

Paperwork & SMSF: how to avoid some common mistakes

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SMSFs are a popular vehicle for accumulating and generating wealth in a tax effective environment. In the rush to get to the exciting ‘nitty gritty’, sometimes important issues are forgotten or mistakes made. The two common SMSF paperwork errors— and how to fix them — are detailed here.

Investment strategies

Every Super fund must have an investment strategy. The investment strategy must have regard to the whole of the circumstances of the fund including, but not limited to:

- the risk involved in making, holding and realising, and the likely return from, the fund’s investments having regard to its objectives and its expected cash flow requirements;
- the composition of the fund’s investments as a whole including the extent to which the investments are diverse or involve the fund in being exposed to risks from inadequate diversification;
- the liquidity of the fund’s investments having regard to its expected cash flow requirements; and
- the ability of the fund to discharge its existing and prospective liabilities.

Few funds have investment strategies that properly meet this requirement. Typically, investment strategies only state the range of assets in which the trustee should invest. They rarely consider issues such as diversification and risks. This is especially relevant for funds that invest heavily in only one or two assets (eg, business real property). It is important to remember that the default investment of a modern prudent trustee is generally taken by courts to be a broad index of listed securities. Accordingly, where a super fund trustee invests in a fashion other than in a broad index of listed securities, the investment strategy should explain why that was a prudent investment decision instead of, say, an index fund.

Remember, that an adviser can be held liable for any losses or damages (including investment losses) a client suffers pursuant to an improper investment strategy. This is especially relevant for a fund with an exotic investment strategy that underperforms a relevant benchmark (eg, the S&P ASX 200).

Happily, the converse is also true: It is a defence to an action for loss or damage suffered by a person as a result of the making of an investment if the defendant establishes that the investment was made in accordance with a proper investment strategy.

Finally, remember that investment strategies should be regularly reviewed and revised as necessary. APRA (albeit not the regulators of SMSFs) states that such a review should occur at least each six month.

Documenting changes of trustee

The rules for documenting changes of trustee are contained both in a fund's specific governing rules as well as in the SIS Act.

A recent Victorian Supreme Court case considered an SMSF change of trustee in light of the fund's specific governing rules. Under the fund's governing rules, there was role of a founder and the power to appoint a new trustee rested with the founder. Documentation was made in which the fund's members (ie, not the founder) purported to appoint a new trustee. The purported appointment failed because this was not a power given to the members. It is interesting to note that the directors of the founder had signed the change of trustee documentation — however they had not signed in their capacity as directors of the founder (eg, in the capacity of fund member).

The SIS Act provides that a person is not eligible to be appointed as a trustee (or director of a trustee) of a super fund unless the person has consented in writing to the appointment. This is separate to the ATO's 'Trustee declaration' that new trustees have been required to make shortly after becoming an SMSF trustee or director of a corporate trustee from 1 July 2007.

If any trustee (or director of a trustee) has not consented in writing to their appointment, they are not eligible to hold that office. This is case regardless of whether they were appointed before or after 1 July 2007.

The implications are:

- change of trustee documentation must comply with the fund's specific governing rules (usually annexed to the deed establishing the fund); and
- the new trustee (or director of a trustee) must consent to their appointment in writing regardless of when they became trustees (or directors).
- Any failure to comply with these requirements can lead to an invalid change of trustee. This may result in exposure as the purported actions by the trustee may be without indemnity of fund assets.

Conclusion

The above common errors in SMSF paperwork can have serious consequences, however, they are also all easily addressed. Advisers should be alert to ensuring appropriate procedures and paperwork is followed. Once they are addressed they can give great peace of mind.

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