Issue #65, 14 September 2009

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In this issue:

A recent draft SMSF ruling (SMSFR 2009/D1) discusses trusteeship of self managed funds. It provides a good opportunity to discuss this issue in more detail. In particular, when can we deviate from the basic rules requiring all members to be trustees and all trustees to be members?

Basic rules

The basic trustee rules for SMSFs are generally well understood.

For a fund with 2 or more members:

- All members must be trustees (or directors of the trustee company);
- All trustees (or directors) must be members of the fund; and
- No member may be an employee[1] of another unless they are relatives.

Where the fund has only one member, the fund's trustee could be:

- Two individuals (the member and one other person who does not employ the member unless they are relatives); or
- A company with either one director (the member) or two directors (the member and one other person – again, as long as the second director does not employ the member unless they are relatives).

In both cases:

- No trustee can receive remuneration for acting as trustee; and
- The trustee must meet the usual requirements for being a trustee of a superannuation fund – for example, they cannot be a 'disqualified person' (eg bankrupt, convicted of an offence involving dishonesty[2], disqualified by the regulator).

There are, however, some important exceptions to these basic rules – ie circumstances under which it is acceptable to breach them without the fund losing its SMSF status.

Exception 1 - Parents of minor children

Parents or guardians of minor children can act as trustees[3] of a superannuation fund to which their child belongs (in place of the child).

Exception 2 - Legal personal representative after death

When a member dies, Section 17A(3)(a) of the Superannuation Industry (Supervision) Act 1993 permits his or her legal personal representative (generally the executor of the estate) to be a trustee of the SMSF for a specific period (discussed below).

There are, however, some important limitations on this provision:

- This section does not provide that the executor

[1] There are some exceptions – for example, where members are co-directors of a company. In this case, they can both be members of the same SMSF even if they are not related.

[2] Although they could have served a life sentence for murder!

[3] In this newsletter, we have simply referred to "trustee" and "trustees". In fact, if the fund has a corporate trustee, we should refer to one or more "directors of the trustee". We have simply used the term trustee throughout for simplicity.

automatically becomes the trustee. In fact, the section simply *allows* the executor to become a trustee without failing the definition of a self managed fund;

- Whether or not the process is automatic will depend on the trust deed. In fact, even if the deed provides that the executor is automatically appointed, SIS requires him / her to accept the appointment before it takes effect;
- The concession is only available for a limited time – the period between the date of death and the date on which death benefits commence to be paid. Where (for example) the deceased's only benefit was a pension that automatically reverted to his or her spouse, this period does not actually occur at all.

Exception 3 - Legal personal representative during lifetime

Section 17A(3)(b) also permits a member's 'legal personal representative' to act as trustee of the member's superannuation fund in his place *during his lifetime*.

This exception is the subject of the draft ruling.

Many assume that few people would actually have a 'legal personal representative' during their lifetime unless they were (say) mentally incapacitated in some way.

However, 'legal personal representative' is actually defined very broadly in SIS. Not only does it include a guardian or trustee of a person who is legally disabled (say mentally incapacitated), **it also includes** *anyone who has an enduring power of attorney* in respect of another person (a fund member in this context).

For instance, it would be entirely possible for a fund member to grant an enduring power of attorney to his daughter and for the daughter to act as trustee of her father's SMSF in his place. This would be possible regardless of the father's health.

This approach is often used by SMSF trustees who are moving overseas.

Readers may recall that we discussed the residency requirements for all superannuation funds in some detail in Issue #61. One of the various tests that a superannuation fund must satisfy in order to be an 'Australian Superannuation Fund'[4] is that the 'central management & control' of the fund must ordinarily be in Australia. While the ATO has previously expressed the opinion that the trustee does not always exercise central management & control[5], it would be fair to say that in the normal course of events it will.

Hence this exception provides a valuable solution by allowing someone other than the (non-resident) members to be trustees and exercise central management & control.

In fact, it also provides solutions to several other trusteeship problems and the opportunities and pitfalls are discussed further below.

Exception 4 - the six month rule

This is perhaps the most powerful exception of all.

In a nutshell, it provides a six month window during which the fund may fail the basic rules but remain a self managed fund.

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[4] This is a requirement in order to be eligible to also be a complying regulated superannuation fund and eligible for the usual tax concessions.

[5] In TR 2008/09 the ATO indicates that in the Commissioner's view, the identity of those who exercise Central Management & Control is a matter of fact (ie who is actually making the decisions?). Hence it could theoretically be someone other than the trustee(s).

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The only circumstance under which it does not apply is when a new member joins the fund – they must become a trustee immediately.

The six month rule gives great scope to fix up trustee problems before they threaten the SMSF status of the fund and these are also discussed further below.

Why doesn't the 6 month exception give us a window for solving residency problems?

Remember that overseas residents are not in danger of breaching the basic rules for SMSF trusteeship (ie, generally all members must be trustees and vice versa). Rather, they have a problem with a completely different rule – the requirement to have central management & control based in Australia.

Exception 3 described earlier simply provides a means of satisfying this requirement (ie appointing someone else to be the trustee) without failing the basic SMSF rules.

So how is all this useful?

Firstly, Exception 3 (the ability to appoint a member's attorney as a trustee in his or her place) provides great scope to deal with problems such as:

- *Elderly members*. They may well appoint a trusted friend or family member to look after their general financial affairs. Exception 3 means that they could also grant an enduring power of attorney and have that person act as trustee of their superannuation fund;
- *Members who are currently mentally capable but where there is some risk to this in the near future*. Again, this is something that is most likely to be relevant for elderly clients;
- *Members who travel*. Dealing with the practicalities of running a self managed fund (renewing term deposits, changing direct debit arrangements etc) can be difficult for those who are frequently away. Even if the members were entirely willing and able to take on the trustee responsibilities, they may simply find it easier to have someone else fill that role.

What are the pitfalls?

We believe the exceptions to the basic SMSF rules (in particular Exception 3) provide an invaluable solution in particular circumstances where it is beneficial to have someone else acting as trustee during a member's lifetime.

However, there's usually a catch – in this case, risks to both the attorney and the member.

We should firstly examine the potential problems for the attorney (ie, the other party that agrees to act as trustee in place of the member).

SMSFR 2009/D1 makes it clear that to take advantage of this particular exception, the attorney must be formally appointed as a trustee (and the member removed as a trustee). Consequently:

- They are exposed to all the usual risks associated with being a trustee of a superannuation fund (fines, gaol terms, being disqualified etc). Remember that in this instance, they are taking this risk *for someone else* – not for their own superannuation fund.
- As they are acting as trustee of a self managed superannuation fund, they cannot be remunerated for their work as trustee. This applies even if they are a professional (say an accountant, financial adviser or lawyer) who has been appointed to the role because they have particular expertise. Note that they cannot be remunerated by anyone. It is even unacceptable for the members to meet the costs personally.

What about the pitfalls for the member who has surrendered the trusteeship of their superannuation fund? Here, the risks are perhaps even greater:

- Once appointed, the new trustee (the attorney) has all the powers of a normal trustee. Unless the deed imposes particular requirements, they are not constrained by the member's wishes. In the extreme, they could make decisions about investments, payment of benefits, insurance etc that the member may oppose;
- Where the member executes an enduring power of attorney in favour of more than one person, only one may be appointed as trustee of the fund in place of the member. This applies even if the enduring power of attorney normally requires those people to act jointly. It therefore potentially undermines one of the safeguards the member has put in place to protect against a rogue attorney;
- What if the enduring power of attorney is revoked? There is no automatic provision that removes them as trustee. Instead, the usual rules of trustee transition apply. Does the deed give the incumbent trustee the power to appoint a new trustee? Does that power rest with the member(s)? Is there a corporate trustee with rules that allow the shareholders to replace directors?

  In our view, it would be important to ensure that members of the fund or shareholders of the corporate trustee retained these important powers to ensure that the attorney ***could*** be forced out if necessary.

  What ***does*** change if the enduring power of attorney is revoked is that Exception 3 no longer applies – ie, having the attorney in place as a trustee will now breach the SMSF definition. While that has no consequences for the fund if the situation is fixed within 6 months (thanks to Exception 4), it is obviously a potentially serious problem;
- These problems may well be compounded by the fact that while the enduring power of attorney is in force, the attorney holds 'member' powers as well. In other words, any discretions, decisions or other powers that rest with the fund's members can be exercised by the attorney in place of the member. This might include, for example, replacing the trustee, taking benefits (within SIS rules of course), amending the trust deed etc.

  Perhaps the saving grace here is that:

  - Because these are not trustee powers, the usual rules for powers of attorney apply. For example, if the document requires decisions to be made jointly, one person cannot unilaterally decide on a course of action; and
  - The member can remove those powers at any time simply by revoking or changing the enduring power of attorney.
- What if the attorney dies while a trustee of the fund? Depending on the precise rules of succession for trusteeship, it is even possible that the attorney's own legal personal representative (say his or her executor) might become trustee of the fund!

Clearly this is not a decision to be taken lightly given the substantial risks for both sides.

Why is Exception 4 (the 6 month rule) important?

This is largely because it provides time to make changes. As mentioned earlier, the six month window applies unless a new member joins. It would be useful in a variety of situations such as:

- a member leaving the fund who does not simultaneously resign as a trustee;
- a trustee dying. For example, consider the case where there are two individual trustees and both are members. If one

Issue #65, 14 September 2009

Heffron
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Heffron Super News

dies, the fund will have just one individual trustee – a situation not normally permitted by the basic rules. However, the fund has six months to rectify this before it breaches the SMSF definition and during that time it could appoint a second trustee, change to a corporate trustee etc;

- an enduring power of attorney being revoked (as mentioned earlier);
- the death of a member whose attorney is currently acting as trustee (since Exception 3 will no longer apply – although bear in mind that Exception 2 may now allow the attorney to remain a trustee until the death benefit is paid);
- a child (whose parent has been acting as trustee) turns 18;
- a trustee resigns for any reason;

and others.

When are these exceptions not a solution?

Someone who is a disqualified person cannot act as trustee of their own self managed superannuation fund. They are also precluded from having their attorney act as trustee of their fund in their place.

The only real option in this situation is to change the fund to a small APRA fund (ie, appoint a professional trustee) or move to a public offer fund.

Why does it all matter?

Throughout this newsletter, we have identified that breaching the basic rules without falling under one of the exceptions means that the fund is no longer an SMSF.

Note that this does not mean superannuation law has been breached, nor does it mean that the fund has become non complying and must pay 45% tax on most of its assets. It simply means that the fund is no longer a self managed superannuation fund.

The problem then is that failing the SMSF definition means that:

- the fund ceases to be eligible for a range of concessions only available to SMSFs (for example, limited reporting to members); and
- must also appoint a professional trustee.

Inevitably, these create further problems effectively making failure a very significant event even if it does not instantly result in non compliance.

Conclusion

SMSFR 2009/D1 clarified some useful points on the application of Exception 3 – ie, appointing the holder of an enduring power of attorney as trustee of a member's superannuation fund during their lifetime.

While the exception is invaluable for those facing particular problems along the lines outlined in this newsletter, it is not without risk to both the members and the attorney.

Enduring Power of Attorney Service

If you would like further information about our Enduring Power of Attorney Service for SMSF trustees (eg for elderly clients), please don't hesitate to contact Duane Pinches on 1300 172 247.

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