AUSTRALIAN
Superannuation
LAW BULLETIN

2010 . Vol 21 No 10

Contents

Information contained in this newsletter is current as at June/July 2010

LexisNexis® Butterworths


AUSTRALIAN
Superannuation
LAW BULLETIN

Contribution deductions: some unintended consequences

Gordon D Mackenzie *UNIVERSITY OF NEW SOUTH WALES*

The relaxation of the borrowing prohibition by superannuation funds and the recently released tax ruling on "contribution" may have some unintended tax consequences. Specifically, s 26–80 of the Income Tax Assessment Act 1997 (Cth) (ITAA97) may deny a tax deduction for borrowing costs in making a loan to a superannuation fund in certain cases.

Section 26–80 provides that:

> (1) You can only deduct under this Act a financing cost connected with a contribution you make to a superannuation plan if you can deduct the contribution under Subdivision 290-B.
> (2) A financing cost connected with a contribution is expenditure incurred to the extent that it relates to obtaining finance to make the contribution, including:
> (a) interest, and payments in the nature of interest; and
> (b) expenses of borrowing.

In other words, it is only entities that can claim a tax deduction for contributing for an employee that can claim interest costs associated with borrowing to make that contribution as a tax deduction. Again, this means that taxpayers who can claim a personal tax deduction for contributing to a superannuation fund — and, indeed, any other person who can contribute, such as a member, parent or spouse — are not able to claim their interest costs on funds borrowed to make that contribution as a tax deduction.

Now the reason for this rule is not entirely clear, but it is a safe bet that it is not a tax related purpose but a prudential purpose — ie, the theory behind superannuation is that it is a fund contained in a very "controlled" environment to ensure that it is used for the purpose for which it is established, being to fund retirement. In addition, it is held in a separate vehicle and is generally not available to creditors of the member. Now that protection would be defeated if members could borrow to contribute to a superannuation fund, since any benefit of accumulating in a superannuation fund protected from creditors would be defeated as the member who borrowed is at risk from the creditors. Hence, members do not get a tax deduction for interest on money borrowed to make a contribution because the government does not want members to do that.

With the relaxation of the borrowing prohibitions, superannuation fund trustees are now able to borrow on a limited recourse basis (s 74A of the Superannuation Industry (Supervision) Act 1993 (Cth)). That can mean that members can lend money to the trustee of a superannuation fund in accordance with the new borrowing restrictions and, in turn, the member can borrow to make the loan to the trustee.

However, if that loan suddenly "transmogrifies" into a contribution, then the interest paid by the member on the money that they have borrowed will not be deductible, as it will have been interest on a loan to make a contribution and s 26–80 of the ITAA97 says, in effect, that only an employer can claim that cost as a deduction.

A loan from a member to the trustee of the superannuation fund can "transmogrify" into a contribution in a number of ways. First, if the member forgives the loan, then that forgiven loan is a contribution to the fund — see para 36 of the Australian Taxation Office's Taxation Ruling TR 2010/1.

However, interest payments in years before the loan is forgiven would seem to be okay, and it would only be interest payments in the year that the loan was forgiven that may be denied deductibility. Indeed, it may only be interest payments after the loan is forgiven that may be denied, because that is when the loan to the fund becomes a contribution that is made to the fund.

What if, instead of the loan being forgiven, the interest payment due from the trustee of the superannuation fund is forgiven? Would all or, indeed, any of the interest payments on the loan be non-deductible under this rule? There may be an argument that it would be, as the wording in s 26–80 refers to a "financing cost *connected with* a contribution" (emphasis added), which would seem to be broad enough to include interest on the loan.

It seems that this problem would not be resolved by interposing another entity between the member and the trustee of the fund. This is because the forgiven loan is

a contribution when it is forgiven by the interposed entity, so the interest costs of that entity would be a "financing cost connected with a contribution you make" and, consequently, non-deductible.

Maybe there is an argument that s 26–80 should be amended to permit deductions for interest on loans that become contributions because they are forgone loans, now that funds can borrow on a limited recourse basis.

Gordon D Mackenzie
Senior Lecturer,
Atax,
Faculty of Law,
University of New South Wales,
gordon.mackenzie@unsw.edu.au,
www.atax.unsw.edu.au

AUSTRALIAN
Superannuation
LAW BULLETIN

Fund governance
The best of the "best" interests debate

Michael Vrisakis *and* ***Sarah Yu*** *FREEHILLS*

The authors found the catchy tune and uplifting lyrics of Tina Turner's 1989 hit "Simply the best" entering their consciousness in the last couple of weeks. This uplift in mood was as a result of the recent New South Wales Supreme Court decision of Justice Rein in *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2010] NSWSC 363; BC201002555. The parallel is that (in the authors' view) Rein J's judgment is "simply the best" judgment that has so far been handed down about s 52(2)(c) of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act).

However, that is where the parallels between the *Manglicmot* judgment and Tina Turner's song end, because, the authors presume, Tina Turner was using the word "best" in the absolute sense of that word — ie, being the best or achieving the best result — whereas Rein J expressly rejected the argument that the word "best" in s 52(2)(c) requires a trustee to achieve the best results. Instead, Rein J held that s 52(2)(c) simply reflects existing trustee duties of undivided loyalty to the beneficiaries and fidelity to the trust instrument and is concerned with process and not outcome.

This judgment reflects the culmination of much work within the industry[1] and, the authors consider, represents a significant step forward in legal thought.

The decisions prior to Manglicmot

In 2006 there were two decisions that touched upon s 52(2)(c) of the SIS Act.

The first was the AXA decision,[2] in which the Administrative Appeals Tribunal considered that the statutory formulation of the "best interests test" was an extension of the general law. Deputy President Forgie and Senior Member Pascoe stated (at [328]):

> For these reasons, we consider that Parliament intended to base the covenants in the SIS Act on those under the general law but to extend their ambit and to do so in an entirely new context. It is a context that is intended to ensure that the covenants are met and not merely that the trustee is able to establish that it exercised its discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was given.

The second was the *Invensys* decision,[3] in which Byrne J stated that s 52(2)(c) appears to be the combination of a trustee's duties to comply with the trust deed and to act solely in the interests of the beneficiaries of the trust, although he declined to decide whether s 52(2)(c) represents a codification of those trustee duties. Byrne J stated (at [107]):

> The covenant inserted into the trust deed appears to be an amalgam of two distinct obligations said to be imposed by law upon trustees of a superannuation fund. The first, which is sometimes referred to as the duty of loyalty or the duty of fidelity to the trust, is that to act in the interests of the beneficiaries; that their interests are paramount and must certainly be placed ahead of the trustee's own interests. Nor may the trustee have regard to considerations which are extraneous to the trust. The second is to pursue to the utmost with appropriate diligence and prudence the interests of the beneficiaries. This will commonly come into play where it is a question whether the trustee of a trust whose objective is to confer financial benefits on beneficiaries has sufficiently pursued these financial interests. And so, in *Cowan v Scargill* [[1985] Ch 270], Megarry V-C said this:
>
> > The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries.
>
> and later,
>
> > Trustees must do the best they can for the benefit of their beneficiaries and not merely avoid harming them.
>
> It is not altogether clear whether para (c) is intended as a codification of one or other or both of these principles. As will appear, it is not necessary that I unravel this.

Since 2006, there had been a hiatus in case law about the meaning of s 52(2)(c) until the *Manglicmot* decision.

Manglicmot

Background

In 1998, Mr Manglicmot (Member) was employed by the Commonwealth Bank of Australia Ltd (CBA) and became a member of the Officers' Superannuation Fund (Fund). The Commonwealth Bank Officers Superannuation Corporation Pty Ltd (Trustee) was the trustee of the Fund. The Member worked as a branch examiner, a

loans officer and an administration clerk. On 25 August 2003, the Member ceased employment with CBA when he accepted an offer of voluntary redundancy.

Change of insurance policies

On 1 July 2003, the Trustee changed the life insurance policy that it held to provide cover for members of the Fund when it terminated the policy that it had with Hannover Life Re of Australasia Ltd and entered into a policy with CommInsure Pty Ltd. Evidence of the following was before the court:

- Hannover had indicated that it was not prepared to renew the policy unless there was:
  - — a 130% increase in the premium; or
  - — a 100% increase in the premium, with the policy being altered to be a non-participating policy with no premium rebate.

  Hannover also indicated that it would not guarantee that the premiums would not increase in the future.
- CommInsure was prepared to provide replacement insurance on terms that "will either match or better the current terms … in the Hannover contract" for an 80% rise in the existing premium and to guarantee level premiums for three years.

The Fund's trust deed provided that total and permanent disability (TPD) "has the same meaning" as in the relevant life insurance policy.

TPD was defined in the Hannover policy as:

> … having been absent from work through injury or illness for an initial period of six (6) consecutive months and in our opinion being incapacitated to such an extent as to render the Insured person unable ever to engage in or work for reward in any occupation or work which he or she is reasonably capable of performing by reason of education, training or experience.

TPD was defined in the CommInsure policy as:

> … if a result of sickness or injury, he or she … has been absent from all employment for 6 consecutive months from the date of disablement and we consider, on the basis of medical and other evidence satisfactory to us, the member will not ever be able to resume any occupation, whether or not for reward, where:
> - date of disablement means the later of:
>   - — the date on which the sickness or injury that was the principle [sic] cause of the member's disablement commenced or occurred; and
>   - — the date the member ceased work.
>
>   …
>
>   The date of disablement must occur while the member is covered under this policy.
> - Occupation means an occupation that the person can perform, on a full time or part time basis, based on the skills and knowledge the person has acquired through previous education, training or experience.

The Member's claim

The Member made a claim for a TPD benefit, which was declined by CommInsure.

The Member claimed that:

- he had suffered injuries in January 2000, in July 2000 and on 5 October 2000 that rendered him unfit for full-time work;
- following those injuries, he suffered pain and disability, rendering him unable to work for more than 15 hours per week as a teller or some other banking work or similar clerical work from the date that his position with CBA was made redundant to six months later; and
- if the Hannover TPD definition had applied, he would have been TPD because the Hannover TPD definition only required the life insured to be unable to work on a full-time basis, whereas under the CommInsure TPD definition a life insured is only TPD if they are unable to work on a full-time or part-time basis.

The Member sued the Trustee to recover the loss and damage that he alleged that he suffered as a result of the defendant breaching its trustee duties that it owed to him. The breach that the Member alleged was the Trustee entering into the CommInsure policy that contained more restrictive terms, being terms that:

- were not customary or appropriate;
- significantly reduced the scope of the cover; and
- were onerous to members because of the incorporation of the words "part-time" in the Hannover TPD definition.

The loss claimed by the Member was the benefit (of approximately $120,000) that he claimed would have been payable to him under the Hannover policy.

Key issues

The key issues considered by the court were the following.

- Was the decision of the Trustee to change life insurers a decision that the court should review?
- Did the Trustee breach the "best" interests covenant that is included in the Fund's trust deed under s 52(2)(c) of the SIS Act?
- Did the Hannover TPD clause mean that a life insured is TPD if unable to work in full-time employment (with part-time employment not being a bar to a TPD claim), compared to the CommInsure TPD clause which required a life insured to be unable to work on either a full-time or a part-time basis in order to be TPD?

- Did the Trustee's decision to change life insurers cause the Member loss?

Each of these issues is discussed below.

Can the court review the Trustee's decision?

Rein J considered (at length) the cases concerning the circumstances in which a court will intervene in a decision by a trustee and concluded as follows.

- The court can only review of a trustee's exercise of a discretion (such as a decision to enter into a life insurance policy) where the trustee has:

  (1) acted for an indirect motive;
  (2) acted without honesty of intention;
  (3) acted without a fair or real and genuine consideration of whether and how the discretion should be exercised; and
  (4) acted for a purpose beyond that for which the power and discretion were bestowed on it.[4]

- If a trustee provides reasons for its decision (as the Trustee had), this does not alter the above test to be applied to the trustee's decision, but if those reasons "are of a kind which no trustee acting reasonably could arrive at or could rely on to justify the exercise of a discretion in the manner adopted",[5] the court can infer from the reasons that the above test has been breached.

This aspect of the judgment is uncontroversial and reflects existing case law.

Rein J held that there was no evidence before the court that indicated that the Trustee's decision to enter into the CommInsure life insurance policy had breached the above test. Rein J commented that the Trustee was bound to consider not only the benefits provided under the Hannover and CommInsure policies, but also the more favourable premiums under the CommInsure policy compared to the Hannover policy and the commitment from CommInsure to match the terms of the Hannover policy.

Section 52(2)(c)

However, the aspect of the judgment that clarifies the boundaries of existing case law is Rein J's comments about the best interests covenant in s 52(2)(c) of the SIS Act.

After considering Byrne J's decision in the *Invensys* case, Rein J concluded that Byrne J's view was that s 52(2)(c) is not different from the general law. As set out above, Byrne J concluded that s 52(2)(c) appears to be an amalgam of the duties imposed on trustees — the duties of a trustee to act solely in the interests of beneficiaries and to comply with the terms of the trust deed.

However, Rein J's judgment added some further substance to Byrne J's Invensys decision. He stated (at [51] and [53]):

> One possible explanation for the words "to ensure that" in s 52(2)(c) is that since the trustees are empowered to delegate, the legislature wanted to make it clear that the trustees could not avoid responsibility for a failure by the delegate to exercise powers in the interests of members by saying that the task was delegated. I think that this explanation gives the words work to do *without imposing on the trustee some kind of guarantee that whatever is done will in fact benefit the members*, as the plaintiff contends. This is consistent with the general law that a trustee company discharges its duty if its officers are competent to perform properly the trust it undertakes, and it is responsible if they do not: *Elder's Trustee [Elder's Trustee and Executor Company Ltd v Higgins* [1963] HCA 48; (1962) 113 CLR 426] at 453 per Dixon CJ, McKiernan and Windier JJ. I do not accept that the trustee is made liable for any outcome which turns out to be unbeneficial to members, even if the original decision which led to that outcome was taken with the best interests of all members in mind. Another way of describing this approach is to say that s 52(2) *is concerned with process, not outcome. Mr Raiment's argument entailed, or came close to, a submission that the trustee was subjected to a regime of strict liability, and I do not accept that the legislative regime intended to create such a radical departure from the existing law …*
> …
> In short then, I do not accept that s 52 imposes a higher standard on a trustee than the general law …

Therefore:

- s 52(2)(c) merely reflects a trustee's general trust law duties;
- those duties require that the trustee's decision-making process is sound (ie, that the trustee only consider the interests of the beneficiaries and comply with the trust deed), rather than require that the trustee's decision obtain a particular outcome; and
- s 52(2)(c) does not impose on a trustee a guarantee to make decisions that will (in fact) benefit members (which would be an unattainable "de facto" standard of care).

Accordingly, the Member had not established that the Trustee had breached s 52(2)(c) of the SIS Act.

Other issues

Because Rein J held that the Trustee had not breached s 52(2)(c), he did not need to consider the other issues. However, he did go on to say:

- it is not clear that the Hannover TPD definition would apply if a life insured was unable to work full time but was still able to work on a part-time basis (although he declined to express a concluded view about this issue); and

- even assuming that the Hannover TPD definition would apply in the situation above, if the CommInsure policy incorporated the Hannover TPD definition, a benefit would not have been payable in relation to the Member under the CommInsure policy because the Member had not satisfied the requirement under the CommInsure policy of being absent from work for at least six months due to the injury or disablement.

Simply the best

This case is an extremely significant progression in superannuation case law and, in our view, to adopt Tina Turner's immortal words, is "simply the best, better than all the rest" in terms of the previous case law decisions about s 52(2)(c) of the SIS Act. It is worthy of an inclusion at the top of the "best seller list" (or at least the list of the most noteworthy superannuation cases) for 2010.

Just as those "simply the best" lyrics have carved out a groove in pop culture, so too Rein J's comments about s 52(2)(c) should resonate in practitioners' minds and in trustee and regulatory circles as the best amplification of the best interests duty.

Michael Vrisakis,
Partner,
Michael.Vrisakis@freehills.com; and

Sarah Yu,
Special Counsel,
Sarah.Yu@freehills.com,
Freehills,
www.freehills.com.au

Footnotes

1. To name a few (and apologies to anybody who has been inadvertently omitted), David Pollard, "Trustees' duties to employers: the scope of the duty of pension trustees", (2005) 20(1) *Trust Law International* 21; Justice Margaret Stone, "The superannuation trustee: are fiduciary obligation and standards appropriate?", Law Council of Australia Superannuation Conference in 2007; Professor Geraint W Thomas, "The duty of trustees to act in the 'best interests' of their beneficiaries", (2008) 2 *Journal of Equity* p 177; (2009) 20(4) Michael Vrisakis, "Fund governance: the best interests hydra", *Australian Superannuation Law Bulletin* p 54; Michael Vrisakis, "Inputs versus outputs — an increased focus on trustee decision making?", (2008) 20(9) *Australian Superannuation Law Bulletin* p 126; Michael Vrisakis, "The primacy of purpose", (2007) 18(7) *Australian Superannuation Law Bulletin* p 79; Marita Wall, "Problems with the covenants in SIS", Law Council of Australia Superannuation Conference in 2008.
2. *Re VBN and Australian Prudential Regulation Authority* (2006) 92 ALD 259; [2006] AATA 710; BC200606560, which involved the AXA Australia Staff Superannuation Plan.
3. *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* (2006) 15 VR 87; 198 FLR 302; [2006] VSC 112; BC200601654.
4. See [34].
5. See [34].


AUSTRALIAN
Superannuation
LAW BULLETIN

Important clarifications for super fund borrowings

Timothy Foster *and* ***Bryce Figot*** *DBA LAWYERS*

The government has announced changes for the super fund borrowing laws to clarify several uncertainties and reduce risks for super funds.

Background

In September 2007, the super fund borrowing prohibition was given an exception, which allowed super funds to borrow on a limited recourse basis. This exception is commonly referred to as the "instalment warrant" exception. Since then, there has been a significant increase in the use of this arrangement by super funds to acquire assets (especially real estate). Several areas of concern have, however, been identified. These concerns raised a need for Parliament to review and amend the current law.

How will this affect my self managed superannuation fund?

Refinancing

A big question under the current borrowing rules was whether refinancing was allowable. The Australian Taxation Office (ATO) stated in a ruling last year that refinancing constitutes a new borrowing, and thus refinancing was not allowable. This was bad news for super funds who borrowed from one lender, as they would be stuck with that lender for the life of the loan even if other more favourable loans later became available.

Under the proposed new law, a super fund will clearly be allowed to refinance a borrowing arrangement.

This change will apply to all instalment borrowing warrant arrangements (even those entered into before the changes are enacted). Thus, borrowings entered into under current law can restructure to the rules once the law is finalised.

Only a single asset may be acquired

The proposed changes will limit borrowing arrangements to be used only to acquire a single asset, or a collection of identical assets together which are treated as a single asset (eg, a collection of ordinary shares in a publicly listed company).

A collection of buildings each under separate strata title, irrespective of whether the buildings are substantially the same at the time of acquisition, is not to be treated as a collection of assets. Also, a collection of shares in different companies would not be permissible.

Practically, this means that a super fund will be allowed to borrow to acquire, for example, 100,000 BHP shares. However, a super fund will not be allowed to borrow to acquire 50,000 BHP shares and 50,000 Rio Tinto shares: instead, two borrowing arrangements would be required.

Further, if a super fund wanted to borrow to acquire, for example, two identical apartments in the same building, it would need two separate borrowings.

No borrowing to fund property development

Many super funds wish to borrow not just to acquire real estate, but also to pay for a development on that real estate. For example, a super fund might wish to borrow to buy land and build a house on that land. Under the current law, the ATO has recently stated that a super fund may borrow money to make capital improvements to real property.

However, under the new law, this will not be allowable. Accordingly, a super fund will only be able to borrow to acquire real estate and not to pay for its development.

Clarification to "replacement assets" means no margin loan facilities

The current law talks about borrowing to acquire both assets and "replacement assets". Some people read into the expression "replacement asset" very broadly. Under this broad interpretation, some people incorrectly believe that a super fund would be able to have a margin loan facility.

However, the proposed changes make it very clear that the concept of a replacement asset is very limited. No margin loan facilities will be possible under the new law.

For example, currently some super funds might borrow to acquire 500 BHP shares and then sell 100 BHP shares and, with the proceeds, acquire some NewsCorp shares. Some argue that this is allowable because the NewsCorp shares constitute replacement assets.

The proposed new law clearly states what assets are allowed to be replaced, and under what circumstances. Broadly, in order to be a replacement asset, an asset must be a share in the same company as the original share and must be worth the same amount as the original share. There is also some scope for the replacement asset rules to apply where the replacement occurs as a result of a takeover, merger, demerger or restructure of the original company. There is no scope for the replacement asset rule to apply to real estate.

Personal guarantees

A big question mark over limited recourse borrowing arrangements is whether related parties may give personal guarantees. Many large lenders require them and refuse to lend on any other basis. However, this causes a concern for the government for the following reason.

Under the concept of a "limited recourse borrowing", if a default occurs, the only recourse that the lender, etc, should have is limited to the asset being acquired. For example, if a fund with two properties borrowed to buy a third property and defaulted on the loan, only the third property would be available to the lender. The other two properties would be safe.

However, assume a related party gives a personal guarantee on behalf of the fund and that related party had to make a payment under the guarantee. In this scenario, the related party would have a right to recover the amount from the super fund's trustee, who in turn would be indemnified out of the fund's assets. This could result in all fund assets being exposed. Accordingly, guarantees potentially undermine the "limited recourse" nature of the borrowings.

The new laws seek to protect fund assets from such outcomes. A related party will still be able to give guarantees. However, the guarantor will have to modify their rights so that they only have recourse to the asset being acquired under the borrowing.

There will be grandfathering for funds that have already entered into borrowing arrangements with related party guarantees. This is being done so as to "avoid any reduction in value" of their property.

Uncertainty — car parks

Remember that super funds will only be able to acquire a "single asset" with borrowings and that two separate real estate titles cannot constitute a single asset. However, an apartment might be on a separate title to its car park, storage room or body corporate rights. Strictly speaking, four borrowings would be required in such a scenario: one for each title. Naturally, this would cause undue costs and it is hoped that this aspect of the proposed law will be clarified before it is enacted.

Conclusion

These changes will provide greater certainty as to what a super fund is and is not allowed to do with limited recourse borrowings.

Timothy Foster,
Consultant,
tfoster@dbalawyers.com.au; and

Bryce Figot,
Senior Associate,
bfigot@dbalawyers.com.au,
DBA Lawyers,
www.dbalawyers.com.au

DBA Lawyers present SMSF seminars around Australia. For more details, visit www.dbalawyers.com.au or phone 03 9092 9400.

AUSTRALIAN
Superannuation
LAW BULLETIN

SMSF related trusts may breach rules

Tracey Di Pinho *HLB MANN JUDD*

Self managed superannuation fund (SMSF) trustees who have set up a unit trust, with the SMSF in turn owning units in the trust, may find themselves inadvertently in breach of the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS).

Last year, the Australian Taxation Office (ATO) released a ruling to give guidance to the way "unpaid distributions" are treated in an SMSF.

As background, SMSFs can hold no more than 5% of their assets as "in-house assets".

If an SMSF exceeds this, then it will have contravened SIS. In-house assets have been defined in SIS to include a loan to, or an investment in, a related party or a "related trust" of the fund.

Unit trusts set up to own business premises are usually treated as a related trust.

In the recent ruling, the ATO's view is that when non-payment of a trust distribution to the SMSF is seen as an arrangement for the provision of credit or other financial accommodation to a related trust, it will be treated as a loan.

Additionally, where the unpaid trust distribution falls within the definition of a loan, the entitlement to receive a trust distribution is considered an asset of the SMSF and may be classed as an investment in the trust.

Unless a transitional exclusion applies, this could mean that the amount of the unpaid trust distribution, and in some cases the investment in the trust itself, would be classed as an in-house asset.

If this totals more than 5% of the total assets of the SMSF, then the SMSF will contravene SIS.

Costly impact

This can have a very costly impact on the tax treatment of the income of the SMSF, and in some cases the trustee will need to sell part of the investment in order to rectify the contravention.

Arm's length

The "arm's length" rule also plays an important part in how the trust and unpaid distribution are treated.

Under this rule, any investment made by a trustee or investment manager of the SMSF must either be conducted on an arm's length basis, or not be more favourable or unfavourable to the trustee of the SMSF than would be expected if the arrangement was conducted on an arm's length basis.

Decisions about whether to seek payment of trust distributions would form part of these dealings and should be made on the same basis as would be expected if the trust was not a related party.

It is the ATO's view that if a trust is not a related party, the SMSF would generally seek payment of any unpaid trust distributions and, therefore, if the SMSF does not seek timely payment, then it could be contravening this section of SIS.

Sole purpose

Another factor that should be considered is whether, by entering into such a transaction, the SMSF is potentially contravening the "sole purpose" rule.

Under this rule, the sole purpose of any SMSF must be the provision of retirement or death benefits for, or in relation to, its members.

Where an SMSF trustee holds a substantial portion of the assets of the SMSF in a related trust as unpaid trust distributions upon which no, or below market rate, interest is being paid, it also suggests that the fund is not being run in a way that satisfies the sole purpose test.

The ATO would argue that the SMSF assets are being used as a low cost source of capital for the related trust, and therefore are not meeting the sole purpose test.

Tracey Di Pinho,
Manager,
tdipinho@hlbwa.com.au,
HLB Mann Judd Perth,
www.hlb.com.au

AUSTRALIAN
Superannuation
LAW BULLETIN

SCT's fact finding role

Stanley Drummond *NORTON ROSE AUSTRALIA*

In *Edington v Superannuation Complaints Tribunal* [2010] FCA 504; BC201003282, the Federal Court (Reeves J) confirmed that the Superannuation Complaints Tribunal (SCT) is permitted to make its own findings of fact only for the purpose of determining whether, in its opinion, the decision under review in its operation was fair and reasonable in the circumstances. The SCT is *not* permitted to conduct a general review of the evidence and decide afresh all findings of fact of the primary decision maker (ie, the trustee) as though the primary decision maker had not made any findings of fact.

Background

In about 1994, the member was diagnosed with schizophrenia (at [3]). In 2002, while trying to escape from two rottweiler dogs, he fell and injured his back and right foot. He claimed that he suffered ongoing injuries from this incident (at [4]).

The member claimed a total and permanent disability (TPD) benefit (at [5]). A delegate of the board of trustees (Trustees) of the superannuation scheme made the following determinations (at [6]):

- The injuries the member sustained in the dog incident did not render him incapable of discharging his work duties. The delegate therefore determined that he was not entitled to receive further income protection benefits.
- Due to his schizophrenia condition, the member was unlikely ever to be able to work again in a job for which he was reasonably qualified by education, training and experience, but the evidence did not establish that his schizophrenia condition was not related to a medical condition existing before he became a member of the scheme. The delegate therefore determined that he was not entitled to be paid a TPD benefit.

The Trustees affirmed the delegate's decision. The matter went to the SCT (which affirmed the Trustees' decision), to the Federal Court, to the Full Federal Court and back to the Trustees (at [9]–[10]).

The Trustees again rejected the member's application for a TPD benefit. The SCT affirmed that decision (at [11]). The member again appealed to the Federal Court.

The Federal Court's decision

The Federal Court stated the role of the SCT in the following terms (at [36]):

> … the Tribunal must, first, identify how the Trustees actually came to their decision. This necessarily requires it to identify the reasoning process that the Trustees employed to reach their decision. Only then can the Tribunal begin to make a proper assessment as to whether, having regard to that reasoning process, the decision was just, unbiased and equitable and was within the bounds of reason, ie fair and reasonable.

the Superannuation Complaints Tribunal (SCT) is permitted to make its own findings of fact only for the purpose of determining whether, in its opinion, the decision under review in its operation was fair and reasonable in the circumstances

The court said (at [29]–[30]) that while the SCT is said to stand "in the shoes" of the primary decision maker, it does so in a qualified sense. It does not have unrestricted fact finding powers. Rather (quoting from *Hornsby v Military Superannuation and Benefits Board of Trustees (No 1)* (2003) 126 FCR 484; 30 Fam LR 535; [2003] FCA 54; BC200300445 at [19] per Mansfield J, which was approved by the Full Federal Court in *Cameron v Board of Trustees of the State Public Sector Superannuation Scheme* (2003) 130 FCR 122; [2003] FCAFC 214; BC20030504 at [42]):

> … the Tribunal may have to make its own findings of fact for the purpose of determining whether, in its opinion, the decision under review in its opinion was fair and reasonable in the circumstances. But it is necessary to make such findings of fact only for that purpose. It does not decide afresh all findings of fact of the primary decision-maker as if that decision had not been made. It does not, in that sense, simply stand in the shoes of the primary decision-maker.

Here, the SCT had "conducted a fresh review of the whole of the evidence in order to ascertain the rights of the parties generally" (at [50]). In the process, it made most, if not all, of the necessary findings of fact afresh, as if the Trustees' material findings had not been made. The SCT's reasons showed that it had "proceeded to decide afresh what it thought the correct decision was, and it then concluded that, because the Trustees' decision was to the same ultimate effect as its decision, their decision must have been fair and reasonable" (at [50]).

By adopting this approach, the SCT had committed an error of law (at [51]). The court accordingly set aside the SCT's decision and remitted the matter to the SCT, to be reconsidered according to law (at [52]).

Take away point

The SCT does not have unrestricted fact finding powers. Rather, it can only make its own findings of fact for the purpose of determining whether, in its opinion, the decision under review was fair and reasonable in the circumstances.

Stanley Drummond,
Senior Associate,
Financial & Investment Services,
stanley.drummond@nortonrose.com,
Norton Rose Australia,
www.nortonrose.com

AUSTRALIAN
Superannuation
LAW BULLETIN

Index to Volume 21

Page numbers in Volume 21 correspond to the following issues:
Issue 1 — pp 1–20
Issue 2 — pp 21–40
Issue 3 — pp 41–56
Issues 4 & 5 — pp 57–80
Issue 6 — pp 81–104
Issue 7 — pp 105–20
Issue 8 — pp 121–36
Issue 9 — pp 137–52
Issue 10 — pp 153–172

Table of articles

This table lists alphabetically by author all articles appearing in Volume 21 of the **Australian Superannuation Law Bulletin.**

Table of cases

This table lists alphabetically all cases appearing in Volume 21 of the* Australian Superannuation Law Bulletin. *Page numbers in bold refer to articles focusing on the relevant case.


AUSTRALIAN
Superannuation
LAW BULLETIN

Table of statutes

***This table lists alphabetically within each jurisdiction all statutes appearing in Volume 21 of the* Australian Superannuation Law Bulletin.**

Australia

Commonwealth

COMMISSIONING EDITOR: Virginia Ginnane BA/LLB MANAGING EDITOR: Kate Hilder SUBSCRIPTIONS INCLUDE: 10 issues plus binder SYDNEY OFFICE: Locked Bag 2222, Chatswood Delivery Centre NSW 2067 Australia DX 29590.

For further information on this product, or other LexisNexis products, PHONE: Customer Relations: 1800 772 772 Monday to Friday 8.00am–6.00pm EST; EMAIL: customer.relations@lexisnexis.com.au; or VISIT www.lexisnexis.com.au for information on our product catalogue. Editorial queries: Virginia Ginnane, virginia.ginnane@lexisnexis.com.au ISSN 1035-2163 Print Post Approved PP 255003/00770 This publication may be cited as (2010) 21(10)*SLB*