

MCMAHON CLARKE LEGAL



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PRIVATE CLIENT

Your guide to wealth management, preservation
and protection for private clients

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PRIVATE CLIENT

Update of superannuation instalment warrants

Synopsis

The amendments to the SIS Act to allow borrowing by superannuation funds in certain circumstances became effective in September 2007. What have we learned in the (almost) 12 months since the changes were made?

Firstly, it is fair to say the take up has probably not been as rapid as some might have expected. No doubt this can, to a large extent, be attributed to the tightening of credit conditions and perhaps to a lesser extent on a general reluctance on the part of self managed superannuation funds (SMSFs) and their trustees and members to commit to a structure which requires them to increase their overall level of gearing. It has also taken some time for the major banks to develop a product which is suited to lending under the new structure although we are aware of a couple of the major banks that have now entered the market.

Despite the relatively slow take up, the opportunity to use debt in one's super fund has certainly attracted interest amongst trustees of SMSFs and certainly our firm has assisted a number of clients in implementing structures for their SMSFs.

ATO Taxpayer Alert TA2008/5

In terms of new information or guidance from the Australian Taxation Office (ATO) TA2008/5 provides some further insight into what the ATO considers are potential areas of concern for superannuation instalment products:


1. Arrangements where interest rates are not commercial. This is particularly relevant where the lender is not 'arms length'. That is, where a member of the SMSF acts as borrower. In these

cases particular care must be taken to ensure the rates charged are commercial. It is important to note the ATO will not tolerate interest rates that are both unrealistically high or low. Having said that, we have seen instances where margins on loans to fund instalment loans for SMSFs are above what might be charged to a traditional borrower and so the window that constitutes a 'commercial' arrangement in this context is probably wider than for traditional loans.

2. The ATO has also expressed concern about the ability to capitalise interest in loan agreements. TA2008/5 does not say this is not permitted, merely that interest which is capitalised may result in the arrangement failing to meet the requirement that the money borrowed is or has been applied for the *acquisition* of an asset. If a related party is providing the funding for the loan it is prudent to remove the ability to capitalise interest on the loan.
3. TA2008/5 also expresses concern about situations where a third party offers to guarantee the loan by the borrowing SMSF. The ATO's concern relates to the ability of the guarantor to recover any loss it suffers against the principal debtor (i.e., the SMSF). A fundamental requirement of super instalment warrant arrangements is that the assets of the SMSF (apart from the asset acquired with the funds borrowed) must not be available to repay any loan. The problem arises because most guarantee documents will include a right for the guarantor to recover against the principal debtor; in this case the SMSF. Therefore if the guarantor has guaranteed the full amount of the loan to the borrower (regardless of any limited recourse the borrower had against the SMSF), then the guarantor's right of recovery against the borrower (SMSF) will also be unlimited unless the guarantee is also of a limited recourse nature. SMSFs wishing to implement an instalment trust arrangement where third party guarantees are being offered must therefore ensure guarantees are appropriately worded.
4. Clients also need to be wary if attempting to use the instalment trust arrangements to fund anything other than the 'acquisition of an asset' in their SMSF. For example, would the arrangement be able to be used to help fund the development of an undeveloped property asset? We are not aware of any public statement by the ATO on this particular matter, but in our view the arrangement is not able to be used if any of the borrowed funds are being used to fund the cost of consultants or other expenses which could not be considered to amount to the 'acquisition of an asset'.

McMahon Clarke Legal can provide information about superannuation instalment warrants generally and how to establish the structure for your clients.



If you would like more information, then please contact [Sean McMahon](#) by email or on 07 3239 2915. 



Family provision—Do grandparents have a moral duty to make provision for their grandchildren?

Grandparent contributions to grandchildren's education

It is not uncommon for grandparents to contribute to the cost of obtaining a private school education for their grandchildren. In the past there has been some speculation as to whether a grandchild receiving such financial assistance may have a basis to make a successful claim for provision from their grandparent's deceased estate if sufficient provision is not made from the grandparent's estate to continue that same level of education.

A decision handed down in the Victorian Supreme Court in September 2003 confirmed the position that the familial generosity of a grandparent should not, in the absence of other relevant circumstances, be recognised as the basis of a direct responsibility to make further testamentary

provision for the private education of a grandchild who is in the care of parents.

The court stated that it is consistently recognised by the court and prevailing community standards that the obligation to maintain and provide for infants ordinarily rests upon their parents, rather than on grandparents.

Recent case

The facts of the case are as follows:

1. The deceased had a son, Stephen, and two infant grandchildren, the children of Stephen and Stephen's de facto wife. Under his Will, the deceased left his entire estate to his wife, the paternal grandmother of Stephen's children.
2. It was contended on behalf of the grandchildren that the deceased made an unconditional promise or assurance to fund the children's private education, the cost of which was estimated to be \$168,000. No provision for that education was made in the deceased's Will and an application for provision from the grandfather's estate was made on behalf of the grandchildren.
3. Counsel for the grandchildren submitted the deceased and his wife assumed to a substantial degree the primary responsibility to provide for the children. It was contended the deceased grandfather assumed the role of breadwinner for the grandchildren because their parents' income was limited to the disability pension of Stephen and the children's mother's intermittent earnings from casual acting. It was submitted the deceased decided the children should have a private secondary education. The deceased had also organised and paid for an application on behalf of one of the children to the college of the grandfather's choosing.
4. Examples of financial assistance, said to have been provided by the grandfather to the grandchildren, included the gift of a house to their father which the grandchildren resided in with their parents and a contribution to rent for a house lived in by the grandchildren and their mother for 12 months when their parents' de facto relationship broke down.

Conclusion

The relevant family provision legislation for each state of Australia confers only a limited jurisdiction to interfere with the freedom of testation. It does not licence the court to affect a redistribution of an estate because it would satisfy notions of familial generosity, or because the claimant has few resources and the defendant taking benefits under the Will is relatively well off.

Rather it remains necessary to establish a need for provision and maintenance in the applicant in order to enliven the jurisdiction. If the need is not established, the court has no jurisdiction to make an order.

The court held in this case that the basic needs of the grandchildren were currently being met by their parents and their parents had the capacity, albeit modest, to continue to meet such needs. The court stated that private school education is generally regarded as a privilege and cannot be characterised as a need.

Further, it is necessary to establish a breach of duty or moral obligation on the part of the testator. Prevailing community standards which may alter according to changing social and economic conditions are the criteria against which the duty and moral obligation and any departure from them must be measured.

The court highlighted that in a circumstance where a grandparent of ample means has done nothing during life to assist a grandchild who has significant needs, the wise and just testator reflective of prevailing community standards might well recognise in circumstances, a moral duty to provide. But, in the current situation, where children are in the primary care of their own parents who are capable of fulfilling their basic needs, prevailing community standards would not, in the absence of some special factor or unusual circumstances, impose on a grandparent responsibility to provide.

The fact that the child's parents are of modest means, while the estate could satisfy the claim without significant adverse impact on the chosen beneficiary will not without more, found a grandparental responsibility to provide maintenance and support.


Comment

Some of your clients with money in a self managed superannuation funds may be providing financial assistance to their grandchildren in an attempt to create a dependency relationship so that benefits can be paid out of the fund to or for the benefit of those grandchildren, tax-free on death. There is a possibility that creating such a dependency may also increase the likelihood of grandchild bringing a successful claim against the estate. For example, it is difficult to argue the grandchildren are dependants for superannuation purposes on the one hand, but then argue they should have no expectation of provision from the estate.

McMahon Clarke Legal can advise potential applicants and executors in relation to family provision

applications.



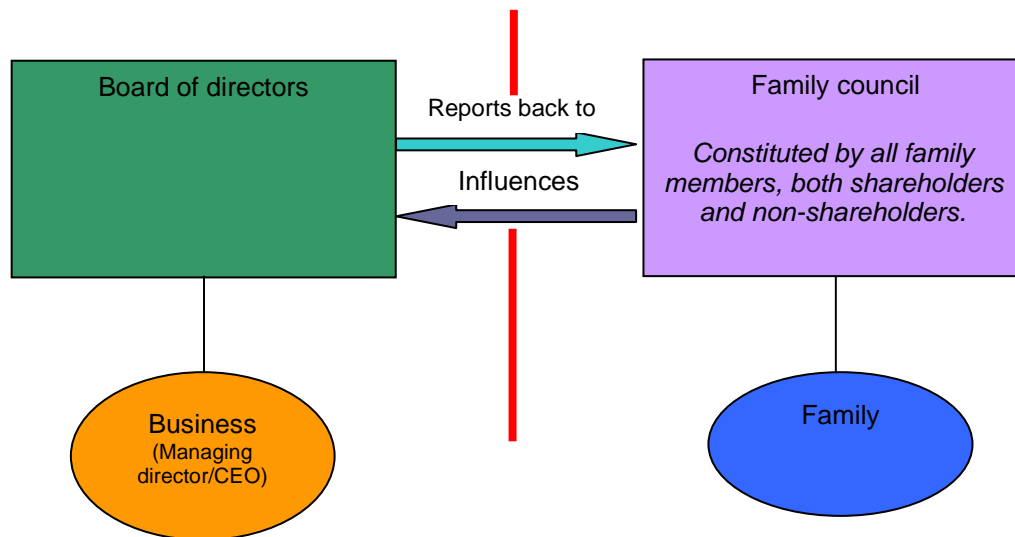
If you would like more information, then please contact [Kristy Dorney](#) by email or on 07 3239 2968. 



Family businesses : family council and board of directors

Synopsis

The [April 2008 edition of *Private Client*](#) contained an article on corporate governance and succession issues in family business. The article touched on the role of a family council and board of directors in family business. This article explores the role of the family council and board of directors in more detail.



Family council

The primary role of the family council is to provide an effective communication link between the family and the board. In a multi-generational family business, the membership of the family council may consist of one representative from each family group and often there will be an independent chairperson.

The family council does not have authority to make business decisions but will have the authority to deal with family matters. For example, its role will include developing and implementing policy and guidelines on when a family member will be invited to join the business, when they will be asked to leave and the criteria for selecting a successor. These guidelines will be developed in consultation with all family members via family meeting days organised by the family council.

The family council may influence board decisions, and often a member of the family council will also sit on the board of directors to ensure the values and ideals of the family are carried through to the day to day management of the business.

The family council can provide a valuable training ground for members of the family hoping to join the business because it provides them with an insight into the business as well as educating them about

financial management and investments.

The role and responsibilities of the family council, the process of electing family council and the family's policies in relation to the business, management successions, share ownership and employment of family members should all be documented in a family constitution.

Board of directors

The board of directors act as the stewards of the family business. The board is responsible for making decisions regarding the operational side of the business which complement the values of the family as communicated to it by the family council. The purpose of the board is to bring objectivity, experience and discipline to the business. The board may make the decisions, or its role may be to advise and offer recommendations to the family managing director.

The role and responsibilities of the board which are relevant to family business include:

1. Protecting the interest of the shareholders (typically, the family members). Whereas, the family council is responsible for determining the overall vision of the business, the board is responsible for strategic planning and the financial management of the business.
2. In a family business context, the board must ensure it communicates with the family council and must temper its business decisions with the family vision and values. There are likely to be some decisions that should not be made without the approval of, or at least consultation with, the family (e.g., a decision to sell the business, change the capital structure, or appoint a new CEO). It is therefore important for the role and powers of the board to be clearly defined and documented.
3. The board may have the responsibility of implementing the policies developed by the family council. For example, it may be required to apply the criteria developed by the family council regarding the participation of a family member in the business. Similarly, it may be required to nominate successors based on criteria developed by the family at the family council. Remuneration of family members and determining job descriptions/roles are also sensitive family issues that can be resolved by a board that has independent directors.


As a family business grows and seeks to commercialise its operations it is often advisable to invite at least one independent, non-family member to sit on the board. The intent is to strike a balance between the wants of the family and the desire to operate a successful business. For example, one of the functions of the independent director may be to ensure the board meetings are meetings about the business, rather than about the family.

Some family businesses hesitate before implementing a formal board structure because of the misconception that it will over-complicate the operation of the business or that boards, particularly those with independent directors, are more suited to large multi-national corporations. This is not necessarily the case. Owners of family businesses, who manage the business on an informal basis and who also tend to keep business information confidential (particularly financial information) can benefit from a more formal and open structure. It can improve processes, communication and productivity within the business.

Once established, it is important that the board is operated in a formal manner. Each director has certain duties to the shareholders and the company that are prescribed by law and that carry civil and criminal penalties if breached. Each director should be made aware of these duties before accepting a directorship.

McMahon Clarke Legal is able to advise on and provide directors with written guidelines on their duties. We are also able to assist family businesses develop and document the role of the family council and the board of directors.



If you would like more information, then please contact **Jane McMahon** by email or on 07 3239 2942. 



Staff promotions

Trio promoted to partners

The partners of McMahon Clarke Legal – Sean McMahon, Langton Clarke, Andrew Shearer-Smith and Mark Lyons, are pleased to announce the appointment of new partners, Chris Mee, David MacLeod and Matthew Moses.

McMahon Clarke Legal now has seven partners, 25 lawyers and a total compliment of 50 employees and practises Australia-wide.



Chris Mee



David MacLeod



Matthew Moses



New appointments

Philip Glass

Philip Glass joined McMahon Clarke Legal in March 2008 as a solicitor with the property team.

Philip holds Bachelor of Laws and Bachelor of Economics degrees from the Northern Territory University. Philip was admitted to practice as a solicitor of the Supreme Court of the Northern Territory in 1997 and was subsequently admitted to practice as a solicitor of the Supreme Court of Queensland in 2000.

Philip has experience in a range of commercial and property matters, including retail, commercial and industrial leasing and commercial property transactions.

For more information, email [Philip Glass](#) or call 07 3239 2939.

Vanessa Sciortino

Vanessa Sciortino joined McMahon Clarke Legal in March 2008 as a solicitor with the property team.

Vanessa holds a Bachelor of Laws from the Queensland University of Technology as well as a Graduate Diploma in Legal Practice. Vanessa was admitted as a solicitor in the Supreme Court of Queensland in January 2006.

Vanessa has experience in the areas of property, commercial and retail leasing and general commercial matters.

For more information, email [Vanessa Sciortino](#) or call 07 3239 2939.

Kylie Costigan

Kylie Costigan joined McMahon Clarke Legal in July 2008 as an associate with the private client team.

Kylie holds a Bachelor of Laws with honours from the University of Queensland and a Graduate Diploma in Practical Legal Education & Training from the University of Queensland. Kylie was admitted to practice as a solicitor in 2004.

Prior to joining McMahon Clarke Legal, Kylie practised almost exclusively in succession law, with a particular focus in the areas of estate planning and estate administration.

For more information, email [Kylie Costigan](mailto:Kylie.Costigan@mcmahonclarke.com) or call 07 3239 2921.



McMahon Clarke Legal specialises in legal services associated with funds management, capital raising and litigation and risk management for listed and unlisted entities. For a full list of our services, please visit the main part of our website at www.mcmahonclarke.com or email us at info@mcmahonclarke.com.

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