

companies versus individuals as trustees

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Resulting from the government's implementation of the *Report of the Taskforce on Reducing the*

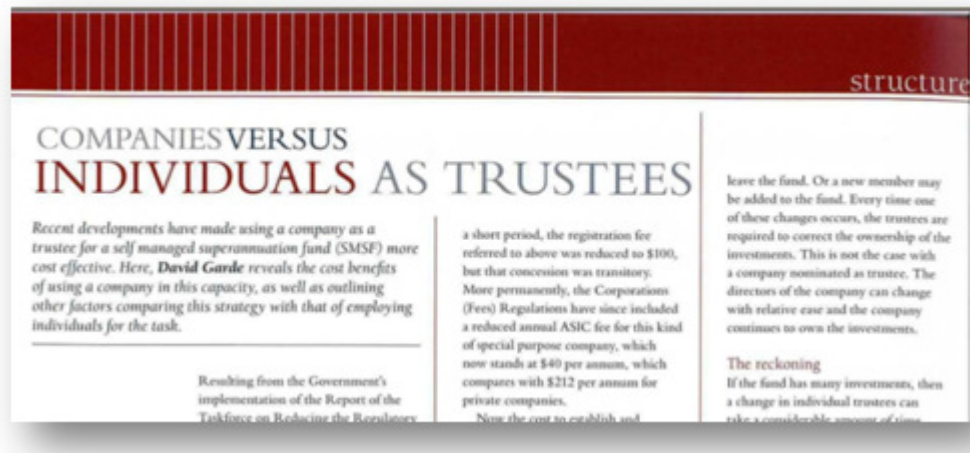
Regulatory Burdens on Business - Rethinking Regulation the fee payable to the Australian Investments & Securities Commission ("ASIC") on the registration of an Australian private company has dropped from \$800 to \$400. Consequently the usual cost of establishment of a private company has also dropped from around \$950 - \$1300 to \$550 - \$900.

With its reliance on the trading or financial corporations power in the Constitution of Australia, the *Superannuation Industry (Supervision) Act 1993* ("SISA") was accompanied by concessions for companies conducted solely as trustees of superannuation funds regulated by SISA. For a short period, the registration fee referred to above was reduced to \$100 but that concession was transitory. More permanently the *Corporations (Fees) Regulations* have since included a reduced annual ASIC fee for this kind of "special purpose company" which now stands at \$40 p.a. which compares with \$212 p.a. for private companies that are not special purpose companies.

With the costs of establishing and maintaining a company to act as a trustee of a self managed superannuation fund ("SMSF") now so low the costs of and reasons for opting for the alternative, having individuals act as the trustees of a SMSF rather than a company, can be brought into focus.

The costs of having individuals as SMSF trustees appear lower at the outset. The members of the fund can act as either individual trustees or as directors of a corporate trustee so the members simply become the individual trustees. No cost there.

An SMSF will then make investments. On each of the investments the names of the trustee(s) need to be recorded as the owner(s) of the investments. Later members retire, die, lose capacity or otherwise leave the fund. Or a new member may be added to the fund. Each and every time one of these changes occurs then, if the trustees are individuals, the trustees are required to correct the ownership of the investments. This is not the case with a company persevering as the trustee. The directors of the company can change with relative ease and the company continues to own the investments.



The reckoning

If the fund has many investments then a change in individual trustees can take a considerable amount of time and effort. All share registries, banks and other issuers of investments would need to be advised of who the new owners of the investment are.

If the fund owns one or more landholdings then the correction becomes procedurally expensive in addition to the inconvenience of having to arrange it.

Example:

Arthur, Beatrice and their daughter, Celine are the individual trustees of their SMSF. Arthur dies.

Their fund owns two business premises which are let, 18 shares packages, 3 managed fund investments and two insurance policies.

It is the duty of the trustees to get the investments of the fund into their own name: see the fact sheet *Self managed superannuation funds (SMSF)—securing the assets of the Fund* from the Australian Taxation Office (“ATO”). Verification that the trustees have done so is a matter to which the auditor of a SMSF must be attentive.

The fund’s administrator is a professional who charges moderate rates. Below is a description of task and a summary of the fees and costs connected with Arthur’s departure as a trustee of the fund to put the whole fund into the ownership of Beatrice and Celine:

Administrator action on	Write to	Receive back	Resolve	Administrator charges	Other charges
Insurance	the insurers to change the owners of the policies and to make a claim in respect of Arthur’s death	a claim form and an application form to the change the owner of the policy to complete	complete a claim and application form	\$300	
Managed funds	the trustees of the managed funds.	forms to apply to change the owner of the investments.	Complete forms, arrange signing and lodge	\$220	
Share packages	the registries for each of the shares	non-market share transfer forms for each of the share packages	Complete transfers, arrange signing and lodge with share registries	\$1150	
Premises 1	solicitor with instructions to	transfer of land prepared	Arrange signing of	\$150	Solicitor fees - \$800

		transfer title	by solicitor	transfers of land and return to solicitor for lodging			(including registration fee, registration lodging fee, duties lodging fee and stamp duty (NSW))
Premises lease	1	solicitor with instructions to prepare an updated lease	lease prepared by solicitor	Arrange signing of lease		\$80	Solicitor fees - \$400
Premises 2		solicitor with instructions to transfer title	transfer of land prepared by solicitor	Arrange signing of transfers of land and return to solicitor for lodging		\$150	Solicitor fees - \$800 (including registration fee, registration lodging fee, duties lodging fee and stamp duty (NSW))
Premises lease	2	solicitor with instructions to prepare an updated lease	lease prepared by solicitor	Arrange signing of lease		\$80	Solicitor fees - \$400

As well as the effort, which a company would not need to make, fees and costs in this case with one change to individual trustees of the fund amount to \$4530 which equates to the costs of establishment of a special purpose company to act as trustee of the SMSF and of ASIC annual fees for it for around 90 years (based on current numbers).

Some funds may not have as many share packages and others may not own land but they may add or lose members more often.

By comparison, the costs associated with Arthur's removal as a director, had Arthur instead been a director of a corporate trustee of the SMSF rather than an individual trustee, are negligible.

Separation of assets

As well as the duty to get investments into their name, trustees have a duty as trustees and under SISA to keep assets of a fund separate from their personal assets, and from the assets of the employers that contribute to the fund, to ensure member assets are protected. It can become administratively difficult to track which activity relates to investments that belong to individuals in their own right and which activity relates to those they hold on behalf of a SMSF especially in the common occurrence where two spouses are individual trustees and they also own other property jointly outside of superannuation. A dedicated corporate trustee assists the individuals involved in a fund to identify what activity relates to their fund and what relates to them personally for matters concerning the fund will generally be addressed to and name the corporate fund trustee.

Despite the ATO's best and perhaps unrealistic efforts in the fact sheet *Self managed superannuation funds (SMSF)–securing the assets of the Fund* referred to above, the trustees remain the only legal means by which ownership of investments by funds is recognised under Australian law. It is therefore incumbent on trustees to administer the fund in a way that ensures there is no mix of fund property with their other property. Errors in this respect can lead to breach of SISA and regulations including those dealing with loans, borrowings and arms length dealings with members.

One individual trustee?

Another risk which may not be foreseen at the outset of a fund is the possibility that the fund could be taken to have come to an end as a trust when the fund loses one of two individual trustees. When the sole trustee of a trust becomes the sole beneficiary of a trust the trust is said to merge, that is, it is no longer a trust: *Brydges v. Brydges* (1796) 3 Ves. 120, 30 E.R. 926. That is consistent with the concept of both a trust and the regime under SISA because a sole trustee cannot owe duties to himself or herself as a sole beneficiary. Section 17A of SISA appears to address this by requiring that, if a SMSF is to have individual trustees there must, at least, be two. To that end the section accommodates, as an exception, participation of a non-member trustee to act as a co-trustee with a sole member to maintain the minimum two individual trustees.

It is understood that the ATO considers that sub-section 17A(4) of SISA allows a SMSF six months to rectify a fund which fails to meet the requirements of section 17A such as the minimum two individual trustees requirement. It is open to doubt whether that perspective will be supported by a court as the addition of a trustee within six months would not normally be remedial to a trust that has ceased to exist. If the trust has merged then there is no basis on which the superannuation arrangements that were in the SMSF could continue to be within a SMSF trust unless sub-section 17A(4) was taken to be a de facto regime that overrides the trust merger rules.

If it does not then the consequences would be serious. Without the ATO's complicity, CGT Events could be taken to have occurred in respect of all of the (former) fund's CGT assets. The investments of the (former) fund would be out of superannuation but presumably the damage that may cause could be minimised if efforts, with the co-operation of the ATO, were made to vest the investments in another regulated superannuation entity forthwith.

A SMSF that has had only one individual trustee at any time may find itself, and the members of it may find themselves, at a disadvantage if the fund is involved in any court action whether it is in the family court, the resisting of a bankruptcy of a member, challenging a tax assessment or contesting an investment that has gone wrong or in other circumstances where the protection by the ATO of the fund's tenure as a SMSF is not available.

A SMSF with a company trustee never need face these difficulties because the *Corporations Act 2001* gives a company separate legal personality. Thus a company is treated by section 17A of SISA and by the courts as capable of being a trustee for a sole individual beneficiary even if that beneficiary is the sole shareholder and director of the company.

Individual trustees and lump sums?

Another disadvantage of individual trustees of a SMSF before a court is the framework of SISA itself. The framework for Commonwealth governance of private sector superannuation by SISA are the trading or financial corporations power and the old age pensions power in the Constitution of Australia. Section 19 of SISA sets out the requirements for a regulated fund which in sub-section 19(3) of SISA includes:

Either of the following must apply:

- (a) the trustee of the fund must be a constitutional corporation pursuant to a requirement contained in the governing rules;
- (b) the governing rules must provide that the sole or primary purpose of the fund is the provision of old-age pensions.

Governing rules of SMSFs often provide extensively for the payment of benefits other than by way of old-age pension. It follows that funds seeking regulation under section 19, but that have governing rules that are inconsistent with a sole or primary purpose of the provision of old-age pensions, should also contain a overriding “deeming” governing rule that negates the operation of other governing rules which conflict with a primary fund purpose of providing old-age pensions while the fund has individual trustees.

Without such a failsafe in the governing rules, an SMSF risks being incapable of becoming regulated by SISA. The election to be regulated is another and separate requirement of sub-section 19(4) of SISA which does not cure a SMSF that cannot become regulated for these reasons under sub-section 19(3).

An overriding deeming provision of this nature puts a fund with individual trustees at a disadvantage. As “primary purpose” in particular is less than a precise concept, individual trustees of a fund will either understand that they cannot invoke governing rules that would otherwise authorise them to pay non-pension benefits or they will be unsure. It would be timely for individual trustees in that predicament to resign in favour of a corporate trustee (with attendant costs possibly similar to those described in the above example) and the corporate trustee could then pay the non-pension benefits.

If a fund is not regulated either because it cannot be regulated or it has not elected to become regulated then it is not entitled to taxation concessions or treatment as a complying superannuation fund. A non-complying superannuation fund is taxed on contributions to it and income it earns presently at the high 45% income tax rate.

Conclusion

Opting for individual trustees may seem a convenient and low cost option for a SMSF at its outset. However this cost advantage over using a corporate trustee may be illusory in the longer term if the fund makes considerable investments, particularly in land, and, for one reason or another, individual trustees of the fund are either added or are taken away.

The disadvantages of having individual trustees may not be readily grasped by members of SMSFs who ultimately need to make the decision as to which type of trustee structure is used. In these respects, practitioners should call on their experiences of costs blowouts when individual trustees of SMSFs change in advising

their clients. They can also be advised that a company as trustee of their SMSF, which can be acquired and maintained for a modest cost, puts them on the more solid footing legally too particularly if they wish to pay all kinds of benefits permitted under SISA and regulations.