

LOSING CAPACITY IN AN SMSF – EFFECTIVE PLANNING STRATEGIES

Sooner, rather than later, members of Self Managed Superannuation Funds (SMSFs) should take steps to ensure their SMSF can continue to function should they suffer diminished capacity

In this article, we consider options available to members of SMSFs to plan for a possible loss of capacity, and documents to be put in place to cater for that possibility.

Loss of capacity

A loss of capacity of a member of a superannuation fund can occur for a variety of reasons, including:

- illness;
- accident; or
- ageing.

SMSF members are reflective of the population in general and, accordingly, a proportion of members will suffer occurrences which cause them to lose capacity either in part or in full, and either temporarily or permanently.

As it is generally not possible to anticipate who will or will not suffer such loss of capacity, planning for that eventuality is an important exercise for **all** SMSF members.

In attending to that planning, individuals should consider who will act as trustee of the SMSF in their place, should they lose the capacity to act themselves, either for a short period of time or for a longer duration.

Rules for Self Managed Superannuation Funds

The basic rule for members and trustees of a SMSF, generally referred to as the trustee/member rule, is that:

- if the trustees of the fund are individuals, then each individual trustee of the fund must be a member of the fund;
- if the trustee of the fund is a company (corporate trustee), each director of the company must be a member of the fund; and
- conversely, each member of the fund must either be an individual trustee of the fund or a director of the corporate trustee.

However, there are some exceptions to those rules which apply in different circumstances. For example, if the SMSF has only one member, the rule changes slightly and the requirements are:

- if the fund has individual trustees, then the member and one other person must be the trustees; or
- if the fund has a corporate trustee, either:
 - the member must be the sole director of the company; or

- the member and one other person can be directors of the company.

Further exceptions to those rules apply in other circumstances. One of those circumstances is the loss of capacity of an individual who is a member of a SMSF and, by virtue of the rules outlined above, is either a trustee of the SMSF or director of the corporate trustee.

Legal Personal Representative

The Legal Personal Representative of an individual is permitted to act in place of the member, either as a trustee of the SMSF or director of the corporate trustee, if that person is either:

- holding an Enduring Power of Attorney granted by the member; or
- for minors, the parent or guardian of the child.

To comply with the trustee/member rules, the member must cease as the trustee or director, and be replaced by their attorney (or attorneys, if more than one) appointed under an Enduring Power of Attorney.

Enduring Power of Attorney

An Enduring Power of Attorney is a document which provides for the

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appointment of one or more persons to effectively ‘stand in the shoes’ of the person who has granted the Enduring Power of Attorney, generally referred to as the ‘donor’.

Providing power to a trusted relative, friend or adviser to act as the attorney goes part of the way to ensuring that the SMSF can continue to operate, regardless of the health of the member.

It is possible to appoint an attorney under a limited Enduring Power of Attorney which provides:

- only for the person to act as a trustee or director of the SMSF in place of the member; or
- with unlimited powers; or
- with powers set somewhere in between.

Each state or territory has specific rules concerning Enduring Powers of Attorney, some of which are considered later in this paper.

Options regarding continuity of an SMSF

What options are available when an individual decides they no longer wish to continue as trustee of a SMSF, or when they have suffered an event which causes a loss of capacity?

Some of the available options include:

- withdraw their benefits from the SMSF;
- transfer their benefits to a large (public offer) superannuation fund;

- continue the SMSF, with the member replaced as trustee by their attorney; or
- transfer the trustee responsibility for the fund to a professional trustee.

However, if the member has lost capacity, they may not be in a position to attend to any of the possible options. That is one reason why having an Enduring Power of Attorney in place for each member of an SMSF before they lose capacity is vitally important.

SMSF trustee

Another important consideration is the type of trustee of the SMSF; whether the members are individual trustees or whether they are directors of the corporate trustee.

When a member loses capacity and changes need to be made to the trustee structure of the SMSF, the difference between individual trustees and a corporate trustee can be quite significant.

Two major issues which impact the process at the time the need arises to replace a member who has lost capacity are:

- the directions provided to the trustees via the trust deed of the fund, particularly in regards to the appointment and removal of trustees; and
- whether or not the member has appointed an Enduring Power of Attorney.

The type of trustee of the SMSF either complicates or eases the process, depending on the powers contained in the trust deed and the position regarding the appointment of an Enduring Power of Attorney.

Trust Deed

The trust deed of a SMSF provides guidance and instructions to the trustee concerning the operation of the SMSF.

In addition to matters such as the appointment and removal of trustees, whether one or more people holding an Enduring Power of Attorney may act as trustee in place of the member is also an important ingredient in a well drafted SMSF trust deed.

If the trust deed is not sufficiently flexible to allow this, where the SMSF has individual trustees, the attorney may not be able to be added as a trustee in place of the member, limiting the continuity options referred to above.

Alternatively, if the SMSF has a corporate trustee, the process is much simpler. The attorney would be appointed as a director of the company.

As the company (not individuals) is the trustee, there is little reference needed to the trust deed of the fund. What must be checked is whether the provisions of the deed require adherence to the basic trustee/member rules mentioned previously, or whether the deed

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includes the permitted exceptions, so that an attorney may act as a director of the corporate trustee in place of the member.

Corporate v Individual Trustees

There are many reasons why a SMSF should have a corporate trustee in preference to individual trustees.

One of those reasons - a simpler process to appoint and remove a director than removing and appointing a new trustee - has been covered above.

Some other, very important reasons, include:

- registration of investments of the fund. As the investments must be recorded in the name of the trustees, any change of individual trustee will require each of the SMSFs investments to be re-registered in the names of the ongoing and new trustees. On the other hand, investments in the name of a corporate trustee will remain so registered, regardless of the change of directors of the company; and
- the process to replace a member who has lost capacity differs according to:
 - whether the trustee comprises individuals or is a corporate entity; and
 - whether an individual has actually been appointed under an Enduring Power of Attorney.

Individual trustees

As mentioned above, whether or not the member has appointed an attorney will determine, to some extent at least, if the option of having the attorney replace the member as a trustee is feasible; as detailed below:

Enduring Power of Attorney in place

Subject to the provisions of the trust deed permitting the replacement of the trustee with the attorney:

- the member is removed as a trustee by the other members; and
- the attorney is appointed as trustee in place of the outgoing trustee.

The assets of the fund will need to be re-registered in the names of all trustees, to reflect the changed trusteeship.

No Enduring Power of Attorney

After the member has lost capacity, it will generally be too late for them to appoint an Enduring Power of Attorney.

Although the remaining members may have power to remove the person as a trustee, there will not be a replacement to be appointed. The state may appoint an Administrator or Guardian - possibly a relative or else a statutory body such as the Public Trustee - to represent the individual.

Provided the trust deed of the fund permits, the state appointed Administrator or Guardian **may** be able to be appointed in place of the outgoing trustee, although that will

be subject to the provisions of the deed.

If the Administrator or Guardian is not permitted under the trust deed to be appointed, the remaining trustees would need to consider the other options covered earlier, including paying the benefits to the member or to another superannuation fund.

Regardless, the assets of the fund will need to be re-registered to reflect the changed trusteeship.

Corporate trustee

Once again, whether or not the member has appointed an Enduring Power of Attorney will impact the complexity involved in removing the member as a director of the corporate trustee, as follows:

Enduring Power of Attorney in place

The attorney, in this instance, will usually be able to:

- be appointed as an additional director of the company; and
- on behalf of the donor, complete correspondence to have them resign as a director (an individual's directorship usually ceases once they lose capacity, meaning that step may be a formality).

The assets of the fund will not need to be re-registered, as the company will remain as trustee.

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usually too late for them to appoint an Enduring Power of Attorney.

If the state or territory has appointed an Administrator or Guardian, then that person (or a representative if a company) could be appointed as a director.

Failing that, the other directors will have a responsibility to ensure the SMSF meets the trustee/member rules, so they will need to decide what action they will take regarding the member's benefit in the SMSF.

State or Territory issues

Although superannuation operates under federal legislation, the rules concerning the appointment of an attorney differ from one state or territory to another.

Enduring Powers of Attorney created under the provisions of one jurisdiction are generally accepted another jurisdiction. However, for a person relocating to a jurisdiction different to the one in which an Enduring Power of Attorney was initially prepared, it would generally be best practice to prepare a new Enduring Power of Attorney under the laws of the jurisdiction of residency.

Is retaining the SMSF the best option?

Earlier in this paper, various options were canvassed in regards to dealing with the superannuation benefits of a member who finds that their capacity has diminished.

Basically, the best option will be determined on an individual basis, after considering both their circumstances and the investments held in the SMSF.

For some people, that may be time to consider withdrawing their benefits from superannuation. For others, that may not be an appropriate decision, for a variety of reasons as diverse as:

- for Centrelink reasons, as their social security benefits may be impacted by the amount withdrawn from superannuation; or
- for estate planning reasons, it may be imperative that their superannuation money does not become part of their estate.

Conclusion

Every individual's circumstances will be different and, thankfully, not all members of a SMSF will find themselves in a position of diminished capacity, either for a short term or longer.

Despite that, some plans which all individuals can implement, **sooner rather than later**, to provide for that eventuality are:

- appointing trusted individual(s) under an Enduring Power of Attorney;
- ensuring the trust deed of the SMSF is current and is flexible enough to permit the appointment of one or more attorneys in place of the

member in their capacity as trustee; and

- if not already in place, change the trustee of the SMSF to a corporate entity.

Attending to those steps will pave the way for a smoother transition, whatever the individual circumstances may dictate.

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