

SMSF pensions

A recent ATO webpage sets out an important message regarding SMSF pensions (www.ato.gov.au/superfunds/content.aspx?doc=/content/00120916.htm). We discuss some key points.

Can SMSFs that borrow pay pensions?

In order to be a pension, the rules of the fund must 'ensure that ... the capital value of the pension and the income from it cannot be used as a security for a borrowing.'

Naturally, this has caused concern for some over the years because it sounds like an SMSF cannot use an asset subject to a limited recourse borrowing arrangement to pay a pension.

DBA Lawyers has always been of the view that this is not the case. Rather, the legislation means the *member personally* cannot use their interest in the pension as security for the *member's* borrowing.

The ATO have confirmed our view, stating:

When applying for loans, members cannot use the capital value of the pension or the income from it as security for a borrowing.

What documents are needed?

The ATO state:

You will need to ensure that the fund's minutes of meetings record that a member has:

- requested to commence a pension
- met a condition of release
- elected to be paid a pension under either the current or the former standards (the option to choose is only available in respect of pensions commencing between 1 July 2007 and 19 September 2007).

(For completeness, there might be circumstances where trustee minutes are not strictly speaking needed, but it certainly is best practice and DBA Lawyers recommends them.)

Naturally, the trust deed should allow for the pension, with the ATO stating:

As an SMSF trustee, you may need to amend your fund trust deed so that it meets the minimum pension standards.

Other documents that should be provided include a PDS specific to the pension and, if the pension is reversionary, a locked in reversionary nomination. Certain deeds will require further documents still.

PENSION DOCUMENTATION

DBA Lawyers offers a range of pension documentation, including documentation to commence and commute pensions: see <http://www.dbalawyers.com.au/products-order-forms/pensions>

Enduring powers of attorney and SMSFs

Daniel Butler and Bryce Figot of DBA Lawyers both presented at the 2013 SPAA National Conference last week.

One aspect of the presentations that drew many questions was the role of enduring power of attorneys ('EPoAs'). This newsletter addresses some of the issues and questions that resulted.

No EPoA? You shouldn't have an SMSF!

Anecdotal evidence suggests very few people actually have EPoAs. SMSF members without EPoAs run a high risk of placing their loved ones through stress and anguish.

Odds of loss of capacity

Statistically, many people will lose capacity. For many, loss of capacity will occur due to loss of memory senility.

What happens to the SMSF where a member loses capacity?

Individual trustees

Generally, if there are multiple trustees, *all* are needed to make a trustee decision. (See paragraphs 18–19 of [Beath v Kousal \[2010\] VSC 24](#).) Accordingly, if one trustee loses capacity, typically he or she must be removed as a trustee or else the other trustee(s) will not be able to run the SMSF.

Corporate trustees

Most constitutions provide that a person automatically ceases to be a director upon loss of capacity. Accordingly, when an SMSF member/director loses capacity, they typically cease to be a director.

Is the fund still an SMSF?

Typically, to be an SMSF, all members must be trustees or directors. Accordingly, loss of capacity will cause the fund to cease being an SMSF either:

- directly, where there is a corporate trustee (because the incapacitated person typically automatically ceased to be a director); or
- indirectly, where there are individual trustees (because the incapacitated person will need to be removed so that the other trustee(s) can continue to make trustee decisions).

The EPoA exception

Generally, all fund members must be trustees/directors in order for the fund to meet the definition of an SMSF. However, a number of exceptions exist.

One exception provides that a fund will not fail to be an SMSF merely because a member is not a trustee/director *if someone who holds an EPoA in respect of that person is a trustee/director.*

Case study — what should happen

Adam and Andrea are members and trustees of an SMSF. Adam holds an EPoA in respect of Andrea and vice versa. Adam loses capacity. Due to the drafting of the SMSF's deed, Andrea can remove Adam as a trustee. Andrea is now the only trustee and (subject to the drafting of the deed) both Andrea and Adam are the members.

On first glance, the fund is not an SMSF because Adam is a member but not a trustee. However, due to the EPoA that Andrea holds, the fund is still an SMSF. This means Andrea can continue to run the fund by herself.

Without an EPoA

If someone loses capacity without an EPoA the situation is very different. Six months after the incapacitated member ceases being a trustee/member, the fund ceases to be an SMSF. In this situation, there are several options:

Option 1 — do nothing. Although the simplest option, this ultimately will lead to disaster. If nothing is done, eventually the ATO steps in. Their powers in this situation include removing the fund's complying status, which would of course be disastrous.

Option 2 — appoint a licensed trustee (ie, an 'RSE licensee') as trustee and thereby convert the fund into a small APRA fund. Naturally RSE licensees charge fees to act and are very conservative as to when and how they act.

Option 3 — seek to roll the incapacitated member to a new fund. Unfortunately, this last option is a case of 'easier said than done'. Among other reasons, there is a provision in the SIS regulations that essentially prohibits rolling members out of funds unless they consent. Naturally, an incapacitated member can not consent.

None of those options are appealing (to say the least). *However, if a member loses capacity without an EPoA those are the only options that typically exist!*

Naturally, this causes tremendous grief for the loved ones left trying to administer the fund.

Accordingly, we are strongly of the view that if someone is unwilling to have an EPoA they should not have an SMSF.

As a final note, it is of course also important to consider questions such as:

- Who should be the holder of the EPoA?
- Who should act if the holder of the EPoA cannot act (ie, who should be the alternate attorney)?

The Complete Guide to SMSFs and Planning for Loss of Capacity and Death

Those wishing to know more about EPoAs in SMSFs, might be interested in DBA Lawyers' book: *The Complete Guide to SMSFs and Planning for Loss of Capacity and Death*: www.dbalawyers.com.au/complete-guide

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