

Five key lessons for SMSFs (from one 751 paragraph case)

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The decision of *Frigger v Trenfield* provides some important reminders for SMSF trustees and their advisers on record keeping and ensuring funds stay compliant.

The judgement in the decision of *Frigger v Trenfield (No 10)* [2021] FCA 1500 runs to over 700 paragraphs, and is only one of a series of cases involving the same parties.

Approximately one-third of the way through the judgement, the following caution is provided 'the reader who has persevered this far should be warned: much of (the) evidence is simply a mess ... It is impossible to describe (it) in a tidy way ... the balance sheets and annual returns are a morass in which no sure footing can be found'.

While much of the decision focuses (necessarily) on dissecting the evidence, that was in many cases undermined by conflicting statements and numerous examples of doctored or forged documentation by the trustees of the SMSF, there are also some key reminders for all SMSF trustees and their advisers.

For ease of reference, the relevant sections of the *Superannuation (Industry) Supervision (SIS) Act 1993* mentioned are extracted at the end of this article.

Complying with the prescribed standards

Section 34(1) of the SIS Act provides that each trustee of a superannuation entity must ensure that the prescribed standards applicable to the operation of the entity are complied with at all times.

SIS Regulation 4.09A(2) contains the following prescribed standard (as permitted by section 31(1) of SIS) - a standard also captured by section 52(2)(g) of SIS:

A trustee of a regulated superannuation fund that is a SMSF must keep the money and other assets of the fund separate from any money and assets, respectively:

- (a) That are held by the trustee personally; or
- (b) That are money or assets, as the case may be, of a standard employer-sponsor, or an associate of a standard employer-sponsor, of the fund.

The court confirmed that any SMSF trustee wishing to comply with this requirement will be careful to ensure that any assets that are part of the SMSF are clearly identified as such.

For example, steps would be taken to ensure:

- 1 formal records of ownership of fund assets clearly note the trustee capacity in which assets are held;
- 2 fund assets are not held in the name of only one of the trustees, particularly where the trustees are individuals who are likely also to hold assets in a personal (non-trustee) capacity.

Acquisitions from members

Section 66(1) of SIS provides a general prohibition on SMSFs acquiring assets from member.

While there are exceptions to the prohibition (under section 66(2) of SIS), the court confirmed that this does not mean the matters in the exception are incorporated as part of the prohibition. Rather, section 66(2) are excuses or justifications for what would otherwise be prohibited.

This means that the onus of establishing that validity of any contribution (for example, of business real property at market value) rests with the members.

Illegal conduct to support case

The court confirmed that it 'will not lightly draw an inference or make an assumption of illegal conduct by a party so that the party (can) rely upon that illegal conduct to make out its case' (see *Coshott v Coshott* [2013] FCA 907, confirmed on appeal).

Here therefore a purported contribution in breach of the section 66(1) prohibition (which was an offence potentially punishable by imprisonment of up to one year under section 66(4)) was held to objectively be something that was unlikely to be intended by the SMSF member.

Furthermore, the purported illegal contribution was prohibited by the SMSF trust deed, as will be the case in most competent SMSF trust deeds.

This meant the trustees of the SMSF were bound not to accept any contribution 'not permitted by superannuation law' and indeed were required to refund or otherwise disgorge it as soon as they became aware of the breach.

Subjective intention of trustees

The court bluntly confirmed that the subjective beliefs of an SMSF trustee are irrelevant in the eyes of the law.

That is, SMSF trustees must manifest their choices objectively.

Record keeping

In relation to record keeping the court confirmed that SMSF trustees must:

A. observe the numerous strictures which are found in SMSF trust deeds and the SIS Act and Regulations concerning the keeping of records, and keeping superannuation assets separate;

A observe the numerous strictures which are found in SMSF trust deeds and the SIS Act and Regulations concerning the keeping of records, and keeping superannuation assets separate;

B prepare balance sheets recording the holding of assets, and have those balance sheets independently audited, in a timely way;

C only open bank accounts in a manner that permits the trustee capacity to be recorded in the account name; or if this is not commercially feasible, record the trusteeship clearly in a separate, contemporaneous document;

D ensure SMSF accounts are not used to stream funds or run a business that are not assets of the SMSF, nor pay personal expenses from SMSF accounts;

E not use personal accounts to transact on behalf of the SMSF.

While the court accepted that many of the above heuristics are inconvenient and it is often easier to disregard them, there will be consequences for non-compliance.

Here those consequences included having penalties imposed by the Tax Office and assets, that were argued by the trustees to be protected on bankruptcy of the members, to instead be available to their creditors

Extracts of SIS

Section 34

Prescribed operating standards must be complied with

Standards must be complied with

(1) Each trustee of a superannuation entity must ensure that the prescribed standards applicable to the operation of the entity are complied with at all times.

Note: Section 166 imposes an administrative penalty for a contravention of subsection (1) in relation to a self managed superannuation fund.

Offence

(2) A person who intentionally or recklessly contravenes subsection (1) commits an offence punishable on conviction by a fine not exceeding 100 penalty units.

Note: Chapter 2 of the Criminal Code sets out the general principles of criminal responsibility.

Standards relating to record keeping obligations

(2A) If standards are prescribed by the regulations for the purposes of paragraph 31(2)(n), 32(2)(g) or 33(2)(e), each trustee of a superannuation entity must ensure that those standards are, when applied to the operation of the entity, complied with at all times.

Penalty: 50 penalty units.

(2B) Subsection (2A) is an offence of strict liability.

Validity of transaction not affected by contravention

(3) A contravention of subsection (1) or (2A) does not affect the validity of a transaction.

Section 52(1) and (2)(g)

Covenants to be included in governing rules—registrable superannuation entities

Governing rules taken to contain covenants

(1) If the governing rules of a registrable superannuation entity do not contain covenants to the effect of the covenants set out in this section, those governing rules are taken to contain covenants to that effect.

(2) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:

(g) to keep the money and other assets of the entity separate from any money and assets, respectively:

Section 66(1) and s 66(2)

Acquisitions of certain assets from members of regulated superannuation funds prohibited

Prohibition

(1) Subject to subsection (2), a trustee or an investment manager of a regulated superannuation fund must not intentionally acquire an asset from a related party of the fund.

Exception - acquisitions of business real property and listed securities

(2) Subsection (1) does not prohibit a trustee or investment manager acquiring an asset from a related party of the fund if:

- (a) the asset is a listed security acquired at market value; or
- (b) if the fund is a superannuation fund with no more than 6 members - the asset is business real property of the related party acquired at market value; or
- (c) the trustee of a regulated superannuation fund acquired the asset under a merger between regulated superannuation funds; or
- (d) the asset is an asset of a kind which the Regulator, by legislative instrument, determines may be acquired by:
 - (i) any fund; or
 - (ii) a class of funds in which the fund is included.