The Tax Institute

# Local Tax Club Geelong

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Novotel Geelong

The Tax Institute

# Resolving and Avoiding Internal Disputes in SMSFs

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# Outline

- Dispute examples
- Tools for resolving or avoiding internal disputes
- What tools could have worked in the examples

# The early accessing brother

Background

- 2 brothers are members of an SMSF
- Also had joint business interests outside of super
- Brothers had a falling out
- Commenced litigation against each other and ultimately agreed to split their business interests
- They left about $70K in the SMSF to assist winding it up

# The early accessing brother

- Our client brother discovered that other brother had accessed funds in the SMSF due to “meeting” hardship grounds of release
- Other brother in fact overdrew his entitlement and took out some of our client brother’s entitlement
    - Facilitated by SMSF’s financial planner

# The early accessing brother

What did we do?

- Main concern was potential ATO penalties and actions against our client brother
- Made a voluntary disclosure to the ATO
- ATO accepted that no penalties would be issued against our client brother
- Rolled out our client brother's interest to another super fund

# The widow of the dead business partner

Background

- 2 business partners and their wives in an SMSF
- All 4 individual trustees
- SMSF held the business real property from which the business operated from
- The SMSF was very illiquid with the only other assets being some cash in bank

# The widow of the dead business partner

Background

- One of the business partners died leaving the other business partner, his wife and the widow in the SMSF and business structures
- The wives were passive in the operation of the business and the SMSF
- There was no shareholders agreement or any other similar agreement to facilitate the exit of the widow from the group

# The widow of the dead business partner

Background

- The deceased had 3 reversionary TRISs and an accumulation account
- His total super balance was below $1.6 million
- The SMSF had insufficient cash to pay out his death benefit
- A dispute arose as to how the widow would be exited from the business and the SMSF

# The widow of the dead business partner

Background

- About 18 months after the death of the business partner, the accountant for the SMSF sent a letter to the widow:
  - Enclosing a cheque to the widow for a lump sum death benefit equal to the deceased's accumulation account at the date of the deceased's death (ie 18 months ago)
  - Confirming the TRISs had automatically been transferred to the widow
  - Enclosing a deed of variation for the SMSF trust deed

# The widow of the dead business partner

Our response on behalf of the widow to accountant

- trustees had the discretion to pay the accumulation benefits
- that the trustees had not made a decision (or even met) to decide how the accumulation benefits were to be paid;
- purported death benefit based lump sum from the deceased’s accumulation account should be based on the current value of the death benefit account
  - which would have been significantly higher given the appreciation of the property since the death of the deceased

# The widow of the dead business partner

Our response on behalf of the widow

- Widow wished that the deceased's accumulation account be paid to her as a death benefit account based pension
- Widow did not agree to the amended deed
    - as it would have allowed trustee voting based on account balances
    - meaning the widow could have been outvoted at the member level

# The widow of the dead business partner

- Negotiations were required as how to exit the widow from the SMSF as:
  - She has no rights to force an exit out of the SMSF
  - The options to increase liquidity of the SMSF are limited
  - The surviving business partner and wife were resisting disposing of the business real property

# The widow of the dead business partner

- Ultimately:
  - The business real property was sold to an entity controlled by the surviving business partner at an agreed market value
  - The widow was rolled out of the SMSF

# How do you exit an SMSF with a terms contract and an LRBA

Background

- A family law split between a couple in an SMSF
- It was agreed that the husband would receive the business real property in the SMSF
- Problem was:
  - One parcel was subject to an uncompleted terms contract from the wife to the SMSF
  - Another parcel was subject to an LRBA with an uncooperative bank

# How do you exit an SMSF with a terms contract and an LRBA

Background

- All money paid into the SMSF as rent was accessed by the wife as payments under the terms contract
- This:
  - Created significant cash flow issues for the SMSF
  - Meant the SMSF could not satisfy its existing LRBA
  - Made it difficult to negotiate with a new lender for the new LRBA

# How do you exit an SMSF with a terms contract and an LRBA?

Therefore, we had to negotiate:

- The assignment of the terms contract
  - both the interest of the vendor from the wife to the husband and the interest of the purchaser from the old SMSF to the new SMSF
- The transfer of the property subject to the LRBA to the new SMSF with a new LRBA and paying out the old LRBA
- Applying for a duty exemption for all of the above transactions
- Ultimately, we were successful

# The silent auction

Background

- 2 brothers and their wives in an SMSF
- Again, brothers had a falling out
- SMSF held units in a “pre-1999 unit trust”
- Pre-1999 unit trust held 3 properties

# The silent auction

Brothers reached an agreement

- Each would put in a silent bid for each property
- The brother with the highest bid would “receive” that property
- The brother who successfully bid for 2 properties would keep the pre-1999 unit trust
- The unsuccessful brother would have to transfer out “his” property

# The helpful brother

- A brother agreed to be a co-trustee of his brother’s sole member SMSF
- The member brother accessed his benefits without meeting a condition of release
- The non-member brother sought advice on how to exit the SMSF and potential exposure
- Non-member brother could resign but not easily transfer assets out of his name

# A tale of 2 (out of 4) members – one incapacitated and one missing

Background

- The SMSF had 4 members who were all individual trustees and were unrelated
- One of the members became incapacitated and one trustee went missing
- We acted for the administrator of the incapacitated member

# A tale of 2 (out of 4) members – one incapacitated and one missing

We were asked to advise on:

- Whether the administrator could make any decisions in place of the incapacitated person in their role as trustee
- Whether the incapacitated member could be paid out their benefits
- What could be done about the missing member

# A tale of 2 (out of 4) members – one incapacitated and one missing

How could member benefits be paid?

- The trustee had the power to pay out benefits and roll out members
- The SMSF trust deed provided trustee voting rights based on the amount of benefits they held in the SMSF
- The quorum for a meeting was all trustees but at an adjourned meeting the quorum was the members who attended

# A tale of 2 (out of 4) members – one incapacitated and one missing

- The administrator's options included:
  - Seek to exercise the incapacitated trustee's power under section 58C of the *Guardianship and Administration Act 1986* (Vic)
  - Rely on the 2 remaining trustees to exercise their powers (at an adjourned meeting) – who held the majority of the benefits
- Administrator was comfortable to rely on the remaining trustees

# A tale of 2 (out of 4) members – one incapacitated and one missing

- In relation to the missing member the remaining 2 trustees could roll him out of the fund
  - Via the adjourned meeting process

# The rogue daughter-in-law

Background

- SMSF included mum, dad, son and daughter-in-law - all as individual trustees
- Mix of assets - some notionally held for mum and dad and some for son and daughter-in-law
- Daughter-in-law most financially literate and controlled the financial side of the SMSF

# The rogue daughter-in-law

Background

- Daughter-in-law and son separated
- Daughter-in-law transferred out of SMSF hers and son’s assets, lodged the final tax return for the SMSF and cancelled the SMSF’s ABN
- When mum and dad discovered what happened the SMSF was effectively frozen

# The rogue daughter-in-law

Background

- The ATO would not take directions from 3 of 4 trustees to re-register the SMSF and would not accept that we had instructions to act on behalf of the SMSF

# The rogue daughter-in-law

Solution

- A meeting of trustees was called through formal processes (daughter-in-law chose not to attend)
- Formal resolutions made to:
  - Appoint us as representatives for the SMSF
  - Re-register the SMSF with the ATO
- Formal resolutions accepted by the ATO as evidence of trustee decisions – SMSF was reinstated

# The lump sum benefit that cannot be made

Background

- The SMSF had 2 members, mum and dad, with dad holding the majority of the benefits
- The SMSF basically had one asset – a valuable property
- Dad did a BDBN stating that all of his benefits where to go to 2 of his 3 children and where to be satisfied by a transfer of the property
- The problems with this included:
  - This would trigger a large CGT assessment that exceeded the balance of the assets of the SMSF
  - This would trigger a large “death tax” withholding obligation, again, which the SMSF did not have

# The lump sum benefit that cannot be made

Solution

- The 2 children agreed to disclaim their interests in the death benefits
- The trustee of the SMSF agreed to sell the property and pay the net proceeds (after costs and CGT) as the death benefit to the wife
- Wife ultimately decided to make some gifts to all 3 children

# The ex-wife, the daughter and the de-facto

Background

- An SMSF members are the husband and his divorced ex-wife
- The husband had 3 children and a long term de-facto
- The husband dies leaving no DBDN
- The executors were the daughter and the de-facto
- Under the will the husband left 70% of the estate to the de-facto and 30% to the children

# The ex-wife, the daughter and the de-facto

Claims

- The de-facto wrote to the ex-wife (being the sole director of the SMSF trustee) and noted:
  - The SMSF no longer met the definition under section 17A of the SIS Act without an LPR appointed
    - This was refuted as there was only one member – the ex-wife
  - There was a positive obligation to appoint the executors as co-directors
    - This was refuted per *Ioppolo v Conti*
- Therefore, it was noted the de-facto and/or the executors had no right to be appointed as directors of the SMSF trustee

# The ex-wife, the daughter and the de-facto

Outcome

- The SMSF trustee (being controlled by ex-wife as sole director) commenced a claim staking process
- The SMSF trustee decided to pay the death benefits 70% to the de-facto and 30% to the children (ie consistent with the will)
- No challenges to the decision were made

# Tools for resolving or avoiding internal disputes

**Separate SMSFs**

- Simple solution
- What are the driving forces for a joint SMSF
  - Cost efficiencies
  - Joint investments
  - Succession
- Can those goals be achieved with separate SMSFs

# Tools for resolving or avoiding internal disputes

**Separate SMSFs**

- For joint investments – alternatives
  - SMSF co-investments – tenants in common
  - Unrelated trust or company
  - Regulation 13.22C company or trust

# Tools for resolving or avoiding internal disputes

**Separate SMSFs**

- LRBAs can be a reason for using a joint SMSF
- Problems for joint LRBAs in multiple SMSFs include:
  - Single acquirable asset rule
  - Banks won’t lend to multiple SMSFs for the same asset
- Therefore, joint SMSF may be a solution
- But important to consider exit mechanisms

# Tools for resolving or avoiding internal disputes

## Separate SMSFs

- Reconsider joint SMSFs for
  - Unrelated persons (business partners)
  - Siblings
  - Children?

# Tools for resolving or avoiding internal disputes

## Corporate trustees

- Make life easier for:
  - Calling meetings
  - Making decisions
  - Signing documents
  - Holding legal title
- Shareholding does not need to match directors
  - Ability to remove rogue directors
  - Ability to pass decisions with an in-operative board

# Tools for resolving or avoiding internal disputes

**Tailored trust deeds and associated documents**

- I think these are a must for SMSFs with unrelated members
- Provisions could be in:
  - the SMSF trust deed or
  - a separate agreement (preferred)

# Tools for resolving or avoiding internal disputes

**Tailored trust deeds and associated documents**

- The provisions could include:
  - How meetings are conducted
  - How voting occurs
  - Whether members can compel an exit
  - How an exit will be effected (forced sale, transfer of assets etc)
  - What happens on the death of a member?
  - A dispute resolution provision that is binding on the parties
  - The use of insurance to fund exits?

# Tools for resolving or avoiding internal disputes

**Guardian role**

- Allows one or more parties to have over-sight of the SMSF
- Powers could include:
  - Consent required for trustee to make certain decisions
  - To remove the trustee
  - To force members out of the SMSF
- But will also need to deal with the succession of the guardian

# What tools could have worked in the examples

**Early accessing brother**

- Separate SMSFs
- Tailored trust deed

# What tools could have worked in the examples

**The widow of the dead business partner**

- Separate SMSFs
- Unrelated trust
- Corporate trustee?
- Tailored trust deed or associated document
  - Exit mechanism
  - Dealing with death of a member
  - Dispute resolution

# What tools could have worked in the examples

## How do you exit an SMSF with a terms contract and an LRBA

- Any tools?

# What tools could have worked in the examples

**Silent auction**

- Separate SMSFs
- Regulation 13.22C unit trust
- Tailored trust deed or associated document
    - Exit mechanism
    - Dispute resolution

# What tools could have worked in the examples

## The helpful brother

- Corporate trustee (single director)

# What tools could have worked in the examples

**The tale of 2 (out of 4) – members – one incapacitated and one missing**

- Public offer super funds
- Separate SMSFs
- Corporate trustee
- Tailored trust deed or associated document
  - Exit mechanism
  - Voting and dispute resolution

# What tools could have worked in the examples

**The rouge daughter-in-law**

- Separate SMSFs
- Corporate trustee
- Tailored trust deed or associated document
  - Exit mechanism
  - Voting and dispute resolution
- Guardian role

# What tools could have worked in the examples

**The lump sum benefit that cannot be made**

- Consideration of CGT and death tax consequences of wishes
- Not locking in the transfer of the property to the 2 children – give them the benefits not the asset
- Taking the property out before death (still CGT problem but prevents the death tax)
- Bring the children in as members?

# What tools could have worked in the examples

**The ex-wife, the daughter and the de-facto**

- A stand alone SMSF
- A BDBN
- A clear succession plan for the SMSF – eg the executors via shareholding

# Questions?

- **Questions?**

# Thank you

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