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Not completely wiped out – Billabong co-founder avoids SMSF trustee disqualification

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The role of trusteeship of any entity is one the courts have regularly highlighted requiring conduct of the highest standards.

In relation to SMSFs, the expectations of trustees are arguably heightened by the legislative obligations also imposed - a fact highlighted by numerous cases over recent years.

Background

The nuances however that will be focused on by decision making authorities in any particular factual matrix can at times be difficult to reconcile.

For example, in *Fitzmaurice and Commissioner of Taxation (Taxation)* [2019] AATA 2217, the tribunal specifically confirmed that verbal advice from the accountant for the SMSF was not something that was appropriate to rely on, partly because the primary responsibility for compliance lies with the trustee of an SMSF, not the advisers to the fund.

Merchant – Overview

In contrast, in the recent high profile decision involving Billabong Surf Clothing co-founder Gordon Merchant, in addressing a similar point, the tribunal held that although the relevant breaches were serious, the offending SMSF transaction was one put forward by EY Partner Ian Burgess (no relation), and despite EY also being the auditor of the SMSF, at no time were the apparent superannuation compliance issues raised with the member.

The SMSF related decision in *Merchant and Commissioner of Taxation* [2024] AATA 1102 was part of a series of cases heard together that saw various transactions successfully attacked by the Tax Office, including pursuant to the anti-avoidance regime under Part IVA.

Relevant to the issue of the member retaining directorship of the corporate trustee, the situation triggering the disqualification was as follows:

(a) the SMSF agreed to acquire from a discretionary trust controlled by the fund member a substantial number of shares in Billabong that had a high cost base, which crystallised a significant capital loss for the trust (the transaction was separately held to have been for the dominant purpose of allowing a capital gain on a related transaction to be offset against the loss created by the 'wash sale');

(b) pursuant to section 126A(2) of the *Superannuation (Industry) Supervision Act* (**SISA**), the Tax Office disqualified Gordon Merchant as a director of the corporate trustee of the SMSF due to the following serious contraventions:

(i) the requirement to comply with operating standards under section 34 of the SISA, in particular to give effect to the investment strategy;

(ii) the sole purpose rule in section 62 of the SISA; and

(iii) section 65 of the SISA, by using the resources of the SMSF to give financial assistance to a member of the fund or relatives.

Interestingly, the Tax Office did on review consider Gordon Merchant to be a fit and proper person, despite the above breaches.

Investment strategy

In refusing to disqualify Gordon Merchant, relevantly the tribunal confirmed as follows:

1. The SISA and *Superannuation (Industry) Supervision Regulations* (**SISR**) do not impose a direct requirement that, in making a particular investment decision (as opposed to formulating the strategy), the trustee must consider or reconsider each of the following matters. Rather, in making an investment decision, the trustee must 'give effect' to the then existing investment strategy which will have been formulated having regard to the circumstances of the entity and review that strategy regularly. The items to be considered in developing the investment strategy are those set out in SISR 4.09(2)), namely:

(a) the risk involved in making, holding and realising, and the likely return from, the entity's investments, having regard to its objectives and expected cash flow requirements;

(b) the composition of the entity's investments as a whole, including the extent to which they are diverse or involve exposure of the entity to risks from inadequate diversification;

(c) the liquidity of the entity's investments, having regard to its expected cash flow requirements;

(d) the ability of the entity to discharge its existing and prospective liabilities;

(e) whether the trustees of the fund should hold a contract of insurance that provides insurance cover for one or more members of the fund.

2. Here the SMSF failed to give effect to its investment strategy, given:

(a) the predominant reason for the acquisition was to crystallise a capital loss in the trust;

(b) none of the criteria in the investment strategy (such as marketability of the asset, anticipated liquidity requirements, the risk involved in making, holding and realising, and the likely return from the asset) could be shown to have been considered;

(c) the stated objective of diversification in the investment strategy had not occurred, instead the purchase led to the SMSF holding 74.4% of its assets in a single company in the class of 'shares in listed companies', as compared to the stated range of 0 to 40% across multiple companies.

Sole purpose test and financial assistance

3. As noted above, the predominant reason for the transaction was to crystallise the capital loss and a substantial purpose was to keep ultimate beneficial or economic ownership of the Billabong shares within the Merchant Group, therefore the transaction also amounted to a beach of the:

(a) sole purpose test under section 62(1) of the SISA (given neither of the above purposes was a core purpose); and

(b) prohibition on providing financial assistance under section 65(1)(b) of the SISA (which is not limited to financial assistance of a direct nature. Rather, the section also prohibits financial assistance via an intermediary, including via a discretionary trust). While the later cancellation of the capital loss (because of the application of Part IVA) may have ultimately meant that no financial assistance was provided, this fact did not undo the earlier breach.

No disqualification

4. Despite the clear breaches, the tribunal confirmed Gordon Merchant should not be disqualified, noting the following:

(a) the Tax Office had itself concluded that Gordon Merchant was a fit and proper person;

(b) at no time had his advisers suggested that the improper transaction risked breaching the provisions of the SISA, and while EY had advised there were tax risks, this was not relevant to the question of disqualification;

(c) it was fair for the member to have thought that the transaction was lawful from a superannuation compliance perspective given it would not be expected that the SMSF's auditor would put forward a transaction which would cause breaches of the SISA;

(d) appropriate and reasonable undertakings had been given by the member, which mitigated the risk of future non-compliance;

(e) while the SISA breaches were serious, they all arose from one course of conduct (being the share sale), thus this was not a case of multiple breaches on multiple occasions;

(f) no weight needed to be placed on protecting the investing public against the risk of re-offending, given the member was only ever likely to be a director of the trustee of his own superannuation fund and there was no need to protect the member from himself.

Ultimately, (as concluded in cases such as *Macalister, in the matter of an application by Macalister* [2021] FCA 1455) the tribunal was satisfied that there was no useful purpose served by disqualification in the peculiar circumstances of the case.