2014 National SMSF Conference

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TH5 Topic 2 – SMSFs and families: the real implications

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Introduction

Sometimes SMSFs are referred to as *family* superannuation funds due to the ability to have mum, dad and two children as members in the fund. However, is this actually a good idea? What happens if there is a fight in the SMSF between parents and children?

This paper considers the hidden implications of having children in an SMSF.

Case study

Consider a seemingly happy family with parents Howard and Marion and children Ritchie and

Joanie. Howard and Marion are the members of an SMSF. Like the majority of SMSFs, there is no corporate trustee. Rather, Howard and Marion are the trustees of the SMSF.

Ritchie and Joanie are young adults, who are both still at university with part time jobs. Howard and Marion decide to invite Ritchie and Joanie to become members of the SMSF. Howard and Marion figure this would be a good way to teach Ritchie and Joanie about investing. Also, they figure that having their children as SMSF members with them has the added bonus of allowing Ritchie and Joanie's super from their part time jobs to be pooled with Howard and Marion's, thereby saving some fees.

For the first few years, all goes well.

However, Joanie falls in love with a boy from the 'wrong side of the tracks'. She eventually moves to another city to pursue a music career. Howard and Marion disapprove. This leads to friction in the family. Joanie becomes estranged from her family.

Howard and Marion now start wondering what will happen to their SMSF.

Options that Howard and Marion face

Broadly, Howard and Marion have four options.

The first option is to try to run the SMSF without Joanie. Ritchie is still on good terms with Howard and Marion so they figure that they have a majority of the trustees. Plus, they figure, Joanie only has a relatively small balance.

However, SMSFs are ultimately governed by trust law and trust law does not operate like this.

Rather, as Street J in *Sky v Body* (1970) 92 WN (NSW) 934 said:

> Inherent in this basic system of trusts is the principle that trustees must act unanimously. They do not hold several offices – they hold a single, joint, inseparable office. If conflicting business considerations lead to such a divergence that the trustees are not able to act unanimously, then the simple position is that they cannot act.

Accordingly, strictly speaking, Howard, Marion and Ritchie need Joanie's input to make a valid trustee decision. Although practically Howard, Marion and Ritchie might still be able to give directions to banks, sharebrokers etc any decisions they make are invalid. They have the sword of Damocles hanging over their head – they know that there is the risk that Joanie could challenge any trustee decision they make.

(If there was a corporate trustee or if there were strategic provisions in the SMSF, the position might be different.)

The second option they have is to forcibly roll Joanie's benefits out of the SMSF. However, the legislation does not allow for this. More specifically, reg 6.29 of the *Superannuation Industry (Supervision) Regulations*

1994 (Cth) provides that there are only a handful of circumstances where members can be rolled out of a regulated superannuation fund. The most obvious circumstance is where the member consents, however, given the strained relationship between Joanie and her parents, she would not consent to any proposal that her parents put to her. Another circumstance is where she is being rolled to a 'successor fund'. On its face, this sounds like a perfect solution. However, to be a successor fund, the trustee of the new fund must agree that the new fund will confer on Joanie equivalent rights to the rights that she had under the original fund. Obviously, finding a superannuation fund trustee that will agree to this will be difficult to say the least.

The third option is that Howard, Marion and Ritchie roll their benefits out of the SMSF, leaving Joanie by herself. This option is riddled with problems. One problem is that the SMSF has carried forward capital losses due to the GFC and rolling out of the SMSF means the benefit of the losses will be lost. Naturally, there are many other problems too.

Finally, more drastic actions can be taken, such as seeking court orders. However, this would be wildly expensive and would presumably only further the rift between Joanie and the rest of the family.

Another option?

There might be another option, but it is not a 'tried and tested' option and is somewhat novel.

Remember, under reg 6.29, trustees can roll out a member's benefits if the member has given to the trustee the member's consent to the transfer.

The SMSF's deed might expressly provide that such consent can be obtained 'upfront' such as when Joanie joined the SMSF, and that the consent can be contingent on that member failing to attend at least two or three trustee meetings.

That being said, this is still a novel option and few SMSF deeds provide for this alternative.

For a template of such consent, email the author at bfigot@dbalawyers.com.au with the following words in the subject line: consent to transfer of member's benefits from fund

However, if such a contingent consent had been obtained upfront, at least it would have provided a leg to stand on for Howard, Marion and Ritchie and they might be in a more attractive position than what they currently find themselves.

Conclusion

Having children in their parents' SMSF exposes the SMSF to risks. One key risk is what happens if there is a falling out between the children and the parents. Although there are ways to try to address these risks, my view is – unless there is a particularly compelling reason to have children in the SMSF – leave them out and avoid the risks altogether.

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