SMSFAdviser

# SMSF disputes: Control issues advisers must address

***By Keeli Cambourne, Deputy Editor, SMSF Adviser and Matthew Burgess, Director, View Legal***

**SMSF control disputes are rarely solved by one "clever clause", and advisers should consider a combination of strategies to help mitigate any challenges, Matthew Burgess, director of View Legal, said.**

Burgess said implementing a combination of careful member selection, tailored governing rules, corporate control planning, dispute resolution pathways, informed consent and exit strategy design can go a long way in ensuring that if any disputes do occur, their impact can be lessened.

"For SMSFs, trustee decision making can be difficult, given the fundamental trustee-member nexus, namely that, subject to limited exceptions, members must also be trustees or directors of the corporate trustee," Burgess said.

"The conservative approach for SMSFs is easily stated: only admit members where there is a high level of confidence that they are commercially minded, aligned on purpose and likely to discharge their trustee duties responsibly."

However, he said in recent years where SMSFs have been able to have up to six members, advisers are increasingly asked whether there are practical ways to reduce the risk of deadlock, dysfunction or court intervention.

He continued that the decision in Notaras v Notaras [2012] NSWSC 947 is a good example of what can go wrong.

The case involved two brothers who were the only members and trustees of an SMSF. The court ultimately removed one brother and appointed a company controlled by the applicant brother as co-trustee.

"While fact-specific, the case remains a useful reminder that once SMSF relationships break down, the pathway back to orderly governance can be expensive, uncertain and imperfect," Burgess said.

"In this context, it is becoming increasingly relevant to consider the various approaches available for SMSFs to reduce the prospects of needing to apply to court in the event of dispute."

Strategies can be implemented

One of those, Burgess said, is proportionate voting, under which each individual trustee's voting rights are linked to their member balance as a proportion of total member interests.

"While this approach may provide a practical day-to-day decision-making mechanism, if there is a desire to use the approach to force out a trustee it is unlikely to be helpful because the party being exited will generally need to cooperate, including in relation to any member benefit rollover or exit process," he said.

Another strategy is to implement a principal, guardian or appointor role that can be used to allow a nominated party to remove or appoint trustees.

"However, the practical utility of this style of power can be limited. In particular, removing a person as trustee does not, of itself, necessarily solve the separate issue of dealing with that person's member interest. Regulation 6.28 is also relevant where member benefits are to be rolled over, given the consent requirements that generally apply," Burgess warned.

“Mandated dispute resolution via mediation can also provide a framework for avoiding a court application. However, where the SMSF dispute is merely one aspect of a wider conflict – for example a matrimonial breakdown, family provision dispute or business separation – compulsory mediation may have limited practical value unless the broader dispute is also being addressed.”

Burgess continued that trustees and advisers could also consider bespoke trustee company shareholder arrangements.

“Where an SMSF has a corporate trustee, the superannuation rules focus on the composition of the directors, rather than prescribing who must own the shares in the trustee company,” he said.

“There are therefore a number of share-related strategies available to regulate management and control of the trustee company and, indirectly, the SMSF. For example, there is significant flexibility as to who the shareholders of the company are and how shareholder decisions are to be made. The rights attaching to shares can also be tailored to hardwire desired outcomes.”

However, he said, share control is not the same as member removal and share-related strategies cannot, by themselves, safely be assumed to force a member out of the SMSF or compel a rollover of that member’s benefits without addressing the separate member consent and superannuation law issues.

Another method of supporting more amicable dispute resolutions, Burgess said, is to include an irrevocable, conditional or unilaterally removable member (URM) structure, which can reduce the risk of unresolvable member disputes.

“Under this model, on admission to an SMSF, the relevant member receives membership rights that are modified from what would otherwise apply to a full member. The URM may pre-sign documents intended to facilitate their future exit from the fund, including consent-related documents,” he said.

“The SMSF trust deed is tailored to empower the founder trustee with the right to remove the URM as trustee if specified triggering events occur, or otherwise at the founder trustee’s discretion. The founder’s rights may also include the ability to cause the URM’s interest in the SMSF to be transferred out of the SMSF.”

He added this approach may be attractive where children, wider family members or second spouses are being admitted to a founder’s SMSF.

“Understandably, many potential members may resist being admitted on anything less than full member terms. They may instead prefer to establish their own SMSF or retain their superannuation entitlements in an industry, retail or other non-SMSF fund,” he noted.

Along the same lines as a URM is the traditional power of attorney, where the relevant member retains full membership rights, but appoints another trustee as their attorney for the purpose of signing documents required to remove them as trustee and member and roll their member benefits to another complying superannuation fund.

“Again, this approach can be commercially sensitive. A member may be reluctant to grant another person such extensive authority over their SMSF benefits, particularly where the power could be exercised during a relationship breakdown or wider family dispute,” Burgess said.

Finally, Burgess said a founder member exit strategy can also be implemented where documentation can instead provide the founding member the right to cease involvement with the SMSF.

“That is, a ‘flipping’ of the URM strategy to instead create the right for the founder member to exit if the SMSF becomes dysfunctional,” he said.

“This approach can be a more palatable model in some cases, because it focuses on preserving the founder’s ability to leave the fund, rather than forcing another member out.”

Burgess added that with any of these approaches, particularly the URM and power of attorney pathways, the relevant member should obtain independent advice before signing the implementation documents.

“Without this, there is a risk that the arrangements may be vulnerable to challenge, including on grounds such as lack of informed consent, unconscionability, breach of fiduciary duty, improper purpose or inconsistency with superannuation law,” he said.

“Furthermore, each of the above approaches, would need to consider the potentially adverse tax, duty and liquidity consequences of funding the payment or rollover of the exiting member’s benefits to a new fund.”