



finance wise

SMSF STRATEGIES SPECIALIST SMSF ADVISER TRAINING

Module 4 – The Trust Deed (The Heart of the Fund)



MODULE 4 OVERVIEW

- ❖ The Trust Deed
- ❖ Trust Deed Compliance and Documentation
- ❖ Varying the Deed



PREVIEW OF MODULE 4

QUIZ QUESTIONS (MULTIPLE CHOICE ANSWERS)

- ❖ A 2003 SMSF Trust Deed provides for an allocated pension only. This means that ...
- ❖ A relevant section where a trustee or adviser cannot breach the governing rules of a fund is ...
- ❖ What case highlighted the ability to recover against a breach of section 55(1)?
- ❖ A Member under the SMSF Strategies trust deed ...
- ❖ Under the 2003 trust deed that was reviewed by Grant in the training video, the variation clause to vary the deed ...

AN SMSF IS A TRUST GOVERNED BY A DEED

- SMSF is a Trust (s. 19), therefore Trust Laws apply
- Key objectives:
 - Concessional taxation guaranteed
 - Compliance with Corporations Act, SIS Act, Tax Act
 - Longevity for future generations
 - Litigation protection
- Important to combine
 - administrative simplicity
 - great flexibility
 - powerful options

AN ILLUSTRATION: SIMPLER SUPER AND ESTATE PLANNING

Why is a flexible deed important? Let's look at an example. Simpler Super has opened up new tax and estate planning opportunities:

- Mandatory cashing (lump sum or pension) at retirement age abolished
- SMSF is a tax-advantaged asset accumulation vehicle
 - 15% tax on earnings, 33.3% discount for capital gain
- SMSF borrowing has opened up new options for structuring investments
- Maximise the amount of super to allow capital preservation in the new Retirement Accumulation Account
- Pension drawdowns tailored to lifestyle needs only
- An on-shore Retiree Tax Haven – use for estate planning!



EXAMPLE: HOW MUCH INCOME DO YOU REALLY NEED?

Other facts:

- own their home
- holiday home rented at peak times to cover all costs
- \$1m in commercial property (outside the fund, held jointly) paying \$60,000 pa rent with tenants paying for all costs except repairs
- new 7 series BMW
- increasing health needs, but ...
- cash in the bank for emergencies, balance is growing every year

SMSF facts:

- SMSF with two members, husband and wife
- 2 properties (\$1.8m), managed fund (\$640,000) since 2007
- 6.7% yield = \$122,000 tax-free
- Max pension = ? Min Pension = 5%



EXAMPLE: HOW MUCH INCOME DO YOU REALLY NEED?

Tax and estate planning strategy:

- Match pension to lifestyle needs, while continuing to build wealth in a tax-advantaged vehicle – SMSF
- Roll back some or all of pensions into accumulation account

Consequences

- Pay 15% on fund earnings attributable to accumulation account
- Tax rate if they sell a property?

Earning \$122k, which will push them into the 32.5% + 2% bracket

Enough cash and assets – too much income?

BUT TO MAKE THIS WORK ...

The trust deed of the fund must include the following rules:



1. No mandatory cashing rule at age 65 or at any time.
2. Trustee of the fund must allow members to use their superannuation benefits for SMSF estate planning purposes.
3. Members must be allowed to roll back one or more of their pensions.
4. Creation of one or more pensions, including pensions with a tax-free component.
5. Creation of general and pension reserves.
6. Segregation of assets between pension and accumulation accounts.
7. Switching of assets between pension and accumulation accounts in conjunction with any pension roll-back.

S55(1) – LITTLE KNOWN BUT ALL-IMPORTANT



A person must not contravene a covenant contained, or taken to be contained, in the governing rules of a superannuation entity. 55(1)

Governing rules defined: Any rules contained in a trust instrument, other document or legislation . . . any unwritten rules governing the establishment or operation of the scheme or trust. 10(1)

Note:

- A breach of the governing rules is not in itself an offence against legislation
- A breach does not render a transaction invalid
- However, a person who suffers loss or damage may recover it by legal action against any person involved in the contravention

DUNSTONE VS IRVING: BACKGROUND

- Case highlighted ability of a member to recover from the trustee against a breach of the governing rules s55(1)

Facts:

- Dunstone (60) and Irving (47) jointly operated a construction and development business in Geelong for 16 years
- Drew equal salaries, shared the management
- Set up a shared SMSF primarily for tax purposes – all assets were held in cash
- Contributions were made approximately 2:1 in favour of Dunstone to maximise the tax deduction (taking into account RBLs)
- Set up a unit trust to access the SMSF cash, which was used as working capital to fund three profitable developments
- By 1997 the balance was \$2.1 million = \$1.37 million (Dunstone) + \$730k (Irving)

DUNSTONE VS IRVING: DISPUTE

- Dunstone left the business in 1997 (aged 57) to pursue other business interests, wanted to roll over his entitlements into another SMSF
- Claimed an ETP of \$1.37 million, based on his annual member statements
- Irving refused to pay out Dunstone's share of the business (50%)
- Also claimed that the SMSF balance should be divided equally, and that allowance should also be made for any tax liabilities from the development activity
- Refused to pay out any SMSF monies until this was agreed; so Dunstone sued
- Case reached court in 2000 (3 years after Dunstone left the business)



DUNSTONE VS IRVING: RULING

- Judge relied entirely on the trust deed
- Accepted expert evidence that the fund had always operated lawfully
- Rejected defendant's case about the existence of an equalisation agreement with respect to the SMSF balances
- Ordered Irving to pay out Dunstone's full balance within 30 days, with an additional \$250,000 to make up for lost earnings

! WOOSTER VS MORRIS: BEFORE THE DEATH OF MR MORRIS

Mr Morris had two daughters from a previous marriage (Mrs Wooster and Mrs Smoel) and a second Mrs Morris

Mr & Mrs Morris members and trustees of an SMSF

In 2008, Mr Morris executed a BDBN in favor of his daughters

Passed away Feb 2010 – daughters were executors of his will (LPRs)

Balance of his account \$924,509

He intended it to go to his daughters, but ...

! WOOSTER VS MORRIS: AFTER THE DEATH OF MR MORRIS

. . . an SMSF is a trust in its own right, not governed by the deceased's will and estate

Surviving trustee (Mrs Morris) appointed her son (former marriage) as co-trustee

Trusteeship changed to a corporate trustee, with Mrs Morris as sole director and shareholder

Exercised her discretion as trustee, found the BDBN to be non-binding, and paid all benefits to herself

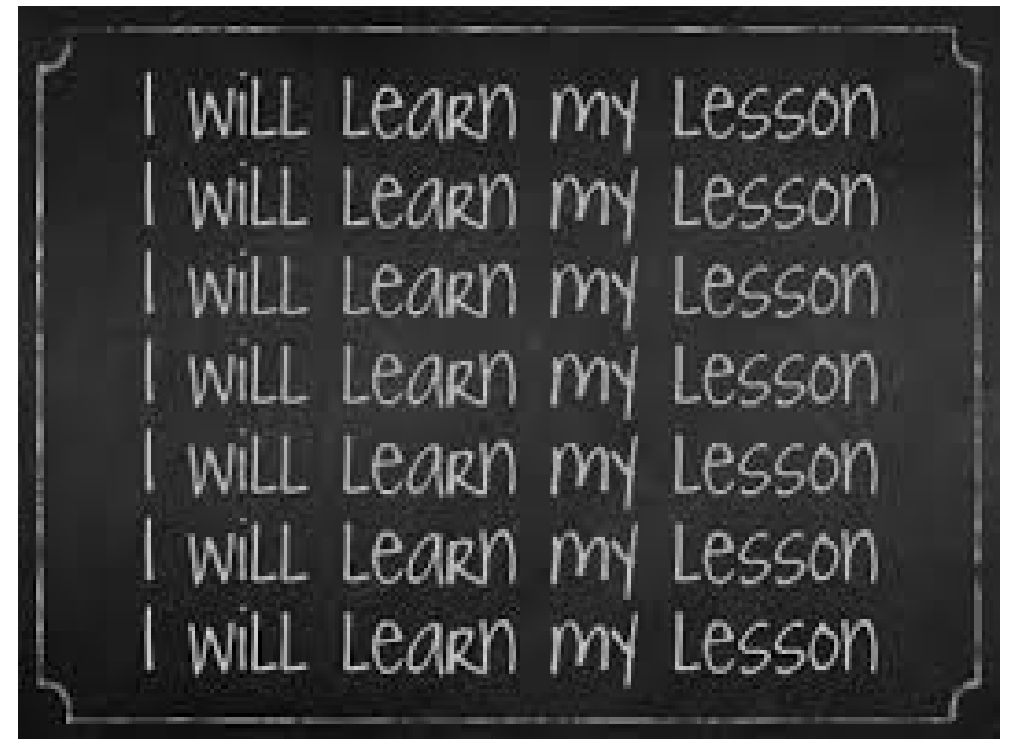
Court ruled for plaintiffs, but SMSF had to pay costs (\$346k), but all SMSF monies were available, including Mrs Morris's own contribution account

LESSONS FROM WOOSTER VS MORRIS

1. LPR does not automatically become the SMSF trustee
2. BDBNs are sound, but cannot prevent bad behaviour
3. Who holds the purse strings? Mrs Morris held them, and it took 3.5 years to cut them

If the Deed allows it, the LPR can become the trustee and even a member (as per SMSF Strategies Trust Deed)

Refer to fwgs blog 16th Nov 2015



UPDATING TRUST DEEDS

Why don't Trust Deeds last forever?

Continual changes in:


- SMSF regulations
- Taxation law
- Family law
- Social security and aged care law
- Estate law
- Family relationships

Best practice: review and update as necessary –

- Every 3 years
- When borrowing
- When adding members

NowInfinity automatically reviews and updates deeds every June

AMENDING 2003 DEED

- Refer to Video (@48 minute mark)
 - Who can be a member
 - Can a TRIS be paid
 - How can trustees be removed and a corporate trustee appointed
 - What reserving strategies are allowed
 - Contributions
 - Variation Rule 12.8 
 - Mandatory cashing
 - Membership cessation
 - Upgrading is a legal process

VIDEO – SETTING UP SMSF

[Http://goo.gl/tefpY](http://goo.gl/tefpY) - setting up a SMSF to last for 100 years (7 minutes)

finance wise



PREVIEW OF MODULE 4

QUIZ QUESTIONS (MULTIPLE CHOICE ANSWERS)

- ❖ A 2003 SMSF Trust Deed provides for an allocated pension only. This means that ...
- ❖ A relevant section where a trustee or adviser cannot breach the governing rules of a fund is ...
- ❖ What case highlighted the ability to recover against a breach of section 55(1)?
- ❖ A Member under the SMSF Strategies trust deed ...
- ❖ Under the 2003 trust deed that was reviewed by Grant in the training video, the variation clause to vary the deed ...



QUIZ TIME

- Go online
- Take the Module 4 Assessment
- Ask us if you have any queries
- You will have TWO opportunities to take the quiz

finance wise