Corporate trustees for SMSFs

The recent AAT decision of *Shail Superannuation Fund and Commissioner of Taxation* [2011] AATA 940 highlights the importance of corporate trustees for SMSFs. Broadly, the decision resulted in a multi-million dollar tax liability for one co-trustee due to the actions of another co-trustee.

Recent data from the ATO indicates that 73% of all SMSFs have individual trustees as at 31 December 2010. Further, during 2010, 90% of newly established SMSFs were established with individual trustees.

As such, *Shail* is relevant to the majority of SMSFs.

Shail superannuation fund

Facts

The Shail Superannuation Fund was established in 1994. The trustees of the fund were Mr and Mrs Shail. The couple had a strained relationship over the years, including a separation. In May-June 2005 Mr Shail transferred $3,460,000 to his bank account in Turkey. Although not expressly stated, it seems that Mr Shail fled Australia leaving the fund with no assets. Mrs Shail claimed she had no knowledge or involvement in the withdrawals.

Neither Mr or Mrs Shail were eligible to withdraw any money from the fund. The ATO issued a notice of non-compliance and assessed the trustees for $1,583,873.68 of tax payable and, in addition, imposed a hefty penalty.

Mrs Shail argued that she should not be held liable since she was not involved in her husband's misappropriation. However, this did not save her from personal liability.

Outcome

The ATO's assessment and the penalty were held to be correct.

Mrs Shail might have separate legal redress against her husband. However, Mr Shail seems to have absconded and, due to Mr Shail's breach of trust, the SMSF appears to have no assets. Accordingly, Mrs Shail is now personally liable for literally millions of dollars.

Co-trustee liability

The decision in *Shail* highlights that each individual co-trustee is jointly and severally liable in respect of an SMSF's liabilities.

There are cases where a co-trustee has not been held liable where that co-trustee has acted prudently and there was no evidence that they had been reckless or negligent in their duties. However, in cases similar to *Shail*, a co-trustee might be liable if they were not acting prudently in the circumstances.

This raises the big question of what to do to minimise this risk especially when a co-trustee relationship sours.

How do corporate trustees stack up?

Generally a company offers limited liability to its shareholders. In the case of a company acting as trustee, a company is typically indemnified from the trust assets. Further, a director is generally not liable for a company's debts.

Accordingly, consider a corporate trustee of an SMSF with only $2 of paid up capital. If such a corporate trustee existed in a *Shail*-like situation, the starting point is that the shareholders might only personally lose $2 instead of Mrs Shail being liable for millions of dollars.

However, there are certain instances where directors are personally liable for debts and other obligations incurred by the company. Section 197 of the *Corporations Act* (Cth) provides that where a trustee company incurs liability, directors are liable if the company:

- has not discharged, and cannot discharge, the liability or that part of it; and
- is not entitled to be fully indemnified against the liability out of trust assets solely because of a breach of trust by the company, etc.

Mr Shail's actions mean that the company might not have been fully indemnified by the SMSF's assets (assuming it had assets). This results in the directors becoming jointly liable with the company.

Accordingly, in *Shail*, even if a corporate trustee was used it might not have protected Mrs Shail. However, in the first instance, a company would provide a 'leg to stand on' so that directors/members should not be personally liable.

We are aware of numerous situations where SMSFs had suffered investment losses (on derivative type transactions), and had other legal exposures, which far exceeded each fund's assets. Where such funds have individuals as trustees, those individuals' personal assets are at risk. Thus, a corporate trustee can provide valuable protection. The costs of implementing a corporate trustee can be justified in most SMSFs.

Excess contributions tax

Proposed legislative change

In December 2011, the Government released exposure draft legislation regarding the 2011 Budget announcement that up to $10,000 of excess concessional contributions can be withdrawn and instead be taxed at the member's marginal tax rates. We are still awaiting the draft legislation to be finalised for a 1 July 2012 start date. While this change is welcome, in our view it does not go far enough.

Trap — defined benefit funds

We have encountered a number of members that have excess contributions tax liabilities due to employee contributions being paid towards a defined benefit fund ('DBF'). (We are also aware of regular monthly spouse contributions also being overlooked.)

With many DBFs an employee contribution is also required. This is typically collected by the employer via regular payroll deductions (post-tax). These contributions represent non-concessional contributions ('NCCs').

Often members and their advisers will not realise that these amounts are counted as NCCs when they are planning their SMSF strategy, as they are contributed directly by the employer (on the member's behalf) to the DBF.

This is a big risk for those looking to utilise the '3 year rule' for NCCs by contributing $150,000 in one income year and $450,000 in the next.

We are aware of instances where the member was prudent enough to make $142,500 of NCCs in the first year to their SMSF. However, this did not stop them from breaching their caps. The post-tax contributions to the DBF sent them slightly over $150,000.

Advisers and members should turn their minds to whether any post-tax contributions being paid due to a DBF or other fund are NCCs. In some circumstances, even if the member's contribution caps are exceeded by a small amount, this can result in a huge tax liability. For example, when utilising the '3 year rule', a $1,000 excess NCC in the first year can give rise to a tax liability of about $70,000.

Fortunately, we have had successful outcomes on a number of recent assignments.

SMSF Online Updates — 10 February 2012 — it's now easy to keep up to date!

DBA Network's webcasts have proved a great success based on client feedback. The first of four SMSF Online Updates for 2012 is on Friday 10 February 2012 from 12 noon to 1.30pm (AEDT). The session will cover some hot topics including the latest cases, legislation, regulatory developments and other SMSF tips and traps.

To register please visit www.dbanetwork.com.au. Alternatively, contact Marie Zarifis on (03) 9092 9400 or dba@dbanetwork.com.au.

DBA Lawyers' SMSF succession planning documentation

DBA Lawyers offers a number of kits and documents that can assist advisers and SMSF members with a 'total SMSF succession planning solution'. This offering includes pension kits, BDBNs and reversionary nomination documentation.

DBA Lawyers publishes *The Complete Guide to SMSFs and Planning for Loss of Capacity and Death* — a 140+ page book that is dedicated to SMSFs planning for death and loss of capacity. The book details the 11 key steps necessary for proper SMSF succession planning for all SMSFs. It contains 90+ examples, detailed case studies and much more.

For more information or to order, visit www.dbalawyers.com.au/smsf-succession-planning.

For further Information please contact:

DBA LAWYERS PTY LTD (ACN 120 513 037) Level 1, 290 Coventry Street, South Melbourne Vic 3205

Ph 03 9092 9400 Fax 03 9092 9440 dba@dbalawyers.com.au www.dbalawyers.com.au