



**Christian Pakpahan, DBA Lawyers**

Christian has worked at leading SMSF law firm DBA Lawyers since June 2017. Prior to becoming a lawyer, Christian worked in banking and finance, particularly in collateral management, equities research and financial journalis



**Daniel Butler, DBA Lawyers**

Dan is one of Australia's leading SMSF lawyers and has worked predominantly in the SMSF, tax and related fields for over 32 years. He is a presenter at Melbourne University's Master of Tax program on the taxation of superannuation and is also a specialist SMSF advisor with the SMSF Association.

# WHAT DISQUALIFIES YOU FROM HAVING AN SMSF?

Christian Pakpahan and Daniel Butler

**T**his article covers the main ways a person becomes a disqualified person, the consequences of disqualification and the options available to those who are disqualified. (We refer to a trustee in this article as covering both individual trustees of an SMSF and directors of SMSF corporate trustees.)

The ATO will use its powers to render an SMSF trustee a disqualified person where it sees the need, especially for illegal early access breaches. There are other ways a person may become disqualified and some people may not even realise they are disqualified. Acting as an SMSF trustee while disqualified has serious ramifications. It is therefore prudent to be aware of which trustees are or may be disqualified and how a trustee may become disqualified.

## Have you ever been convicted of an offence involving dishonest conduct?

The first way a person can be a disqualified person is if they were ever convicted of an offence involving dishonest conduct. This is regardless of whether the conviction was in Australia or a foreign country.

Whether an offence is 'in respect of dishonest conduct' is not defined. However, explanatory material to the legislation includes an example of a person convicted of a minor shoplifting offence 20 years

ago as an example of an offence involving dishonesty that would disqualify a person. On the other hand, arguably a person convicted of assault is not disqualified, since there is no dishonest intent.

Generally a person who is convicted of an offence involving dishonest conduct is a disqualified person for life. An exception to this rule exists that allows the ATO to waive a person's disqualified status. Such an application must be made within 14 days of the conviction. Accordingly, a person who anticipates a conviction must act very quickly.

An application outside of this 14 day period may be considered if the ATO is satisfied that there are 'exceptional circumstances' that prevented the application from being made within time. Also, a waiver can only apply if the offence did not involve serious dishonest conduct where the penalty is no more than two years' imprisonment or a fine no greater than a specified amount (e.g. 120 penalty units).

## Are you a person that is subject to a civil penalty order?

The second way a person can become disqualified is if a civil penalty order was made against them. Civil penalties are broadly punitive sanctions imposed by the government as restitution for wrongdoing that are imposed through civil procedure rather than criminal process. Civil penalties are typically codified in legislation. Some of the specific civil penalty provisions relating to superannuation are outlined in s 193 of the *Superannuation Industry (Supervision) Act 1993* (Cth) ('SISA'), which include:



### The quote

*If a disqualified person knows they are disqualified and continues to act as an SMSF trustee, they will be committing an offence with substantial criminal and civil penalties.*

| Section | Description  |
|---------|--|
| 62(1)   | Sole purpose test  |
| 65(1)   | Prohibition on lending to members  |
| 67(1)   | Borrowing restrictions   |
| 68B(1)  | Promotion of illegal early release schemes   |
| 84(1)   | Compliance of in-house asset rules   |
| 85(1)   | Prohibition of in-house asset rules avoidance schemes                                |
| 106(1)  | Duty to notify the Regulator of significant adverse events                           |
| 109(1)  | Investments of superannuation entity to be made and maintained on arm's length basis |
| 109(1A) | Dealing with another party not at arm's length                                       |

In addition to the above SISA provisions, a person may also be disqualified if they are subject to a civil penalty order under other legislation.

### Are you an undischarged bankrupt?

A person who is an undischarged bankrupt is also disqualified, including an undischarged under a foreign bankruptcy law. However, once a person's bankruptcy period ends, they will cease to be a disqualified person unless they are disqualified for other reasons.

### Are you disqualified by ATO action?

In FY2018 the ATO made 257 SMSF trustees from around 169 SMSFs disqualified. Most disqualifications related to illegal early release of money from SMSFs (around 70% of 169 funds).

Another method open to the ATO is to disqualify because of contraventions of the SISA. The ATO must take into account the nature or seriousness of the contraventions or the number of contraventions. This includes:

- The behaviour of the person in relation to the contravention,
- The extent to which a fund's assets were impacted by the contravention,
- The extent to which the fund's assets were exposed to financial risk,
- The number and extent of contraventions over a period of time,
- The nature of the contravention in the overall scheme of legislation, and
- Any future compliance risk.

The ATO can also disqualify if it is satisfied that a person is not a 'fit and proper person' to be a trustee. In regard to the fitness of a person, the ATO considers whether the person has the relevant skills to be an SMSF trustee having regard to, among other things, the person's competency and the responsibilities of an SMSF trustee as well as their ability to answer questions put by the ATO.

In regard to whether someone is a proper person to be an SMSF trustee, the ATO considers the person's

general behaviour, conduct, reputation and character. Factors that the ATO will consider in assessing this include, among other things, willingness to comply, proper independence in carrying out the role, whether they have been sanctioned by a professional or regulatory body, management of personal debts, integrity and involvement in entities which have been wound up. Naturally, a person who has outstanding tax debts with the ATO or who has been involved with phoenix company activity would not look good.

Disqualification under this limb can result in adverse public exposure. A person's disqualified status can easily be obtained from a web search. This adverse public exposure can have a serious adverse impact on a person's reputation, profession or business. We have had to assist numerous professional and business people who would have suffered considerable loss of business if they were disqualified.

### Consequences of being a disqualified person

If a disqualified person knows they are disqualified and continues to act as an SMSF trustee, they will be committing an offence with substantial criminal and civil penalties. Furthermore, it is also an offence for a disqualified person to be an SMSF trustee and not tell the ATO immediately in writing. A disqualified person must also immediately cease being a trustee. Company directors also have an obligation to notify ASIC.

On its website the ATO says that:

*"If you resign as a trustee your SMSF effectively has six months to restructure itself. Generally this will mean rolling your super interest out of the fund."*

Broadly, once an SMSF trustee ceases to act the SMSF has a maximum six month period to comply with the trustee-member rules before it ceases to be an SMSF. An SMSF member is required to be a trustee or a director of a corporate trustee to satisfy the definition of an SMSF. Once disqualified, the person can no longer be an SMSF trustee. The law also prevents the member's legal personal representative (e.g. a person appointed under an enduring power of attorney) from being a trustee in place of a disqualified person. So this may force the person to cease being a member of the SMSF unless another option is chosen.

### Options to a disqualified person remaining in an SMSF

Where a person is disqualified the two main options are to roll over the disqualified person's member benefits to a large (APRA) superannuation fund (e.g. an industry or public offer fund) or convert the SMSF into a small APRA fund by appointing an APRA approved trustee.

If the disqualified person has retired or attained 65 or satisfied another condition of release with a nil cashing restriction, they can also consider withdrawing all of their benefits from the SMSF. Corrective action must occur within six months of the trustee's disqualification.

**Conclusion**

The matter of disqualification should be monitored well before establishing an SMSF and continually monitored during its life. Advisers should include, for instance, a regular query to clients whether they have been disqualified for any of the above reasons. Clients are not always forthcoming about offences or other indiscretions they may have been guilty of over the years. **FS**