

Setting up a Self Managed Superannuation Fund Individual v Corporate Trustee

When you establish a superannuation fund for a client, one of the first issues to consider is whether the trustee should be a company or a group of individuals.

Why is it relevant in the first place?

In order to be eligible for all the tax concessions traditionally associated with superannuation funds, a new fund must formally elect to be regulated by the Superannuation Industry (Supervision) Act 1993 (SIS). This legislation empowers the regulator to impose a number of different types of penalties for breaches (including gaol terms and fines for trustees).

Under the Australian constitution, the government only has the power to legislate in relation to particular matters – two of which are “constitutional corporations” (companies) and old-age pensions.

Thus, in order to be regulated under SIS, a superannuation fund must either:

- have a trustee that is a company (and under SIS, the trust deed must actually *require* the trustee to be a company); **OR**
- have the primary purpose of providing old-age pensions (in which case the trustee can be either a company or a group of individuals).

Note that this *doesn't* mean that clients who opt for the second approach (ie, a primary purpose of providing old-age pensions) necessarily have to take their benefits in pension form from their SMSF. The fund must simply ensure that its primary purpose (as articulated in the deed) is to provide old-age pensions on retirement – albeit it can allow the beneficiary to elect to receive an alternative lump sum benefit when retirement actually occurs.

Note also that clients who decide on one approach initially can change their minds in the future. Sometimes this will require a change to the trust deed but not necessarily. Under our trust deed, for example, no change is required as both options are accommodated.

However, as with any change in members or trustees of SMSFs, it will be necessary to report the change to the regulator.

What do most people do?

To date, most SMSFs have been established with individual trustees. For example, at 30 June 2009 around 71% of all SMSFs had individual trustees and in fact nearly 90% of

new funds established in 2007/08 and 2008/09 had individual trustees¹. In other words, the dominance of individual trustees over corporate trustees is increasing.

What do we recommend?

In fact, our view is that having a corporate trustees is a better approach and we have outlined the reasons below. We also recommend that this company has no function other than the trusteeship of the SMSF – even if the client already has other companies that are (say) trustees of other trusts within the family group etc.

However, the statistics certainly emphasise the fact that many people still use individual trustees and this is by no means an unreasonable choice to make. We have therefore also highlighted some of the benefits of individual trustees below.

Advantages of using a corporate trustee

Corporate trustees have the advantage of:

- *administrative ease when a new trustee or member joins.* If a new member joins a self managed fund, that person must generally become a trustee (either by joining the board of the trustee company or becoming one of the group of individuals that acts as trustee for the fund). With a corporate trustee this is straightforward – the relevant ASIC forms are completed, resolutions prepared and the change takes effect.

When the trustee is a group of individuals, there is an extra step involved – the names in which all the Fund's investments are held should be changed to reflect the change in trusteeship. This can be time consuming if the Fund owns a great number of investments. It can even create other practical challenges – for example, many banks insist on the fund opening a new bank account (and closing the old one) rather than simply changing the trustee name. This can be a nuisance if the fund has established direct debit arrangements for pensions and other periodic payments.

Often this benefit is dismissed on the basis that membership of a self managed fund changes only rarely – many clients have already made a decision that they will not have their children in their fund and hence there are unlikely to be any new members or trustees. Bear in mind, however, that there are a range of circumstances where a client may grant someone an enduring power of attorney so that person can act as trustee (or director of the trustee company) in their stead. These include:

- moving overseas (where the change may be temporary and designed to ensure that the fund retains its status as an "Australian Superannuation Fund" and therefore eligible for the usual superannuation tax concessions); or
- getting older and deciding to have a child, a trusted friend or other relative handle the formalities of managing the self managed fund. A situation where one of the members had dementia (and had granted someone else an enduring power of attorney beforehand) might be exactly the sort of situation where a new trustee would be admitted.

¹ Super System Review (2010) – Final Report – Chapter 8, Section 4.3

In both cases, the change would be far easier to implement if the fund had a corporate trustee.

- *better protection on death.* One of the questions often asked about self managed superannuation funds is “who gets my super when I die?”. The rules on this are the same regardless of whether or not the fund has individual trustees or a trustee company but a corporate trustee certainly makes the transition easier. For a start, death means that one trustee (or director) is no longer a trustee (or director) – a corporate trustee therefore has all the administrative benefits described above. Secondly, a corporate trustee does not “die” even if all of its directors do. Rather, the company continues but (generally) has new shareholders (whoever has inherited the shares in the corporate trustee). What happens next depends on the precise rules embedded in the company’s Memorandum and Articles (or Constitution) but generally the shareholders are able to elect new directors who continue to operate the fund. Importantly, “control” of the superannuation fund can be managed very closely without needing a change in trustee that might require (say) the agreement of the fund’s remaining members;
- *single member funds.* A corporate trustee can have a single director which is ideal for clients wishing to establish a fund with only one person involved. If they have individual trustees instead, they must have another person share the trustee responsibilities as it is not possible to have a single individual trustee of a superannuation fund. Whilst that second person does not have to be a member, they do have to be actively involved in the trustee decisions made in relation to the fund;
- *easier to ensure super fund assets are kept separate from individual affairs.* An important requirement of superannuation law is to maintain a clear division between personal and superannuation assets. This can be made easier when the assets are actually owned by different entities (eg, personal assets are owned by the individuals and super fund assets are owned by the trustee company) rather than by the same group of people in different capacities. The issue is particularly relevant where property holdings are involved because land titles offices generally only record the **owner** of the property, not the capacity in which it is held. It is therefore not possible to tell whether a property is owned by a couple in their own right or as trustees of their SMSF simply by looking at the title deeds.
- *lenders’ requirements.* Funds that intend to borrow as part of their investment strategy will find that most third party lenders require the trustee of the fund to be a company.
- *protection of personal assets in the event of a claim against the trustee.* One of the common arguments in favour of a corporate trustee is asset protection – ie, problems within the Fund which result in a claim on the trustee cannot extend to a claim on the directors’ personal assets (whereas an individual trustee’s assets would be at risk). This is an important benefit in some situations – for example, say the trustee (on behalf of a self managed superannuation fund) owned a building and was sued in relation to an injury sustained by someone in that building. If the trustee was a group of individuals, they are jointly and severally liable and their personal assets would potentially be exposed. In contrast, liability would be limited in the event that the trustee was a proprietary limited company.

However, there are two points to note on this issue. Firstly, most deeds (including ours) permit trustees to be indemnified from the assets of the Fund under certain circumstances. This means that the assets of the Fund would be used first in the event of any relevant claim.

Secondly, the corporate structure is unlikely to provide protection from the various penalties that can be levied by the courts under SIS (fines, gaol terms etc). SIS is specifically worded to ensure that the regulator is able to pursue any “person” (where person includes a company) involved in a breach of the legislation. Where a \$2 corporate trustee was involved, the regulator would no doubt pursue the directors of the trustee company rather than the company itself.

Advantages of individual trustees

In other circumstances a group of individuals will be more appropriate:

- *fewer statutory forms, lower costs and less reporting.* With a group of individuals, there is no need to complete ASIC forms (say, in the event of a change in the trustee group) and ASIC annual returns. Note, however, that these tasks are not particularly onerous and a reduced annual ASIC fee applies for companies which only act as the trustee of a superannuation fund. It is now possible to set up a company for the sole purpose of acting as trustee of a self managed superannuation fund for less than \$1,000 and the ongoing costs are also modest.
- *fewer procedural issues to consider.* The trust deed of a superannuation fund will often set out any particular procedures which must be followed in relation to decision making (for example, any notice periods for the calling of meetings, what constitutes a quorum, whether resolutions can be passed by circulation rather than attendance at a meeting etc). A company will usually also specify these in its Memorandum and Articles (or Constitution). Consequently, when a fund has a corporate trustee, the trustee must ensure that it complies with both the Memorandum and Articles of the company **and** the requirements of the trust deed;
- *less risk of misunderstanding where the power lies.* A related point to the procedural issues above – the trust deed may well indicate where control of the fund lies in terms of how the trustee is appointed, who may belong to the fund, how decisions are made etc. When a fund has individual trustees, they need look no further than the trust deed to answer these questions and consequently each member and trustee will have a clear understanding of their ability to control outcomes within the fund.

The situation is more complicated when a fund has a corporate trustee, however, in that the actions of that company will also be governed by its Memorandum and Articles (or Constitution). It is entirely possible for the trust deed to state that decisions will be made by majority (with each trustee having one vote) but for the company’s constitution to state that voting rights are proportional to the member’s underlying balance in the self managed superannuation fund. In this situation, there is only one trustee (the company) and hence the deed’s provisions on making decisions by majority are effectively meaningless – what will actually drive decision making for this fund is how the company decides to cast its vote.

Simply reading the trust deed in this situation would give a misleading impression of where control of the fund actually lies;

- *different penalty unit regime.* Under SIS, fines imposed on trustees, advisors etc are defined in terms of “penalty units”. Each penalty unit is currently worth \$110 – ie, a fine of 1,000 penalty units equates to a fine of \$110,000. In the case of some breaches, SIS gives the courts the ability to levy a higher fine on companies than individuals (the company fine is five times the individual fine). It is unlikely that the regulator would ask the courts to impose a higher fine on a \$2 trustee company (it is more likely to pursue the directors individually). However, in the event of a serious breach, the courts may well fine the corporate trustee directly (at the higher level) if the trustee is (say) a trading entity with significant assets.

Regardless of the trustee structure, the responsibilities of those acting in trustee capacities for a superannuation fund (either individually or as a director of a company) are the same. They must comply with the various rules and prudently manage the fund’s assets for its members’ retirement.

For many clients, the decision between having individual trustees or a trustee company will be a fairly minor issue but for all the reasons outlined here we would certainly encourage a corporate trustee.

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