5 Potential errors when running an SMSF

While an SMSF offers a number of benefits and can be a great way to grow your retirement savings, it is important to ensure your fund remains compliant at all times. With the superannuation laws constantly changing it can be easy to make a mistake when managing your fund.

In 2019-20 the Australian Taxation Office reported 36,700 breaches of superannuation rules by trustees of 12,700 SMSFs. These breaches ranged from minor administrative contraventions, to more serious contraventions such as breaches to the rules around loans/financial assistance to members, in-house assets and separation of assets.

The ATO have a wide range of enforcement powers, meaning that they are able to impose significant penalties should you knowingly do the wrong thing in your SMSF (this can include being made non-complying and paying tax of 45% of the SMSF's assets to the ATO). Therefore, it is important that as trustee, to keep yourself up-to-date with your responsibilities to ensure your fund remains compliant at all times.

Here are 5 potential errors to avoid when running your SMSF:

(1) **Personal use of fund's assets, including early access to superannuation benefits**
One of the main errors made by trustees is accessing their superannuation benefits early. Early access and personal use of fund's assets are consistently at the top of the ATO's top 10 compliance mistakes every year.

All SMSFs that are established need to comply with the sole purpose test, meaning the sole purpose of the SMSF is to provide benefits to members when they retire. This test applies to all assets, including collectibles (such as cars, jewellery, artwork etc.). You are only allowed to access the funds in your SMSF once a Condition of Release is met. In 2019-20, 9.3% of the contraventions reported to the ATO related to breaches of the sole purpose test.

Prior to purchasing an investment, it is important to ask yourself, "What is the purpose of this investment?" If it is to provide immediate benefit to a member of the fund or related party, then don't do it, as it will not meet the sole purpose test.

Other errors that are commonly made by trustees include; providing loans to relatives or members of the fund (20.4% of contraventions reported to the ATO in 2019-20), and paying expenses out of the fund that are not fund expenses. Both of these actions are not allowed as they breach the sole purpose test, and put the SMSF at risk of having penalties applied or being made non-compliant.

(2) **Breach of the in-house asset rules**
The in-house asset rules are another area where trustees commonly make mistakes. 17.9% of contraventions reported to the ATO in 2019-20 were related to breaches of the in-house asset rules. The in-house asset rules state that the amount invested in in-house assets (ie. investments involving related parties) must not exceed 5% of the market value of the fund's total assets.

As the market value of the fund's assets constantly change it is important to regularly monitor your fund to ensure that, as the values of your investments change, your in-house assets do not go over the 5% limit. Breaches of the in-house asset rules may result in the ATO issuing you with a penalty of up to $13,320 from 1 July 2020.

In times when markets are volatile it may be easy for your in-house assets to exceed the 5% limit. Should this occur, you are required to dispose of the excess within the next financial year in accordance with a written plan. It is important to note that no disposals may be necessary if market movements in the following year assist in bringing your in-house assets under 5%. However, a written plan is still required.

(3) **Assets recorded in the wrong name**
Recording assets in the wrong name is another mistake that is often made by trustees that can easily be avoided. As trustee of an SMSF you are required by law to ensure that you keep the money and assets of the fund separate from other money and assets (eg. your personal assets).

12.7% of contraventions reported to the ATO in 2019-20 were related to separation of assets. Assets in your SMSF should be recorded in a way that clearly shows legal ownership by the fund and distinguishes them from your personal assets. This not only will ensure you aren't breaching the superannuation laws, but will also keep them protected in the event that you, as trustee, are involved in financial trouble.

In the event of a change of trustee/membership of the fund it is much easier if the SMSF is set up with a corporate trustee as opposed to individual trustees. This is because all asset registers, managed funds, investment and broking accounts, must be changed to reflect the change in individual trustees. Whereas, if a corporate trustee was in place, no change would be necessary as the company would still be the owner of the assets and only the directorship of the company would require updating.

(4) **Investing outside the investment strategy**
Another common error in which trustees are typically penalised for, is investing in assets outside of their investment strategy. Under superannuation law, all trustees are required to prepare an investment strategy that outlines the fund's objectives and specifies the type of assets the fund can invest in.

Your investment strategy can be changed as often as you like, either to take advantage of a new investment opportunity or to suit your changing circumstances. It is important to note that should your investments stray from your investment strategy you may be fined by the ATO.

To avoid any penalties or fines, it is important to review and potentially amend your investment strategy every 12 months. In addition, you should also review your investment strategy when there is a significant change to a member's circumstances (eg. a new pension is commenced, or a member dies etc.).

(5) **Failure to plan for death or loss of capacity of a member**
By not considering a succession plan for your SMSF you are making a mistake. Although often overlooked, succession planning is an essential part of running a successful SMSF.

Should a trustee die or lose legal capacity, there is a possibility that the money in your SMSF may be tied up and inaccessible if appropriate steps have not been taken beforehand. Worse still, if you have not prepared a succession plan, your superannuation benefits may be left in the control of someone who is not willing to act in accordance with your wishes. For more information refer to our fact sheets 'Death and Incapacity - Who is in control of your SMSF?' and 'Why is an Enduring Power of Attorney Essential'.

It is important, that whilst you have control, you consider and plan for potential events that will have a major impact on your SMSF. This will help limit the uncertainty and risk around who may potentially end up controlling your retirement savings.

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