

Six member SMSFs — important trap hinted at by the Senate Economics Legislation Committee

[DBA dbalawyers.com.au/smsf-deeds/six-member-smsfs-important-trap-hinted-at-by-the-senate-economics-legislation-committee](http://dbalawyers.com.au/smsf-deeds/six-member-smsfs-important-trap-hinted-at-by-the-senate-economics-legislation-committee)

23/11/2020

When considering six member SMSFs, the Senate Economics Legislation Committee has hinted at an important trap that advisers must remember.



Background

On 27 April 2018 the then Minister for Revenue and Financial Services Kelly O'Dwyer MP announced that the government would expand the limit on the maximum number of members in SMSFs from four to six. In Minister O'Dwyer's media release, she was quoted as describing the purpose of the change as follows:

The change will allow for greater flexibility and, given the growth in the sector to date, will ensure SMSFs remain compelling retirement savings vehicles into the future.

The next month, the Federal government released the 2018-19 Budget. The Budget confirmed this change, stating:

The Government will increase the maximum number of allowable members in new and existing self-managed superannuation funds and small APRA funds from four to six, from 1 July 2019. This will provide greater flexibility for joint management of retirement savings, in particular for large families.

This will provide greater flexibility for joint management of retirement savings, in particular for large families.

However, the measure then languished until earlier this year when the Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020 was introduced. The explanatory memorandum described the change as follows:

Increasing the allowable size of these funds increases choice and flexibility for members. SMSFs are often used by families as a vehicle for controlling their own superannuation savings and investment strategies. For families with more than four members, currently the only real options are to create two SMSFs (which would incur extra costs) or place their superannuation in a large fund. This change will help large families to include all their family members in their SMSF.

The Senate referred the Bill to the Economics Legislation Committee. Earlier this month, the committee delivered its report. The full text of the report is available at https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLAB/SMSF/Report

The committee found that:

The changes provide families managing joint superannuation funds with greater control and reduced costs, which in turn will increase the need for greater financial literacy and accountability to effectively manage those investments as trustees. The committee is broadly supportive of measures that increase individuals' engagement with their retirement saving and encourage improved financial literacy.

Accordingly, the committee recommended that the Bill be passed. Presumably it will be passed soon.

Trap hinted at by the Senate Economics Legislation Committee

However, the committee did hint at a trap.

The committee's report summarised the various submissions the committee received. Some of those submissions referred to common problems with increased membership such as the 'ability for majority of members to override the wishes of the minority'. Furthermore, there were dissenting senators who wished for the Bill to not be passed. Those dissenting senators made several unsuccessful recommendations, including the following:

Given the potential for increased conflict in the effective governance of SMSFs by trustees, especially if they are family members, the government should ensure a minimum standard of protections are in place for each member of the SMSF, especially with regard to mandatory education and dispute resolution to balance the interests of the increase in the numbers of trustees and members.

Again, the above recommendation was unsuccessful. However, there already is an important minimum standard of protection that already exists. It is already important in a three or four member SMSF (and sometimes even in a two member SMSF). It will be even more important in any future five or six member SMSFs.

Namely, under reg 6.29 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('SISR'), 'a member's benefits in a fund must not be transferred from the fund unless: (a) the member has given to the trustee the member's consent to the transfer ...'

'Consent' in this context means written consent (SISR reg 6.27B).

There are limited exceptions to this rule, such as if implementing a successor fund transfer. However, for technical reasons, successor fund transfers are not broadly possible in respect of SMSFs.

Therefore, if admitting additional members to an SMSF, one must remember that members cannot later be rolled out unless the member has first given to the trustee the member's consent to the transfer. This is the case regardless of how small or seemingly insignificant a member's balance might be.

Case study

Consider, for example, Charles and Alexandra. They admit their children into their SMSF because Charles and Alexandra feel that:

- the SMSF's fees (as a percentage of total assets) are very low and very transparent; and
- it will be a good way for their children to gain practical 'hands on' financial management experience.

Initially all goes well. However, after several years, there is an estrangement in respect of one child. That child then relishes the power he has as a member (and therefore as a trustee) of the fund. He insists on being invited to trustee meetings, only to then veto each vote and slow down all matters concerning the fund.

The other trustees — who incidentally have 99% of the member balances — soon become fed up. They wish to roll that child out.

However, reg 6.29 effectively prohibits this.

Solutions

Several potential solutions exist.

One potential solution is as follows. Before Charles and Alexandra admit their children to the SMSF, they arrange for 'conditional membership' documentation to be prepared. Essentially, this involves the new members providing — upon admission of membership — their consent to be rolled out upon certain contingent events occurring. One such contingent event is that member(s) with the majority account balance determine that the conditional member should leave.

Conclusion

The Senate Economics Legislation Committee's report in respect of six member SMSFs has hinted at an important trap. Namely, it alludes to the potential for disputes within an SMSF as well as minimum standards of protection. One existing protection is the prohibition on transferring a member's benefits out of a superannuation fund unless that member's written consent is first received. This is an issue whenever admitting new members to an SMSF. There are a number of potential solutions, such as admitting the new member as a conditional member.

DBA Lawyers can assist in drafting conditional member documentation. See <https://www.dbalawyers.com.au/admit-conditional-member/>

Related articles

[Six member SMSFs -- the pros and cons](#)

[Admit a conditional member](#)

[An adviser's guide to SMSF deeds](#)

[Why should you order trusts from DBA Lawyers?](#)

* * *

This article is for general information only and should not be relied upon without first seeking advice from an appropriately qualified professional.

By Bryce Figot, Special Counsel (bfigot@dbalawyers.com.au) and Daniel Butler, Director (dbutler@dbalawyers.com.au), DBA Lawyers

18 November 2020

Download date: 30/03/2021 Copyright © DBA Lawyers Pty Ltd.

Any information provided on this website (including any blog posts) are mere summaries and general information provided for educational purposes only. This is no substitute for expert advice. Anyone seeking to rely on this content should obtain expert advice to confirm particular issues especially as the law is subject to ongoing changes and substantial penalties can be imposed.

As a law firm DBA Lawyers Pty Ltd is not licensed to give financial product advice under the *Corporations Act 2001* (Cth).