

## 3 strikes don't always mean you're out as an SMSF trustee

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A recent court decision has highlighted that there are nuances in any case that can determine whether breaches of an SMSF trusteeship result in automatic disqualification.

Matthew Burgess, director of View Legal, said the role of trusteeship of any entity is one the courts have regularly highlighted requires conduct of the highest standards and concerning SMSFs, the expectations of trustees are arguably heightened by the legislative obligations also imposed.

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

"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 appropriate to rely on, partly because the primary responsibility for compliance lies with the trustee of an SMSF, not the advisers to the fund."

However, the tribunal made a different decision in the recent high-profile decision involving Billabong Surf Clothing co-founder Gordon Merchant in addressing a similar point.

Burgess said in this instance the tribunal held that although the three relevant breaches made by Merchant were serious, the offending SMSF transaction was one put forward by former 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 ATO including under the anti-avoidance regime under Part IVA," Burgess said.

Several situations were relevant to the issue of the member retaining the directorship of the corporate trustee, including the fact that 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.

These shares "crystallised" a significant capital loss for the trust and the transaction was separately held to have been to allow a capital gain on a related transaction to be offset against the loss created by the "wash sale".

"Additionally, pursuant to section 126A(2) of the Superannuation (Industry) Supervision Act (SISA), the ATO disqualified Gordon Merchant as a director of the corporate trustee of the SMSF due to several serious contraventions including the requirement to comply with operating standards under section 34 of the SISA, in particular, to give effect to the investment strategy," Burgess said.

"He also failed the sole purpose rule in section 62 of the SISA and section 65 by using the resources of the SMSF to give financial assistance to a member of the fund or relatives. Interestingly, on review, the ATO did consider Merchant to be a fit and proper person despite the above breaches."

Burgess said regarding the investment strategy, the court documents indicated Merchant was not disqualified because firstly the Superannuation Industry (Supervision) Act (SISA) and Superannuation (Industry) Supervision

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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 certain matters.

“It stated that 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,” he said.

He said the court continued that 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.

“In this case, the SMSF failed to give effect to its investment strategy, given firstly that the predominant reason for the acquisition was to crystallise a capital loss in the trust. Secondly, it stated that 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,” Burgess said.

“Furthermore, the stated objective of diversification in the investment strategy had not occurred, instead the purchase led to the SMSF holding 74.4 per cent 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 per cent across multiple companies.”

Burgess continued that regarding the sole purpose test and financial assistance, the facts of the case showed that 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 breach of not just the sole purpose test under section 62(1) of the SISA (given neither of the above purposes was a core purpose) but also the prohibition on providing financial assistance under section 65(1)(b) of the SISA which is not limited to financial assistance of a direct nature,” he said.

“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.”

Burgess said despite the clear breaches, the tribunal confirmed Merchant should not be disqualified, noting that the ATO had concluded that he was a fit and proper person and at no time had his advisers suggested that the improper transaction risked breaching the provisions of the SISA.

“While EY had advised there were tax risks, this was not relevant to the question of disqualification,” Burgess said.

“The tribunal also said 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.”

The ruling continued that appropriate and reasonable undertakings had been given by the member, which mitigated the risk of future non-compliance and 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.

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“It stated that 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 superannuation fund and there was no need to protect the member from himself,” Burgess said.