

# 7 Key Reasons to have a Corporate Trustee in your SMSF

Whilst establishing your SMSFs with individuals acting as trustees may save a few dollars in the short term, the benefits of registering a corporate trustee for your new SMSF can far outweigh the short term savings.

**Outlined in this paper are seven key reasons to establish SMSFs with a corporate trustee.**

## **Reason 1 – Succession upon death**

A company is an indefinitely continuing entity. Consequently, having a company as trustee for the Fund ensures control of the SMSF is always certain – an especially important factor when a member of the SMSF dies.

### **Example:**

Jack and Jill are members of a SMSF, and both are individual trustees. Jack dies, leaving Jill as the sole remaining member and individual trustee for the Fund. In order for the SMSF to remain compliant, Jill must appoint a second individual trustee.

Jill, at some stage<sup>1</sup>, will need to appoint another person to act as an individual trustee. This means Jill will relinquish full control of the Fund.

The above scenario may have a number of outcomes. Jill may have children that she wishes to appoint as trustees of the Fund, in which case documentation to appoint the children as members and trustees of the SMSF would be required to be completed. She would also have to change the name in which all of the Fund's assets are held.

Jill may also not have any children, or close relatives that she trusts to share control of her Fund. In this case, Jill may decide to establish a corporate trustee company, and act as the sole director, to ensure she retains full control of the SMSF.

In this scenario, she would need to establish the company and prepare relevant documentation to change the trustee of the Fund. She would also have to change the name in which all of the Fund's assets are held.

Had Jack and Jill established the SMSF with a corporate trustee in the first instance, none of the above would be an issue.

After his death, Jack's membership would effectively cease and Jill would continue as the sole member of the Fund and sole director of the corporate trustee, without having to appoint another trustee, prepare any change of trustee documentation or change the name in which the Fund assets are held. She would also automatically maintain full control of the Fund.

## **Reason 2 – Trustee litigation exposure**

Another important reason to have a corporate trustee is litigation exposure. Individuals acting as trustee of a SMSF are jointly and severally liable for any actions taken

against the Fund, as they hold the assets of the Fund in their individual names. Should litigation against the Fund exceed the assets held in the name of the trustees (as trustees for the Fund), the personal assets of the individuals may become at risk.

Companies, on the other hand, have limited liability. This generally ensures litigation against the Fund is limited:

- firstly, to the assets held in the SMSF; and
- secondly, to the assets held in the name of the company itself.

Liability generally does not extend to the directors of the company. If the company is a sole purpose SMSF trustee company, this will generally ensure any claim against the Fund is limited to the assets held by the company as trustee for the SMSF, and no director's assets will be at risk.

The joint and several liabilities of individual trustees were highlighted in the 2011 AAT case regarding Shail Superannuation Fund.

Basically, Mr and Mrs Shail were the individual trustees of their SMSF. Mr Shail fled Australia after transferring almost \$3.5 million of SMSF money to an overseas bank account. The ATO then assessed the trustees for tax and penalties of more than \$1.5 million.

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As the SMSF had minimal funds remaining, Mrs Shail was personally required to meet the liability.

The above scenario would have resulted in a different outcome had the trustee of the SMSF been a corporate entity. In that event, Mrs Shail would not have been personally liable for the shortfall in tax.

## Reason 3 – Administrative Efficiency

One of the key benefits of a SMSF is its fluidity - such as allowing multiple generations of a family to come and go from the Fund. Instances of changes in membership to a SMSF may include:

- Parents admitting their children into the Fund;
- The marriage of an existing member of the SMSF to a non-member of the Fund;
- The divorce of members within the Fund;
- Upon the incapacity of a member of the Fund, where their Legal Personal Representative is appointed as a trustee of the SMSF in that members stead; or
- Upon the death of a member of the Fund, where their Legal Personal Representative is appointed until the death benefits have been paid.

Whenever a change in membership occurs, a change in trusteeship is generally also required to occur, if the SMSF has individual trustees.

The fact trustees and members can come and go easily from a SMSF, raises a time consuming and costly administration problem for SMSFs with individual trustees, as the law requires the assets of SMSFs to be held in the names of all of the trustees of the Fund.

Consequently, whenever a new trustee is appointed to the Fund, or an existing trustee leaves the Fund, the Fund is required to notify all relevant registries and offices (and provide a range of documents) to change the name or names under which the assets of the SMSF are registered.

Furthermore, legal advice as to the procedures to remove / appoint the trustee and member, as determined by the Fund's trust deed, must also be taken. Overall, the admission and removal of individual trustees can be a costly and time consuming exercise.

In contrast, when a new member joins a SMSF with a corporate trustee, the corporate trustee itself does not change, only the underlying directorship of the company changes.

The assets are still held in the same name - that is, the name of the company - so there is no need to change the name in which the assets of the Fund are held.

## Reason 4 - Lump Sum Payments

For a SMSF to receive its concessional taxation status, it must elect to be regulated by the ATO and comply with the laws and regulations outlined in the Superannuation Industry

(Supervision) Act 1993 (SIS Act) and Superannuation Industry (Supervision) Regulations 1994 (SIS Regs).

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Section 19 of the SIS Act is very specific in its determination of what constitutes a regulated SMSF, effectively stating that the trustee must either be:

- a constitutional corporation; or
- the purpose of the Fund must be to pay a pension or pensions.

The consequence of this is that the SMSF must either have:

- a corporate trustee; or
- individual trustees, in which case the SMSF must have, as its sole or primary purpose, the payment of old age pensions.

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The effect of the legislation is that a SMSF with a corporate trustee may pay benefits as either a lump sum or a pension. However, SMSFs with individual trustees must, in the first instance, aim to pay benefits in the form of pensions.

Strictly speaking, in order for a SMSF with individual trustees to compliantly pay a lump sum benefit, the member receiving the benefit would have to provide a written request to the trustees for the payment to be made as a lump sum benefit.

## Reason 5 – SMSF Borrowing

If it is intended that the SMSF will borrow to acquire an asset under the limited recourse borrowing arrangement provisions (LRBA), lenders may require that the SMSF have a corporate trustee.

As a rule, the vast majority of banks lending to SMSFs in relation to LRBAs impose a requirement that all loans for the purchase of residential property by a SMSF have a company as the trustee of the SMSF.

Therefore, a SMSF established with individual trustees may need to go through the process of appointing a corporate trustee and, following that, convert the assets owned by the SMSF into the name of the new trustee of the Fund should the Fund decide to enter into a LRBA

## Reason 6 – SMSF Administrative Penalties

Parliament recently passed legislation which was introduced to

enable the Australian Taxation Office (ATO) to apply monetary penalties to trustees of SMSFs in the event of certain breaches of the SIS Act.

If a SMSF has individual trustees, **each** trustee may be liable to pay the 'administrative penalty'. Alternatively, if the SMSF has a corporate trustee, the penalty is levied on the company (and each director is jointly and severally liable to pay that penalty).

This is explained in examples contained in the Explanatory Memorandum to the Bill introducing the administrative penalties.

In the examples, a SMSF has contravened section 35B of the SIS Act, which requires preparation of the accounts and statements for the Fund, and contains an administrative penalty of 10 units<sup>2</sup>.

The examples indicate that:

- with individual trustees, each trustee would be liable for the 10 unit penalty; whereas
- with a corporate trustee, the 10 unit penalty would be applied once only (i.e. to be shared amongst the directors).

## Reason 7 – Sole Member Funds

If a SMSF with individual trustees has a sole member, the SIS Act requires that the SMSF must have a second individual trustee. This will mean that the sole member will have to relinquish some control over the Fund to another person.

Alternatively, the SIS Act provides that a sole member SMSF can have a company as trustee with either **one**

**or two** directors, one of which must be the member. In this case a sole member can assume total control over the SMSF by appointing themselves as the sole director of the corporate trustee.

A sobering thought - the vast majority of SMSFs are established as two member Funds, predominantly with husband and wife as the members. Therefore, the members are not concerned, at that stage, with issues relevant to single member SMSFs.

However, through either death or divorce, those SMSFs are likely to become single member Funds at some point in the future.

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*Most SMSFs will become single member SMSFs at some time in the future.*

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## Other Considerations

### Costs in establishing a Company as Trustee

Some are put off by the initial cost involved in establishing a company to act as trustee of the SMSF.

However, the actual costs associated with a sole purpose SMSF trustee company are low compared to the

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extra costs that can be incurred with individual trustee SMSFs, especially in documenting trustee changes.

In addition, if you also consider the succession and litigation advantages of a company over individuals, the overall cost effectiveness of a company will generally outweigh the initial incorporation costs.

Further to this, the ongoing cost of a sole purpose SMSF trustee company, the ASIC levy, is \$47 per annum.

Therefore, after overcoming the initial registration costs, the ongoing costs are minimal.

Given all of the above, the amount of money 'saved' by not registering a company to act as corporate trustee of the SMSF can prove to be false economy.

### More information

Should you have any queries or require more information, please contact us on 03 5144 4422.

### Notes:

- <sup>1</sup> Generally, the appointment of an additional individual trustee must be made within 6 months of commencement of payment of benefits following the death of a member.
- <sup>2</sup> Administrative penalty units are currently \$170 each.

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