The Great Debate - Hot estate planning & succession planning topics

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Introduction

In the presentation we consider many questions. One such question is whether people should allow children in their SMSF. This has many implications in a succession planning context, which we discuss in the presentation.

However, this paper seeks to drill further into this question, but from a slightly different angle.

The paper does not so much wish to specifically consider the prospect of six member SMSFs. (Naturally, Scott Hay-Bartlem and Clinton Jackson consider six member SMSFs in some detail in their presentation 'Multi-member SMSFs – The good, the bad and the ugly'.)

However, if and when the Treasury Laws Amendment (Self-Managed Superannuation Funds) Bill 2020 becomes law, the question of whether to allow children into an SMSF will become even more relevant, and indeed would magnify, amplify and exacerbate the issues illustrated by the following case study. This is especially the case given:

- Shane's criminal history (ie, Shane may well be ineligible to be part of an SMSF); and
- Kevin's degenerative cognitive disorder (ie, Kevin may well be unable to become a trustee himself when he turns 18 or to execute an enduring power of attorney).

Case Study

Recall the seemingly happy Corrigan family, involving Das, Sal, their daughter Shazza and her husband Con.

Das, Sal, Shazza and Con are members and trustees of the 'On Just Terms SMSF'. There is no corporate trustee. Rather, all individually are the trustees of the SMSF.

Das and Sal might have originally invited Shazza to become a member as they thought it would be a good way to teach Shazza about investing.

When Shazza married Con, inviting Con to join the SMSF as well seemed logical because he is an accountant.

Also, Das and Sal figure that having Shazza and Con as SMSF members with them has the added bonus of allowing Con and Shazza's super to be pooled with Das and Sal's, thereby saving some fees.

For the first few years, all goes well.

However, ultimately tensions mount between Das and Sal, and Shazza and Con. Shazza becomes estranged from her family.

Das and Sal now start wondering what will happen to their SMSF.

Options that Das and Sal face

Das and Sal have various options.

The first option is to try to run the SMSF without Shazza. Assume — miraculously enough — Con is still on good terms with his parents-in-law Das and Sal. (If Con sides with Shazza, then this first option would be even less feasible.)

Das and Sal therefore figure that they have a majority of the trustees. Plus, they figure, Shazza only has a relatively small balance.

However, SMSFs are ultimately governed by trust law and trust law does not operate like this. Rather, as Street J in *Sky v Body* (1970) 92 WN (NSW) 934 said:

> *Inherent in this basic system of trusts is the principle that trustees must act unanimously. They do not hold several offices – they hold a single, joint, inseparable office. If conflicting business considerations lead to such a*

> *divergence that the trustees are not able to act unanimously, then the simple position is that they cannot act.*

Accordingly, strictly speaking, Das, Sal and Con need Shazza's input to make a valid trustee decision. Although practically speaking Das, Sal and Con might still be able to give directions to banks, sharebrokers etc, any decisions they make are invalid. They have the sword of Damocles hanging over their head – they know that there is the risk that Shazza could challenge any trustee decision they make.

(If there was a corporate trustee or strategic provisions in the SMSF, their position might be different.)

The second option they have is to forcibly roll Shazza's benefits out of the SMSF. However, the legislation does not allow for this. More specifically, reg 6.29 of the Superannuation Industry (Supervision) Regulations 1994 (Cth) provides that there are only a handful of circumstances where members can be rolled out of a regulated superannuation fund.

The most obvious circumstance is where the member provides written consent, however, given the strained relationship between Shazza and her parents, she would not consent to any proposal that her parents put to her, even if it is via Con.

Another circumstance is where she is being rolled to a 'successor fund'. On its face, this sounds like a perfect solution. However, to be a successor fund, the trustee of the new fund must agree that the new fund will confer on Shazza equivalent rights to the rights that she had under the original fund. Obviously, finding a superannuation fund trustee that will agree to this will be difficult to say the least.

The third option is that Das and Sal (and possibly Con too) roll their benefits out of the SMSF, leaving Shazza by herself.

This option is riddled with problems. One problem is that the SMSF might have, say, carried forward capital losses due to the GFC and rolling out of the SMSF means the benefit of the losses will be lost. Naturally, there are many other problems too. One such additional problem is the illiquid nature of certain assets of the SMSFs. Although the Beauty salon is presumably business real property and could theoretically be rolled to a new SMSF, this gives rise to questions of:

- stamp duty and
- CGT.

Also, the SMSF has other assets, such as the set of jousting sticks. Section 66 of the *Superannuation Industry (Supervision) Act 1993* (Cth) prevents such an asset from being rolled *in specie* from one SMSF to another.

Finally, more drastic actions can be taken, such as seeking court orders. However, this would be wildly expensive and would presumably only further the rift between Shazza and the rest of the family.

Another option?

There are other options, but they become 'novel'.

One such option involves remembering that, under reg 6.29 of the Superannuation Industry (Supervision) Regulations 1994 (Cth), trustees can roll out a member's benefits if the member has given to the trustee the member's consent to the transfer.

The SMSF's deed might expressly provide that such consent can be obtained 'upfront' such as when Shazza joined the SMSF, and that the consent can be contingent on that member failing to attend at least two or three trustee meetings.

That being said, this is still a novel option and few SMSF deeds provide for this alternative. However, if such a contingent consent had been obtained upfront, at least it would have provided a leg to stand on for Das, Sal and Con and they might be in a more attractive position than what they currently find themselves.

Conclusion

Having children in their parents' or parents'-in-law SMSF exposes the SMSF to risks. One key risk is what happens if there is a falling out between the children and the parents. Although there are ways to try to address these risks, those risks have to be weighted very carefully against any perceived benefits.

These risks only become magnified when considering succession planning, particularly if not all children (eg, Shane and/or Kevin) are eligible to participate in the SMSF.

This paper is general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.