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SMSF membership rules overlooked

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SMSF trustees and auditors are being caught out by state-based rules on who can be part of a multi-member fund.

SMSF practitioners and trustees are overlooking rules related to the operation of a trust where a fund has more than four members and conflating the roles they hold in those circumstances, a specialist lawyer has noted.

View Legal director Matthew Burgess said he was seeing more SMSFs and auditors failing to comply with state-based limits on who could be a trustee.

"What am I talking about? I'm talking about this idea that, in relation to individual trustees, most states have a hard limit of four trustees of an SMSF," Burgess said during a presentation hosted by The Auditor's Institute today.

"What that means is if we put a fifth member into the fund and we purport to have them as the fifth trustee, the trusteeship is in fact invalid in that scenario.

"It usually starts with the client. It then gets missed by the accountant and then potentially gets missed by the auditor.

"If it does get caught up, not only do you have a potential breach on your hands, but you have also the potential invalidity of every decision, every acquisition, everything that has been done by the fund since the breach initially occurred."

He pointed out corporate trustees, which are often highlighted by legal experts in the sector, were the easiest workaround for this problem.

"This is another example as to why they are so important because with a corporate trustee it doesn't become an issue in terms of number of trustees because you've only got one trustee," he said.

"The beauty is, from an Australian Securities and Investments Commission perspective and from a *Corporations Law* perspective, you can have an unlimited number of directors and that gets around that prohibition at law.

"There's a whole range of other reasons as to why a corporate trustee is a sensational idea on first principles, but this is another one to add to your list in relation to any fund that has five or six individual members."

However, he noted SMSFs should not use a corporate trustee to add an excessive number of directors, given each of them will also be a member of the fund.

"If every member is a director, then how many trustees do we need to have in the SMSF?" he said.

"This is a very important question because you have a company that is the corporate trustee and under the state law test that is only one trustee and you can have an unlimited number of directors.

"That's fine for me to say, but you can actually only have six directors because you can only have six members when we're talking about an SMSF."