some people shouldn't have these," he said.

"Therefore, you shouldn't fear saying 'no' just because you're going to lose the client potentially. You shouldn't tell [them] to do it just because you know [they're] going to get told 'yes' somewhere else," he said.

La Greca suggested helping clients understand if they are suited to SMSFs by making sure they are aware of their responsibilities in this environment.

"A lot of people talk about the benefits of SMSFs but very few people talk about the downsides, the personal responsibility, the exposure to penalties, the flow-on effects of all that," he said.

The ATO website provides a breakdown of the rules and free penalty education courses that have been designed to help people decide if they want an SMSF.

"You can actually say to someone that if they're not sure about what they're getting into, go and look at these courses online from the ATO — costs nothing to do them. Run yourself through them and they will actually show you and explain to you what you actually have to do as a trustee," La Greca said.

Conclusion

SMSF trustees can be prone to making errors such as not keeping correct paperwork, failing to keep assets separate and breaching investment standards. Since changes occurred within superannuation legislation in 2017, clients are also readapting to the difference between the transfer balance cap and the total superannuation balance, and learning how to manage their superannuation for their death.

Advisers can help clients navigate difficulties by helping clients understand better what they want and how to achieve this aim, including advising them against setting up an SMSF if they judge they are not suited to one.

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Legislation

Corporations Act 2001