# You know an SMSF has passed its used by date when…

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# You know an SMSF has passed its use by date when…

## What happens when it is too late or there are complications which can cause potential harm to the SMSF, including insolvency of the corporate trustee which is conducting a business.

There are implications for a Self-Managed Super Fund (**SMSF**) where the Trustee (corporate trustee or otherwise) of the SMSF, or a member of the SMSF, is facing insolvency or is an insolvent. Those implications could be fatal for a SMSF and some of them are explored in further detail below.

There are a few strategies that can be put in place, however, to minimise the disruption to a SMSF in certain circumstances. They include:

a. avoid having an individual as a trustee of the SMSF wherever possible;

b. ensuring that a corporate trustee is established with the sole purpose of being the trustee of the specific SMSF; and

c. draft the trust deed in a way that permits the appointment of a replacement trustee by the members upon the disqualification of the incumbent trustee.

Really, the cost of setting up a separate sole/ specific purpose company in these circumstances is heavily outweighed by the significant reduction in risk (particularly where there is more than one member of the SMSF) associated with not having an individual or a multi-purpose company as the trustee of the SMSF. This will become more evident throughout this paper.

**Basic requirements under the Superannuation Industry (Supervision) Act, 1993 (Cth) (SIS Act) to establish a SMSF**

Summary of basic conditions for a SMSF[1]:

- One to four members[2];
- Members actively participate in the fund's management;

[1] See section 17A of the SIS Act and Leow & Murphy, Australian Master Superannuation Guide, 22nd Edition, paragraph 5,000 at page 488-500.
[2] Note *Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020* currently before the Senate which, if passed, will increase the total permitted number of members to six.

- Members must be the individual trustees or directors of the corporate trustee of the fund;
- Members have full responsibility for the fund's management, investment and general administration functions.

Where a SMSF fails to meet the basic conditions set out above, and none of the exceptions apply, it may mean that the fund does not meet the SMSF definition. In that case, the fund generally remains a SMSF until the earlier of:

- the appointment of an RSE licensee (whereupon it will become a small APRA fund, known as a "SAF"); or
- six months from the event that caused the fund to fail to comply with the definition.[3]

All of this becomes relevant when considering insolvency implications. If, for example, the fund is not a complying fund at the time of a member's/trustee's/director's bankruptcy then there is a potential greater risk that the bankrupt member's/trustee's/director's bankrupt estate will have access to the superannuation of that individual. This is set out in more detail below.

The decision as to whether to appoint members in their personal capacities as trustees of the SMSF or to have a corporate trustee is a personal matter for each fund. However, it is hard to see the benefit of having an individual as trustee of the SMSF, apart from expediency of establishment.

Having a single-purpose corporate trustee makes separating the assets of the SMSF from personal assets of members/trustees more visible (more easily ensuring that this requirement under the SIS Act is met). It is also likely to minimise the risk of fund assets being inadvertently mixed with other personal and business assets , which is also advantageous in the event that a member or their business ends up in some form of insolvency administration and there is a requirement to show (or prove) that the assets belong to the SMSF and not the individual in their personal or business (non-trust or non-super) capacity.

**What is insolvency?**

At a very basic level, "insolvency" is when a company or a person is unable to pay their debts as and when they fall due[4]. The definition contained in the *Corporations Act 2001* (Cth)(**Corporations Act**) itself isn't of great assistance, but years of case law has developed a number of tests and a series of indicia that assist to determine or infer the solvency (or otherwise) of an entity. These typically include things like:

- A cash flow test;
- The working capital ratio analysis;
- Whether there is a history of continuing trading losses;
- Whether any bank accounts are overdrawn;

[3] See section 17A(4) SIS Act.
[4] See s95A Corporations Act, 2001 (Cth).

- Defaults in making interest or instalment payments;
- The expiry, or non-extension, of funding;
- Late payment reminders, fees, demands, arising from an inability to pay creditors within the agreed terms of trade;
- Proceedings being issued or threatened, arising from the non-payment of debts;
- Non-payment (or failure to pay on time) of statutory debts such as GST, Income Tax, CGT, Land Tax, State Revenue charges;
- Non-replacement of core machinery or tools required to conduct business;
- Promises of payment that are never met – the old "cheque is in the mail" doesn't work so well these days;
- Inability to raise funds to satisfy debts;
- Failure to produce accurate financial information on a timely basis.

The list is non-exhaustive.

Much has been written about what insolvency is, when it arises and what tests you use to assess solvency. Those technical questions are beyond the scope of this paper, but it is strongly recommended that should you consider that your client may be facing insolvency, that expert accounting and/ or legal advice be sought.

The Corporations Act sets out the rules that govern companies in situations where those companies are not solvent, and the *Bankruptcy Act, 1966* (Cth) (**Bankruptcy Act**) sets out the rules that govern when an individual is or becomes insolvent.

Under the Corporations Act, the options available when a company is insolvent, or is likely to become insolvent, are the appointment of "Receivers and Managers", "Administrators" or "Liquidators". Each form of insolvency administration has its own purpose as well as benefits and detriments. Regardless of which form of insolvency administration a company goes through, it will be expensive, and the assets of the company will be depleted as they will be, at first instance, used to pay the insolvency practitioner his/her remuneration ahead of repaying most of the unsecured creditors.

For the purposes of this presentation, the most topical form of administration is "Liquidation" which will be discussed below. However, when considering the facts of the Case Study of the Corrigan Family there are other forms of insolvency administration that are relevant. Namely:

- Receivership: i.e. if Spiros Petrolous seeks to enforce a loan/ loan agreement against the 'On Just Terms SMSF'. This could be a contractual receivership pursuant to the written terms of any loan agreement; which would then be governed by the Corporations Act, or it could be a Court appointed Receivership in the event that a written loan agreement does not exist or is not sufficient for Mr Petrolous to rely upon.
- A Receiver can also be appointed (usually by the Court) to preserve, recover and/ or sell the assets held in a trust capacity.
- Post 3 January 2021 (in South Australia) once the COVID-19 Emergency Relief Regulations expire, Shazza's nail and beauty business could face insolvency action if it is unable to meet its commitments to landlords (the On Just Terms SMSF) or financiers (Mr Petrolous) or other creditors. This would obviously then have flow on effects for the On Just Terms SMSF.

- Bankruptcy – if Shane is pursued civilly for embezzling money from Corrigan & Son Motor Crash Repair Pty Ltd (**Company**) and judgment is entered, his bankruptcy could follow.

**Bankruptcy**

Whilst bankruptcy is not necessarily relevant on the face of the Case Study, there remain a number of aspects of bankruptcy law that ought to be borne in mind when advising someone how to set up their SMSF.

One of the major differences between bankruptcy and liquidation is that in bankruptcy the assets of the bankrupt vest pursuant to section 58 of the Bankruptcy Act in the trustee of the bankrupt estate.

Section 58 of the Bankruptcy Act provides:

> *"(1) Subject to this Act, where a debtor becomes a bankrupt:*
>
> > *(a) the property of the bankrupt, not being after-acquired property, vests forthwith in the Official Trustee or, if, at the time when the debtor becomes a bankrupt, a registered trustee becomes the trustee of the estate of the bankrupt by virtue of section 156A, in that registered trustee;"*

Section 5 of the Bankruptcy Act, defines "the property of the bankrupt" to mean:

> *"(a) except in subsections 58(3) and (4):*
>
> > *(i) the property divisible among the bankrupt's creditors; and*
> > *(ii) any rights and powers in relation to that property that would have been exercisable by the bankrupt if he or she had not become a bankrupt."*

Section 5 of the Bankruptcy Act defines "property" to mean:

> " *real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property*".

"Property divisible among the bankrupt's creditors" is set out in section 116 of the Bankruptcy Act. Section 116(2)(a) of the *Bankruptcy Act* excludes property held in trust by the bankrupt for another person, and section 116(2)(d)(iii) excludes the bankrupt's interest in a regulated superannuation fund within the meaning of the SIS Act.

In the recent decision of <u>Boensch v Pascoe</u> [2019] HCA 49 at [15] the Court confirmed that trust property (and by analogy Superannuation assets) vest in the Bankruptcy Trustee, but that they are not available for distribution to the bankrupt's creditors.

> *"…provided the bankrupt has a valid beneficial interest in the trust property, the trust property will vest in the trustee in bankruptcy subject to the equities to which it is subject in the hands of the bankrupt. For these purposes, a valid beneficial interest means a vested or (subject to applicable laws as to*

> *remoteness of vesting) contingent right or power to obtain some personal benefit from the trust property."*

It is important to note that it will be for the bankrupt and/ or another interested party (which might be, for example, the SMSF trustee) to establish that the assets in the name of the bankrupt are assets owned on trust or are superannuation funds. This could be difficult if records have not been kept in accordance with the SIS Act and/ or assets have co-mingled.

Importantly, if a SMSF is no longer considered to be a "regulated" SMSF in accordance with the SIS Act then this also opens up an argument that in those circumstances, the bankrupt's superannuation does become available for distribution to the bankrupt's creditors. Whilst it is unlikely that a fund will cease to be regulated – even where it might cease to be a complying fund, the possibility should not be ignored and the criteria for satisfying the definition under section 19 of the SIS Act should be borne in mind; for a fund to be a regulated fund the following criteria must be satisfied:

(i) there must be a trustee;
(ii) the trustee must be a "constitutional corporation", or the fund trust deed must provide for the sole or primary purpose of the fund to be the provision of old-age pensions; and
(iii) the regulator must have been provided with an irrevocable election notice for the fund to be a regulated fund.

Another implication of assets vesting in a bankruptcy trustee is that potentially, depending on how the trust deed has been drafted, the right to appoint a replacement trustee may be a right that vests in the Bankruptcy Trustee. This is not considered in further detail in this paper, but it is flagged as a potential issue and another reason why it is preferable to have a corporate trustee of a SMSF.

**Effect of Bankruptcy**

If a member of a SMSF becomes bankrupt, he/she will no longer be able to act as a trustee or as a director of a corporate trustee in respect of their SMSF, as they will be a "disqualified person" for the purposes of section 120 of the SIS Act. Section 120 of the SIS Act disqualifies, amongst others, an "insolvent under administration" which includes a person who is bankrupt or who is subject to Part X of the Bankruptcy Act.

Further, section 17A(10) of the SIS Act makes it clear that a member who has become disqualified, for example due to bankruptcy, cannot appoint a legal personal representative to act in place of the disqualified person. Accordingly, a bankrupt can no longer be a trustee/ director and consequently cannot be a member of a SMSF.

Interestingly, however, in the recent decision of *Australian Securities and Investment Commission v Helou (No 2)* [2020] FCA 1650 Beach J of the Federal Court granted leave to a disqualified director (who was not disqualified by reason of insolvency) pursuant to section 206G of the Corporations Act to continue to manage a number of closely held companies so as to not cause detriment to underlying trusts and a SMSF of which the director was associated. It is of interest whether this decision may have wider application to matters where bankruptcy is in issue or whether such leave would not be sufficient, without further orders, to rectify or overcome section 120(2)(e) and 126K(1)(c) of the SIS Act.

It would appear, therefore, that if there are no other members, then the SMSF is likely to require winding-up in these circumstances, or perhaps an application for an APRA trustee to be appointed (although this could be quite expensive and may not be able to be efficaciously managed if there are complex direct private investments held in the SMSF), but may be warranted if the balance of the SMSF is substantial and more direct investments (such as real property) are desired which are not likely to be available through a retail or industry superannuation fund.

In the event that there are other members of the fund, the SIS Act provides a grace period of 6 months for the bankrupt to facilitate his/ her withdrawal from the fund, though in practice it may take longer to achieve, and consultation with the Commissioner of Taxation will then be required to avoid administrative penalties and the fund being treated as non-complying.

**Liquidation**

Technically, when a company is not able to be rehabilitated it goes into liquidation. This happens either directly (through members or directors of the Company) or by reason of a creditor of the company making a Court application to wind up the company. Alternatively, a liquidation could happen as a consequence of a voluntary administration that does not result in a deed of company arrangement.

As a general proposition, it would be unlikely that a trustee company that was the trustee of a SMSF only, would be able to go through the ordinary process of administration and then liquidation given the requirements of the SIS Act.

With reference to the Case Study, it appears that the directors of the Company have called in the liquidators as a result of:

- the non-payment of creditors; and
- the discovery of Shane's long existing embezzlement from the Company.

The appointment of the liquidator would have been achieved by the directors resolving that the company was insolvent or likely to be insolvent. It is likely that this decision would have been made without reference to the On Just Terms SMSF and was simply a business decision made considering the interests of the creditors of the Company and potentially the exposure of the directors of the Company to penalty or liability in respect of insolvent trading. Complications instantly arise, however, as the Company is also the Trustee of the On Just Terms SMSF. This will be discussed further below.

**Powers of the Liquidator**

The Corporations Act sets out the powers of a liquidator, which includes, relevantly that the Liquidator <u>may</u>:

477(2)(c) *"sell or otherwise dispose of, in any manner, all or any part of the property of the company";* and

477(2)(m) *do all such other things as are necessary for winding up the affairs of the company and distributing its property.*

In *<u>Porter v Miller Street Pty Limited</u>* [2008] FCAFC 77 the Full Federal Court (Sundberg, Jacobson and Gordon JJ) considered the duty of a liquidator in relation to trust assets and said at [44]-[45]:

> *[44] In a winding up, the duty of the liquidator is to identify the assets of the company, and in that process to ascertain whether particular assets under the control of the company are beneficially owned by the company or by others: Nathan at 688[5]. The liquidator must do all "other things as are necessary for the winding up of the affairs of the company and distributing its property": s 477(2)(m) of the Corporations Act.*
>
> *[45] In fulfilling those tasks, the liquidator cannot disregard the fact that the company holds property in trust for others. And to the extent that the company does hold property in trust for others, the liquidator must "act in a responsible way in the administration of the trust in the name of the company": Crest Realty at 672. As we have said, what the duty to "act in a responsible way" will involve, and what degree of "administration" of the trust will be necessary, depends upon the particular circumstances: Re Crest Realty at 672.*

Further, in Commonwealth v Byrnes [2018] VSCA 41 at [62] the Court held:

> *"Property held by the insolvent on trust for beneficiaries is excluded from distribution to the creditors, expressly under bankruptcy legislation, and by undisputed analogy in the case of corporations. It is not property of the company."*

These decisions make it clear that the liquidator will be seeking to establish that assets in the name of the Company are, in fact, assets of the Company. Anyone seeking to establish that the Company holds assets in the capacity as trustee of a trust (or in this case as trustee of a SMSF) must have sufficient documentary evidence to support that assertion.

It must be borne in mind that the starting point will be that the asset is owned by the Company unless and until there is evidence to support that the asset is owned in a trustee capacity.

This will always put the member of a SMSF which appointed a corporate trustee (that operates as a trading trustee) in the position that they will need to establish that the company owns those assets as trustee of a SMSF. This is perhaps one of the more convincing reasons as to why a corporate trustee of a SMSF should have no other purpose other than to be the trustee of the SMSF.

**What assets come under the control of the Liquidator?**

**Trustee company's right of indemnity**

As a matter of trust law, a trustee has a right of indemnity out of the assets of the Trust. That right of indemnity encompasses a right of reimbursement; to be repaid monies expended on behalf of the trust in the capacity as trustee, and also a right

[5] *Re GB Nathan & Co Pty Ltd (in liq)* (1991) 24 NSWLR 674.

of exoneration – being the right to be paid for the debts incurred in the trustee's name on behalf of the trust.

The right of indemnity confers on the trustee a proprietary right in the trust/ SMSF property. In a bankruptcy situation, that right vests or passes to the bankruptcy trustee and in a liquidation scenario, it becomes an asset to which the liquidator has access for the benefit of the trustee's creditors.[6]

There are restrictions in the SIS Act as to how a trustee can incur certain fund expenses and it is certainly recommended that the SMSF satisfy its own debts out of the fund itself rather than from monies extended by the trustee; but it is possible that a trustee has paid for some expenses and requires reimbursement. This then creates an issue upon insolvency, particularly if a new trustee is appointed to the SMSF and there becomes competing claims against the assets of the SMSF. This is further complicated by the liquidator looking to the assets of the SMSF to be paid his/her remuneration on the basis that there are no other (or no assets of value) remaining in the trustee company now in liquidation.

Despite the right of indemnity being often referred to as a lien over, or a charge against, the trustee company's assets, the decision in *Re Amerind Pty Ltd (in liq)* [2017] VSC 127 at [380]-[389] seems to indicate that it is not a registrable interest under the *Personal Properties Securities Act* (2009) (Cth); meaning that corporate trustees do not need to register their lien/ right of indemnity on the Personal Properties Securities Register (**PPSR**). However, I note that those comments were made *obiter dicta*; meaning it was a comment made about something that the court was not actually required to address and that this area of law remains unsettled.

**Liquidator's Access to Trust Property**

In situations where a company conducts its own business as well as acting as a trustee of a trust, there had previously been a controversy under the law (as between the various States and Territories of Australia) as to whether the assets of the underlying trust should be accessible to creditors of the trading company (and the liquidator) and if so in what priority. This is particularly relevant to the Case Study given that the Company traded its own business as well as acted as the Trustee of the SMSF. As the Case Study indicates that the only assets available to satisfy creditors were the trust (or the SMSF) assets; this obviously raises the question as to what assets, if any, can be accessed for this purpose.

Pre June 2019, there were two main views on this point:

1. that proceeds of realisation were distributable among creditors generally, as was held in *Re Enhill Pty Ltd* [1983] 1 VR 561; or
2. that proceeds of realisation were distributable only as between trust creditors, as was held in *In re Suco Gold Pty Ltd (In liq)* (1983) 33 SASR 99.

However, the recent High Court decision in *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20 (***Carter Holt Harvey***) now appears

[6] *Commonwealth v Byrnes* [2018] VSCA 41 at [96].

to have put that controversy to rest. I note however, that the *Carter Holt Harvey* decision was in relation to a receivership of a company that only traded as trustee of the underlying trust and there were no creditors that were not trust creditors. Consequently, the comments made by the Court could arguably be said to be *obiter dicta*, but I conclude that they are persuasive nonetheless and will have application to liquidations and cases where the trustee is not a sole purpose trustee.

In _Carter Holt Harvey_ the High Court unanimously held that a corporate trustee's interest in and in relation to trust assets fell within the meaning of the term 'property of the company'.

At [24] to [28], Kiefel CJ, Keane and Edelman JJ said that:

- the trust is not a separate entity and does not have a separate solvency status from the trustee;
- a trustee is personally liable for debts incurred as trustee, regardless of whether or not the creditors knew of the existence of the trust;
- "trust assets" meant "the rights held on trust by the trustee" and "trust creditors" meant "those creditors of the trustee whose debts were properly incurred with authority in the course of trust business";
- generally, trust property did not form part of the estate available for distribution to creditors, however, there was an exception where a trustee is permitted to derive any benefit from the rights held on trust, including by means of the trustee's "right of indemnity";
- to the extent of the power, the trust rights are no longer property held solely in the interests of the beneficiaries of the trust.

Further, at [34] to [36], their Honours said that:

- where a right of indemnity operates, trust assets are subject to two competing proprietary rights: the trustee's and the beneficiaries. The trustee's rights take priority over those of the beneficiaries to the extent of the trustee's powers of indemnity;
- when a trust is in the hands of a liquidator or trustee in bankruptcy, the power of exoneration can only be used to pay trust creditors; and
- the liquidator or trustee in bankruptcy has the same rights as the trustee did.

This case settles the law, at least in respect of receiverships, that if a trustee had a right of indemnity or exoneration in relation to costs incurred whilst acting as trustee of the trust, then the same right (and access to trust assets to satisfy that right) exists in the hands of a receiver. However, the High Court went further, at paragraphs [37] to [44], in response to the Commonwealth's primary submission that the proceeds from the sale of trust assets should be used for the discharge of all other debts - not merely trust creditors, and said that the Commonwealth's submission was wrong.

At [40]:

> *"the purpose of the power of exoneration is not to exonerate the trustee's personal estate unconditionally. It is to exonerate the trustee's estate only from authorised liabilities incurred in the course of the business of the trust.. the "limited purposes" of the power of exoneration … are part of the nature and character of the power of exoneration itself. The liquidator took the power of exoneration with all of its characteristics"*

At [44]:

*"Recognising that the power of exoneration can only be used according to its terms is not to give priority to debts incurred by the trustee with authority over other proved debts and claims. It is, instead, to confine the use of trust funds by the power of exoneration to the discharge of those debts. Further, the proportionate payment requirement in s 555 is premised upon the extent to which the property of the company can "meet" those debts. The intrinsic limit of the power of exoneration precludes it from being used to meet debts other than those incurred with authority for the conduct of the trust business.`*[7] (emphasis added)

So this is good news for the On Just Terms SMSF as:

- the debts incurred by the Company that were not authorised trust debts would not likely be satisfied out of the assets of the SMSF; and
- the liquidator's costs and fees of liquidating the Company in so far as those costs and fees relate to the business of Corrigan & Son are not costs that will be borne by the SMSF.

However, it is possible that there will be other expenses incurred by the liquidator in relation to the SMSF or until such time as a new trustee is appointed to the SMSF that could result in the liquidator seeking to have those costs paid from the assets of the SMSF – for example, the cost of obtaining legal advice as trustee of the SMSF in connection with the liquidation. In those circumstances it is advisable to change the trustee of the SMSF at the earliest possible opportunity ensuring that the requirements of the SIS Act are met in the process.

**Liquidator's investigations**

The Corporations Act provides Liquidators with broad powers of investigation and specific powers to recover assets of companies in liquidation for the benefit of creditors of the company. One of those powers is to recover funds transferred within a defined period before the winding-up commenced in circumstances where the payment was:

1. an unfair preference received by a creditor of the company ahead of other creditors; or
2. an uncommercial transaction; or
3. a director-related transaction.

With reference to the Case Study, it would appear that the SMSF could be pursued by the Liquidator of the Company to recover the "sizeable concessional contribution" that was made to "Das's super account in the On Just Terms SMSF". It seems clear that the payment was made by a director of the Company (Con) at a time that the Company was insolvent or likely to become insolvent and the payment was made to benefit Das. This would result in the fund (the trustee of the fund) being ordered to disgorge the payment back to the Company.

[7] See also the judgment of Gordon J at [149]- [158].

Similarly, if the trustee was an individual and not a corporate trustee, then section 128B or 128C of the *Bankruptcy Act* would be used to recover any void superannuation contributions.

**Replacement of Trustee**

It is a common clause in trust deeds that the Trustee will automatically be removed upon insolvency or the entry into a form of insolvency administration.

Trust law dictates that this type of clause in a trust deed operates to put the trustee in the position as a bare trustee; meaning that the corporate trustee (in administration or liquidation) simply holds the assets in name only but has no power of sale. This could cause further cost and issues for the SMSF in that a receiver and manager may need to be appointed to realise the assets of the SMSF in the event that a new trustee cannot readily be appointed.

In *Kite v Mooney* [2017]] FCA 653 at [57] the Court stated:

> 'Upon the appointment of Messrs Kite and Hutchins as administrators, by reason of the operation of cl 5.2.5 of the Trust Deed, the Company ceased to be trustee of the Trust. In those circumstances the Company remains a bare trustee and may still hold the assets of the Trust, but its duties, rights and powers are limited to protecting the Trust assets. As bare trustee, the Company retains its right of indemnity or exoneration and its lien over the assets of the Trust: *Caterpillar Financial Australia Limited v Ovens Nominees Pty* Ltd [2011] FCA 677 (Gordon J) at [26].'[8]

This can, of course, cause issues where assets are in the hands of the Liquidator of the former trustee and that Liquidator may wish to claim against assets in the hands of a successor trustee. Again, this appears to be a good reason to appoint a company as trustee of a SMSF whose sole purpose is to be that SMSF's trustee, so that the chances of this type of issue arising are significantly reduced.

**Will the Trustee be disqualified?**

If Corrigan & Son was placed into liquidation, then there is no doubt that it would have met the test of "disqualified person" in section 120 of the SIS Act. Although it is worth noting that section 120(2)(e) of the SIS Act only makes reference to the company having "begun to be wound up".

There are no further definitions of what is meant by "begun to be wound up" in the SIS Act and I have been unable to find any case law detailing what those words actually mean. It is likely, therefore, that the use of the words "begun to be wound up" might actually capture the period of time before a company is in fact wound up. This could mean that a corporate trustee could become a "disqualified person" from the point in time that a creditor serves a statutory demand to wind up the company, or at the time that the company fails to pay the statutory demand, both of which could be months before the Company is, in fact, wound up.

[8] See also *Parker v Dengi Pty Ltd (in liq)* [2018] FCA 444 at [30].

The effect of a trustee company becoming a "disqualified person" are complicated in circumstances where the trustee company is not a sole purpose trustee. This could mean that, similar to the facts in the Case Study, whilst the trustee company is insolvent, the SMSF is not.

In _Deputy Commissioner of Taxation, Re The Mai Family Pty Ltd (in liq) v The Mai Family Pty Ltd (in liq)_ [2019] FCA 865 the court found that where The Mai Family Pty Ltd was a sole purpose trustee for the Mai Family SMSF, it was appropriate for The Mai Family Pty Ltd to resign as trustee of the trust/ SMSF in circumstances where upon liquidation it became a "disqualified person" within the meaning of section 120(2)(e) of the SIS Act. As the company was a sole purpose trustee, it was clear that the SMSF was insolvent and that it was unlikely that another entity would agree to take over the role of trustee. Further, the trust deed made appointing a replacement trustee difficult in circumstances where the SMSF was non-compliant as is had a disqualified person as its trustee. Accordingly, the Court ordered pursuant to section 57(1) of the *Federal Court of Australia Act* 1976 (Cth) that the liquidator be appointed receiver and manager of the assets of the fund, and be entitled to recoup the costs of the receivership and the liquidation from the sale of the assets of the SMSF.

It is hard to see how it would be appropriate to appoint a receiver and manager to a SMSF in circumstances where the fund was solvent, however, this may be the only option if the provisions of the trust deed do not permit the appointment of a new trustee in circumstances where the old trustee is a disqualified person. It may be relevant in those circumstances to consider whether there is any mechanism for replacing the trustee under the relevant State or Territory trustee legislation or pursuant to the inherent jurisdiction of the court.

This may also raise the issue as to whether, even if the trust deed contains a power to permit the old trustee to appoint a new trustee, the act of appointing the new trustee would be considered to be an act of a trustee which would then have the disqualified trustee (and potentially the liquidator) committing an offence under section 126K of the SIS Act.

In _Re Stansfield DIY Wealth Pty Ltd (in liq)_ [2014] NSWSC 1484 (**Re Stansfield**), Brereton J said (at [35]):

> *"By operation of* Superannuation Industry (Supervision) Act*, 1993 s120(2)(e), upon the commencement of the winding up the [trustee] became a disqualified person for the purposes of that legislation and thereafter commits an offence under s 126K if it is or acts as trustee of a superannuation entity. However, nothing in the Act provides that upon becoming a disqualified person a trustee thereupon ceases to be trustee."*

Further, at [36] the Court held that:

> *"If the company in liquidation were to exercise any of the trustee's powers under the trust deed - including the power of sale - it would be acting as trustee, in contravention on s 126K. The liquidator would probably be liable as an accessory."*

Liquidators are, generally, risk adverse and as officers of the court will not want to find themselves in a position of contravening legislation. There is no doubt, therefore, that all liquidators in this position would take steps to have the company in

liquidation resign as trustee. This is where the terms of the trust deed would be critical to the appointment of a replacement trustee. In the event that the trust deed restricts the appointment such as in *The Mai Family Pty Ltd (in liq)* case then the only option may be the appointment of a receiver and manager. However, where the trust deed permits the members to appoint a new trustee in similar terms of the *Re Stansfield* decision, then a sensible outcome can be achieved by a replacement trustee being appointed by members to continue the business of the SMSF.

**Conclusion**

Thankfully, in the Case Study, a last minute rescue package from the Company's creditors saves the Company from liquidation. If, the Company's creditors had not been so generous, then, in my opinion:

1. the Trustee would have been disqualified as trustee of the SMSF;
2. depending on the terms of the trust deed, it may have been difficult to appoint a replacement trustee resulting in the appointment of a receiver and manager to the SMSF assets;
3. there may have been some difficulty in establishing that the SMSF owned certain assets including the cars and the jousting sticks (even though they were fake);
4. the liquidator would have had a right to be paid his/ her remuneration for dealing with SMSF assets, obtaining advice in respect of the SMSF and determining who owned the assets; and
5. the assets that could not be established as SMSF assets would, therefore, have become assets of the Company in liquidation and available to the liquidator and the creditors of the Company.

Therefore it is recommended, from an insolvency law perspective, that:

6. a trustee of a SMSF be a sole purpose company set up to hold/ manage the assets of the SMSF only;
7. trust deeds be reviewed to determine what automatically happens (if anything) upon the entry by the trustee into any form of insolvency administration; and
8. trust deeds be reviewed to simplify the mechanism for appointing a new trustee, thereby ensuring the longevity of the SMSF in the event that the trustee becomes the subject of insolvency administration.