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INCAPACITY AND YOUR SMSF

As an SMSF member, you should consider the consequences that could arise if you are unable to act as trustee (e.g. due to mental incapacity). In this article, we highlight the problems that can arise and solutions available under the superannuation laws.

Incapacity and your SMSF

To qualify as an 'SMSF', one requirement is for all fund members to be trustee, or director of the corporate trustee (exceptions apply). If you become unable to act as trustee due to mental incapacity, your fund will cease to be an SMSF if you stay a member, unless either of the following people can act as SMSF trustee in your place:

- your enduring power of attorney; or
- the personal trustee appointed to act on your behalf whilst you are under a legal disability.

If neither of the above can be appointed as trustee, you generally have six months to remove yourself as a fund member (e.g. transfer to a retail fund).

However, this can create upheaval, because your SMSF may have to realise assets to facilitate the transfer of your superannuation balance. The forced sale of assets can lead to unintended tax consequences (e.g. capital gains tax). Further, if the SMSF has to sell a commercial property from which a related family business operates, this can create additional costs and disruptions for the business.

**EXAMPLE**—Henry and Rose are members and trustees of an SMSF. The fund owns a commercial property that is leased to their son, Jarrad, to conduct his trucking business. Henry becomes mentally incapacitated and unable to act as trustee. Unless arrangements are in place for a personal trustee or enduring power of attorney to stand in Henry's place, the property may have to be sold to allow Henry's balance to be transferred.

Enduring power of attorney

An 'enduring power of attorney' is a legal document allowing you to appoint someone else to make legal and financial decisions on your behalf, even if you lose mental capacity. To be valid, the enduring power of attorney must be granted whilst you still have mental capacity – it is too late after you become incapacitated. This is to ensure that you can understand the effect of granting this power.

A person to whom you have granted a valid enduring power of attorney can generally be appointed to act as SMSF trustee in your place. A person is not automatically appointed as trustee because they hold an enduring power of attorney – they must actually be appointed. Where such an appointment is made, incapacity should not force your superannuation balance to be transferred from your SMSF.

**INFO**—An attorney can only act as trustee for you if you have appointed them as an 'enduring power of attorney' – a general power of attorney is not sufficient because this power **ceases** if you become legally incapacitated. The grant of the enduring power of attorney must comply with State or Territory laws.

Bankruptcy

You cannot remain a member of an SMSF if you go bankrupt. That is, you **cannot** appoint an enduring power of attorney nor any other person to act as SMSF trustee on your behalf. In these circumstances, you will generally need to transfer your superannuation balance out of your SMSF.

**WARNING**—Due to the level of responsibility that an enduring power of attorney carries, it is wise to seek specialist advice before arranging for the appointment. Check your fund and company trustee rules (if applicable) for any requirements or restrictions applying to the appointment.



“Generally speaking, your SMSF can make repairs and improvements to a property held under a borrowing arrangement without breaching the borrowing rules.”

*“Property development activities such as subdividing the land or building a new house are generally not permitted under the borrowing rules.”*

## BORROWING ARRANGEMENTS AND PROPERTY

A number of SMSFs have entered into permitted borrowing arrangements to acquire assets, such as real estate. In this article, we highlight that your SMSF can undertake basic repairs and renovations to a property held under a borrowing arrangement. However, redeveloping the property is not permitted.

### Borrowing arrangements

SMSFs are generally not permitted to borrow money. Government policy behind this prohibition is aimed at ensuring your retirement income is not at risk from gearing assets.

However, as a limited exception, your SMSF is permitted to borrow to acquire an asset, such as real estate, on the basis that strict conditions are met, including: quarantining asset ownership in a separate holding trust, and ensuring that only a ‘single’ asset is held under the arrangement (other conditions apply).

Generally speaking, your SMSF can make repairs and improvements to a property held under a borrowing arrangement without breaching the borrowing rules.

**WARNING**—Property development activities such as subdividing the land or building a new house are generally not permitted under the borrowing rules. Further, refurbishing a property to change a residential property to a commercial property (or vice versa) are also likely to breach the rules.

**EXAMPLE**—Frances and John, as trustees of their SMSF purchased a residential property using a qualifying borrowing arrangement. Their SMSF wishes to refurbish the property into a clothing shop. According to the ATO, this change will breach the borrowing rules, and should not be undertaken whilst the borrowing remains in place.

The table outlines whether building works to a property held under a borrowing arrangement will breach the superannuation rules.

Building Work	Permitted?
Renovation – pergola built to add an outdoor area	Yes
Renovation – new kitchen	Yes
Subdividing the land	No
New house built on existing suburban land	No
Renovation – adding two bedrooms	Yes
Shop refurbished (still remains commercial)	Yes
Repair – replace guttering	Yes
Residential house changed to commercial use (e.g., a shop or doctor’s surgery)	No

**WARNING**—Broadly, your SMSF can use borrowed money to undertake repairs to a property subject to a borrowing arrangement. However, the superannuation laws do not allow your SMSF to use borrowings to improve the property – they must be paid for with other cash resources of the fund.

## UPDATE ON TAX REFORM

In March 2015, the Government started a review into Australia’s tax system. The Government is conducting this review because the cost of our tax system is higher than it needs to be.

Initially, the Government released a range of issues for discussion (also called the ‘White Paper’), on which it subsequently received input from businesses and ordinary Australians. The next phase involves the Government releasing a range of tax options (also referred to as the ‘Green Paper’). This is expected to be published next year.

In relation to superannuation, it is too early to tell what proposals (if any) the Government will put forward. However, in the discussion paper, the Government stated that the following issues were being considered:

- the different earnings rates applying to fund income in accumulation phase compared to pension phase; and
- whether the superannuation tax concessions are targeted appropriately.

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