

Help or hindrance? Ensuring the trust deed supports your clients' super dreams

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General issues & Armageddon planning

Thinking that a Trust Deed will serve a particular purpose or assist in reaching a client's particular superannuation goal without taking the right steps is madness. The idea of a 'set and forget' Deed is outdated. It is important to ensure that you are familiar with the particular Deed for each specific client. Only then can you know whether the Deed is 'fit for purpose' or if it can perform in the way you need it to. Initially you need to take a look at some general aspects of each SMSF's Deed:

- ✓ Is it (correctly) signed?
- ✓ Is it dated?
- ✓ Do you have a complete version or are pages missing?
- ✓ Do you have the original or only a scanned copy?
- ✓ Can you amend it if you need to?
- ✓ Is the full name of the SMSF clear and is this the name you've been using on documents?
- ✓ Has the establishment Deed been amended? Do you have the amendment Deed?
- ✓ Has the Trustee of the Fund been changed? Do you have the change of trustee Deed?
- ✓ If there are subsequent Deeds or other important documents is the Fund name consistently used?
- ✓ Is the Trust Deed available or has it been lost?

Do you have an Armageddon plan?

The minimum requirements of a Trust Deed are generally ensuring that you can get money in and get money out ensuring that you maintaining tax concessions.

In addition to this each client is going to have issues and requirements that are unique to them; which is why Armageddon planning is personal rather than 'one size fits all'.

The Armageddon plan is the basis to review the Trust Deed as you need to find out ('road test') how the Deed will react in certain situations and what it will permit.

If the Deed doesn't react in the way you need it to or permit particular behaviour, then it's likely you will need to amend it. Armageddon planning ensures these amendments can be completed before the events occur.

Some examples of Armageddon issues are:

- *Incapacity of a member* – who will take over in operating the Fund? If there's no one to take control, then what is the 'ejector button' option to get out of the SMSF?
- *Blended family* – potential loss of control of the Fund through incapacity or death of one member. What is the plan to avoid the chaos?
- *Notional estate risk* within family provision claims which are made on the estate of a member – is the client at risk, and if so what can be done to minimise the risk?
- *Divorce* – How will one member exit the Fund? How would a splitting order or flagging order impact the operation of the Fund? Is a strategy required for 'lumpy' or complex investment strategies to continue?
- *'Break up' with business partner within same Fund* – how do you facilitate an exit from the Fund if the business is intertwined i.e. holds business real property used in the course of the business.
- *Residency issues* – does the client currently or in the future intend to spend significant periods outside of Australia. How will you manage the Central Management & Control of the Fund to ensure tax concessions? Is the relevant member likely to completely forfeit decision making to an Enduring Power of Attorney whilst out of the country?
- *Bankruptcy/conviction* – is there a risk of disqualification?

1. Life events – death

It is important to remember that Deeds must be followed for the payment of death benefits; however, they may impose an obligation on the Trustee to pay benefits in accordance with a binding nomination made by a member.

The Trust Deed however must state that nominations can be non-lapsing (SMSFD 2008/3) if the member wants to avoid renewing a binding nomination every 3 years; which is the fallback position if the Deed is silent (s59 SIS Act, Reg 6.17A (7) SIS Regulations).

An example of wording that I have seen includes

Death benefits nominations (binding or non-binding) will not lapse 'by reason only of the passage of time'.

John has a binding death benefit nomination. Let's kill John for the purposes of Armageddon planning. The Trust Deed must be checked to see if John's nomination is binding on the Trustee.

Examples of questions in an Armageddon plan may include:

- is the nomination valid and binding on the Trustee
- is there a rule in the Deed as to death benefits
- is the Trustee structure complaint or do you need to amend the Trustee (needs to be rectified within 6 months from date of death)
- is John still considered to be a member following death – if so, how does this impact the payment of death benefits
- how are benefits to be paid – lump sum/pension
- is there a reversionary pension in place

What if John left a binding nomination form as prescribed by the Deed (which is signed but not witnessed) which is in favour of Jenny, and a more recent nomination (signed and witnessed yet not on the prescribed form) in favour of John's previous wife Roseanne.

The Deed will answer whether there are witnessing requirements and may provide further requirements for the Trustee which may or may not include the exercise of discretion.

Where the Trust Deed permits the Trustee to exercise discretion in their decision making it is critical to use great care.

An example of where a decision by the Trustee may be based on factual data and opinion could be in the process of paying out death benefits of a member. The Deed may define a 'dependant' as:

"any child of the member or any other person who, in the opinion of the trustee, at the time of death was a dependant of the member".

The case law of *Karger v Paul* [1984] provides some cautionary advice to Trustees who exercise discretion and run the risk of having that decision making questioned by other parties. Here the Judge offered the following guidance to Trustees:

The discretionary power given to the trustees..... was a power.....upon the request of Mr Smith, in their **absolute and unfettered discretion** to pay or transfer the whole or part of the capital of the estate to him.

In my opinion the effect of the authorities is that, with one exception, **the exercise of a discretion** in these terms **will not be examined** or reviewed by the courts **so long as the essential component parts** of the exercise of the **particular discretion are present**.

Those essential component parts are present **if the discretion is exercised by the trustees in good faith**, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.

The exception is that the validity of the trustees' **reasons will be examined** and reviewed **if the trustees choose to state their reasons** for their exercise of discretion." McGarvie J (emphasis added)

This makes it clear that only where reasons are given by the Trustee in exercising a discretion can the validity be questioned by a review of the decision making.

To find out whether a Trustee has appropriately formed an opinion or exercised a discretion

- look at the Trust Deed
- was the correct question addressed
- based on the information – 'would a trustee acting honestly and reasonably have come to the same conclusion'? (Sayseng v Kellogg Superannuation Pty Ltd [2003])

Consider the following clauses in a Trust Deed

CLAUSE 1 - Binding Death Benefit Nomination

A Member may **give** the Trustee a Binding Death Benefit Nomination (BDBN) requiring that the Trustee pay Benefits arising on the death of the Member to a person specified in the BDBN, being the **LPR and/or Dependants** of the Member in **the form** specified in clause 2.

CLAUSE 2 - Binding Death Benefit Nomination

A BDBN must be in writing and

1. signed and dated by the Member in the presence of two witnesses who are at least 18 years of age, who are not Dependants nominated by the Member in the BDBN or the LPR

AND

2. must specify that the witness declares that the BDBN was
signed by the Member in their presence

Who is likely to receive the death benefits of John when considering the two nominations; one to Jenny and one to Roseanne.

It would require further consideration of the requirements in the Trust Deed such as

- was either nomination given to the Trustee
- is Roseanne John's Legal Personal Representative? If not she is unlikely to be a SIS dependant

If both are not binding on the Trustee; what happens? The answer will be in the Deed.

2. Life events – divorce

It is important to keep updating nominations in relation to death benefits in the event of relationship breakdown; for de facto or married clients.

Upon separation – a current spouse (i.e. married but not divorced) is still a SIS Act Dependant.

Upon divorce – a former spouse is not a SIS Act Dependant.

If a nomination is still in place at the member's death and they have separated from or divorced their partner – how does this impact the overall nomination? The answer is in the Deed.

There may be a provision in the Deed to the effect of

Should part or all of the nomination fail the benefit payable shall be paid to the Member's LPR but if a grant of Probate or Letters of administration in respect of the estate of the Member is not made within two years after their death the benefit payable shall be treated as a forfeited benefit and applied by the Trustee in accordance with the provisions of clause 2.

Clause 2 – Forfeiture of benefits

The Trustee shall apply the amount forfeited as the Trustee, in its absolute discretion, determines and the Trustee may, in its absolute discretion, in order to relieve hardship only, apply the whole or any part of the amount forfeited for the maintenance or support of the Member's dependants as the Trustee in its absolute discretion determines.

A nomination in favour of a separated spouse may still be valid, however even if it was invalid if the ex-spouse controls the Trustee then discretion may be exercised in a manner not desired by the deceased member.

This shows how important it is to keep the nomination updated but to also be aware of the impact of the Deed should the nomination fail for reasons outside of the member's control or succession planning.

Here, the member may wish to amend the Deed to remove Trustee discretion or provide parameters or even 'hard wiring' the Trust Deed.

3. Life events – payment of benefits

John and Jenny want to commence a Transition to Retirement pension in the future. You advise them that they can't until they reach preservation age; which for them is 60.

The Deed states

"a member must be 65 years of age or over and retired to commence an income stream"

The Deed doesn't appear to permit TTR pensions. There should be an express power permitting the Trustee to pay benefits. As a result the Deed will need to be amended to allow for payment of benefits to a member by an income stream before they are 65 and retired.

Amendments to the Deed may be required in multiple sections such as

- the definition of 'pension' or 'income stream'
- the 'payment of benefits to members' section
- any other conditions imposed on the payment of benefits

Being aware that there may be an issue is the first step. Engaging specialist SMSF lawyers to confirm and correct any suspected issues is the next step.

4. Life events - investment

John and Jenny tell you that they want to use an LRBA to acquire a property in the Fund.

You will need to review powers of investment

- is an LRBA permitted, and
- are all the powers expressly outlined

Is there an express power to borrow to purchase real property, mortgage trust property, appoint a custodian/holding trustee, lease trust property?

5. Amending the Deed

You find the clauses relating to 'Variation of Trust Deed'. It states that the variation must be:

- 1) by oral declaration or written resolution, or
- 2) by Deed executed by the Trustee

What could go wrong? Amending the Deed through oral declaration is difficult to demonstrate to third parties such as banks or the ATO if not documented. John and Jenny may want to amend this provision to safeguard against potential issues.

It is also important to understand whether there are any limitations on the amendment power.

TRUST DEED TO DO LIST

1. prepare an Armageddon Plan for each client
 - a. check the plan against the Trust Deed
 - b. if you think there is an issue refer to an SMSF lawyer
 - c. make sure the Trust Deed can cope with Armageddon
2. **start with any 'Dirty Deeds'**- get specialist help on lost, incorrect Deeds
3. prepare a checklist showing Armageddon event/relevant clauses in the Deed for each client and outcome
4. does the client want to retain Trustee discretion in the Deed or remove it
5. don't think that it won't happen

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