

## SMSF appointors – perhaps permissible?

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**The recent discretionary trust related case of *Cihan v Cihan* [2022] NSWSC 538 appears to confirm that appointors (including of SMSFs) may not owe any fiduciary duties.**

Previous articles in SMSF Adviser have explored the concept of an SMSF trust deed using a principal, guardian, nominator or appointor role to empower a party to unilaterally remove a trustee.

Practically, the utility of this style of power is questionable given the SMSF rules require a member to consent to any removal from a fund (see SIS Regulation 6.28).

Furthermore, this style of role may be a fiduciary one, meaning someone cannot exercise the power for their own benefit.

### Case background

The recent discretionary trust related case of *Cihan v Cihan* [2022] NSWSC 538 appears to confirm however that appointors (including of SMSFs) may not owe any fiduciary duties.

The case is also a reminder that the go to mantra of 'read the deed' of SMSF and trust advisers is ultimately subject to the nuances of interpretations handed down by the courts from time to time.

The background to the case involved a discretionary trust established by a father, as sole individual trustee, with immediate family members (including 2 sons) as potential beneficiaries and one of the sons the sole 'nominator' (with the ability to unilaterally change the trustee).

Following numerous falling outs between the father and the sons, a series of 5 deeds of variation seeking to secure control of the trust were entered into by various parties.

### Court decision

In ultimately determining that the only deed of variation that was effective was one that saw the father retain his role as sole trustee and have himself and his 2 sons acting as nominators, with the ability to make decisions by a majority, the court confirmed:

- 1 The interpretation of the original trust deed was not assisted by it being 'an inartistic instrument' - riddled with typographical errors, provisions that repeated others and numbering of items in the schedule which did not line up with the references in the operative clauses.
- 2 Where there is a wide power of variation (the relevant power in the deed here is extracted at the end of this article), it is rare that a court will seek to curtail the power.
- 3 Thus, decisions such as in *Jenkins v Ellett* [2007] QSC 154 may be questionable, at least to the extent they rely on an argument that a nominator's role can not be subverted by the trustee it was designed to supervise by amending a trust deed.

- 4 That is, if the power to vary under a deed is wide, this can allow a trustee to change a nominator, without the consent of the nominator; and without destroying the substratum of the deed. While this conclusion arguably runs counter to the decision in *Jenkins*, critically the variation power in *Jenkins* was materially narrower than in the deed in the case here and similar decisions that have permitted trustees to unilaterally change an incumbent appointor such as *Mercanti v Mercanti* (2016) 50 WAR 495.
- 5 Furthermore, even whereas here, a deed sets out circumstances in which a nominator would cease to hold office, and the line of succession if that occurred, this did not implicitly curtail the trustee's power of amendment. Indeed, a power of amendment is perfectly consistent with the existence of specified terms in a trust deed. Any argument to the contrary, taken to its logical conclusion, would in fact prevent any amendments being made at all.
- 6 The court also rejected an argument that a nominator could have their actions in changing a trustee unwound on the basis of the doctrine of fraud on a power (being an exercise of a power with an intention contrary to, or not justified by, the instrument creating it). In particular, it was held that in the context of a modern discretionary trust - and arguably SMSFs - the use by an appointor of a power to replace the trustee so as to maintain or exercise control over the trust will not necessarily be inconsistent with the purpose for which the power was conferred, provided that there is no intention on the appointor's part that the appointee is to act otherwise than properly in the interests of the trust and in accordance with its terms (see *Baba v Sheehan* [2021] NSWCA 58).
- 7 While the trustee here was on record as saying his purpose in establishing the trust was to avoid tax on 'his' assets, this of itself did not mean the trust was a sham - a conclusion arguably also relevant for SMSFs. In particular the court confirmed that if it were possible to achieve the flexibility and tax advantages associated with a discretionary trust structure while retaining legal ownership and control of the founder's assets, then 'everyone would probably do it'. However, the reality is that in order to achieve those results it is necessary for ownership and control of the trust property to be given up, as a matter of law, to the trustee - and this is what had occurred here.

## Unilateral and uncommunicated trustee removal

Finally, in relation to extensive debate about whether notice was required to be given to a trustee of their removal before it was effective, the court concluded this was the case - despite the fact that there was no such requirement explicitly set out in the trust deed. This conclusion is in contrast to the recent decision in *Edwards & Anor v Brougham* [2022] SASC 8, where it was held:

- (a) it is not necessary for a trust deed to have a condition for effective removal of a trustee the giving of notice to the trustee being removed;
- (b) the key reason for not requiring a removed trustee to be notified is that a former trustee, who continues to exercise powers honestly without notice of their removal, will be protected in several ways, for example they are indemnified by trust assets (assuming they have acted honestly).

In the context of SMSFs it is clear that unilateral, uncommunicated, trustee removal is generally not permissible given that under SIS all trustees must also be members. This conclusion is subject to the concept of 'unilaterally removable members' (URM).

Under this approach, on admission to an SMSF, the relevant member has a membership with rights that are modified from what would otherwise be the case for a 'full' member. The member who is a URM pre-signs their consent to exiting the fund.

The SMSF trust deed is tailored to empower the 'founder' trustee with the right to remove the person admitted as a URM as a trustee if certain 'triggering events' occur or otherwise in the relevant trustee's discretion.

## **Power of amendment**

- (a) *The Trustee may at any time in its discretion add any member of the Cihan family as a new beneficiary to or take out any existing beneficiary from the deed.*
- (b) *The Trustee may at any time in its discretion by a revocable or irrevocable deed alter, revoke or add to any of the provisions of this deed and may make new provisions in addition (sic) to or to the exclusion (sic) of any of the provisions of this deed, at the time in force, such alteration, revocation or addition shall, if not expressed to be irrevocable, be similarly capable of being altered, revoked or added to by a subsequent deed;*
- (c) *No such alteration, revocation or addition shall result in the Trust Fund or any part thereof becoming payable to the Settlor.*
- (d) *No such alteration, revocation or addition shall have or be construed to have the effect of divesting or varying in any way the interest of any beneficiary in income or capital (sic) of the Trust Fund which has been distributed to that beneficiary pursuant to Clauses 4, 5A or 15;*
- (e) *No such alteration, revocation or addition shall extend or be construed to have the effect of extending the Distribution Date beyond the latest date provided for in this deed.*