PS LA 2006/17 - Self-managed superannuation funds - disqualification of individuals to prohibit them from acting as a trustee of a self-managed superannuation fund

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Self-managed superannuation funds – disqualification of individuals to prohibit them from acting as a trustee of a self-managed superannuation fund

This Law Administration Practice Statement outlines the circumstances in which you can consider disqualifying an individual and thereby prohibit them from acting as a trustee of a self-managed super fund.

This practice statement is an internal ATO document, and is an instruction to ATO staff.

Taxpayers can rely on this practice statement to provide them with protection from interest and penalties in the following way. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

1. What this practice statement is about

An individual[1] may be disqualified from acting as a trustee of a self-managed super fund (SMSF) in two ways – through the operation of law[2], or by a decision of the Commissioner under section 126A of the *Superannuation Industry (Supervision) Act 1993* (SISA).[3]

This practice statement sets out what you need to consider when making a decision under section 126A.

A person must not act as a trustee of an SMSF or a responsible officer of a corporate trustee when they know they are a disqualified person. A disqualified person who acts as a trustee or responsible officer while they are disqualified commits an offence.[4]

Under section 120 an individual is a disqualified person by operation of law where they have been/are:

- convicted of an offence involving dishonesty (subparagraph 120(1)(a)(i))
- subject to a civil penalty order (subparagraph 120(1)(a)(ii))
- an undischarged bankrupt (subparagraph 120(1)(b))
- disqualified by the Commissioner under section 126A (subparagraph 120(1)(c)(i)).

[1] In their own right, or as responsible officer for a corporate trustee.
[2] Section 120 of the *Superannuation Industry (Supervision) Act 1993* (SISA).
[3] All further legislative references are to the SISA, unless otherwise specified.
[4] Section 126K

2. When can an individual be disqualified under section 126A?

Under section 126A, an individual can be disqualified if:

1. they contravene the SISA or the *Financial Sector (Collection of Data) Act 2001* (FS Act) and the nature, seriousness or number of the contravention or contraventions provide grounds for disqualification[5], or
2. the Commissioner is satisfied that the individual is otherwise not a fit and proper person.[6]

It is only if the nature, seriousness or number of contraventions under subsections 126A(1) and (2) are not considered sufficient to disqualify, that you need to consider the decision as to whether the individual is a fit and proper person.

An individual cannot be disqualified for contraventions of the SISA under subsections 126A(1) and (2) unless the entity is a regulated superannuation fund, and meets the definition(s) under sections 10 and 19.

Where a regulated superannuation fund does not exist, it is only possible to disqualify an individual under the 'fit and proper' provisions contained in subsection 126A(3).

Even if an individual is not presently acting as a trustee of an SMSF, they may still be disqualified as a preventative measure because they present a future compliance risk. In these instances, the disqualification can only be under subsection 126A(3) – not being a fit and proper person.

[5] Subsections 126A(1) and (2)
[6] Subsection 126A(3)

3. Disqualification – general considerations

When making a decision about disqualification, you should keep in mind the overarching principles of:

- the *Taxpayers' Charter*
- the ATO compliance model
- the good decision-making model.

Disqualification under section 126A is primarily aimed at protecting the integrity of the superannuation system. It should be applied where the Commissioner is concerned that allowing the individual to remain in the position of trustee would present a future compliance risk.

Where an individual removes themselves voluntarily from the position of trustee prior to the decision being made, disqualification may no longer be necessary. However, if the offer to remove themselves is not considered to be bona fide, disqualification may still be an appropriate step.

Disqualification may be done in isolation or in conjunction with other compliance options. However the seriousness and nature of the contraventions must be considered on a case-by-case basis to determine if disqualification is still an appropriate course of action.

4. Are there options other than disqualification that can be taken in relation to a contravention?

Options other than disqualification include:

- administrative penalties in relation to SMSFs[7]
- issuing a direction to undertake education if the contravention occurred after 1 July 2014[8]
- issuing a direction to rectify a contravention if the contravention occurred after 1 July 2014[9]
- accepting an undertaking from the trustee to rectify the contravention(s)[10]
- issuing the fund with a notice of non-compliance[11]
- as part of an investigation, freezing the assets of the fund where there is a risk of the members' benefits being eroded or further eroded[12]
- consideration of other applicable Commonwealth laws available to the Commissioner.

5. What process should I follow?

Where appropriate, prior to disqualification you should allow the individual to preserve their benefits, but clearly set out the time limits in which they must do so. For example, the Commissioner may provide the individual with the opportunity to roll over the funds to an independently managed superannuation fund[13].

Where a decision is made to disqualify one particular individual, this does not lead to the conclusion that all other individuals who are/were trustees of the same fund should be disqualified. The circumstances surrounding each individual's actions must be considered with a holistic view of the facts.

Once a decision has been made to disqualify an individual, you must:

- give the individual written notice of the disqualification[14], and
- publish details of the disqualification in the Government Notices Gazette *in accordance with BSL practices.*[15]

DISQUALIFYING UNDER SUBSECTIONS 126A(1) or (2) – CONTRAVENTIONS

6. General considerations

When considering disqualification in relation to contraventions of the relevant legislation, you should:

- look at the acts of the individual
- consider all the facts of the case
- consider whether there is a future compliance risk.

The nature, number and seriousness of contraventions are a question of fact and degree, and it is not possible to apply prescriptive rules to the decision to disqualify.

Each case has to be considered individually. Some examples of relevant considerations when determining the seriousness of a contravention are:

- the behaviour of the trustee in relation to the contravention

[7] Section 166
[8] Section 160
[9] Section 159
[10] See Law Administration Practice Statement PS LA 2006/18 *Self-managed superannuation funds – enforceable undertakings*
[11] See Law Administration Practice Statement PS LA 2006/19 *Self-managed superannuation funds – notice of non-compliance*
[12] Section 264

[13] Defined by Logan J in *Vivian v Fitzgeralds* (2007) 69 ATR 834 at [38], as a fund that is contradistinctive to an SMSF
[14] Subsection 126A(6)
[15] Subsection 126A(7)

- the extent to which the fund's assets were affected by the contravention
- the extent to which the fund's assets were exposed to financial risk and whether there was any loss to the value of the fund
- the number and extent of contraventions over a period of time[16]
- the nature of the contravention in the overall scheme of the legislation. For example, a contravention involving an artificial arrangement intended to undermine the regulatory provisions or the tax concessions offered to SMSFs is likely to be serious.

7. Assessing the future compliance risk

Disqualification is designed to protect the investing public against the risk that people with a history of non-compliance will re-offend.[17] A key factor in making the decision to disqualify an individual is whether, by not taking such action, there will be a future compliance risk.

An individual will be considered to have a future compliance risk if it is reasonable to draw that conclusion from their compliance history. This includes considering matters in relation to their SMSF, own personal tax affairs, or that of any other entity in which they have been in a position of responsibility.

Consideration should be given to all four of the following aspects of compliance, both before and after a contravention:

- registration – whether the trustee is registered for all relevant roles
- lodgment – whether the individual has lodged all returns in the correct format on time without prompting from the Commissioner
- reporting – whether the individual has demonstrated a willingness to report correctly
- payment of debt – whether the individual paid debts voluntarily by their due dates. Further, if the individual has an outstanding debt, whether they have entered into a payment arrangement and fulfilled their payment obligations under the arrangement.

It is imperative to remember that sometimes mistakes are made. What is important is that the individual demonstrates a willingness to comply with their obligations.

[16] *Preuss v. Australian Prudential Regulation Authority* [2005] AATA 748; 60 ATR 1137
[17] *AAT Case* [2002] AATA 1233 at 12

DISQUALIFYING UNDER SUBSECTION 126A(3) – FIT AND PROPER PERSON

8. What do I take into account when assessing an individual as 'fit and proper'?

You need to look at two things when deciding whether an individual is a fit and proper person.

The fitness of the person – which is determined with reference to the skills required for them to satisfy the obligations as trustee, including their qualifications, experience and competence.

Factors to consider include whether the person:

- possesses a reasonable level of skills, knowledge, expertise, experience, diligence and soundness of judgment to undertake and fulfil particular duties and responsibilities of being an SMSF trustee.
- answers questions by the ATO in a manner that is reasonable in the circumstances.

Deciding whether an **individual is a proper person to be a trustee** entails looking at their general behaviour and conduct in the discharge of their duties, and also their reputation and character in relation to the conduct of any relevant business activities.

Some considerations are whether they have:

- demonstrated a willingness to comply with regulatory or other professional requirements
- carried out their role with proper independence
- been reprimanded or otherwise sanctioned by a professional or regulatory body
- managed their personal debts
- demonstrated a high level of integrity
- been substantially involved in the management of entities which have been wound up or failed.

Contraventions which, although not sufficient to warrant disqualification under subsections 126A(1) and (2), may also influence your decision here.

Both fitness and propriety need to be considered in light of the reasonable risks of the individual potentially:

- misappropriating fund monies
- dealing with fund assets in an illegal way
- failing to keep proper records
- knowingly providing inaccurate or misleading information to the ATO, and

- repeatedly and or deliberately failing to provide information to the ATO in compliance with their reporting obligations.

Generally, situations where a trustee may be found not to be a 'fit and proper' person include, but are not limited to, where the trustee:

- allows a contravention by another trustee to occur
- fails to take reasonable steps to prevent a contravention
- fails to notify the Regulator as soon as is reasonably practicable to do so after becoming aware of a contravention by another trustee
- performs their duties in a manner which allows other trustees to contravene the SISA or the FS Act.

In making the decision to disqualify an individual for not being 'fit and proper' the Commissioner will take into account the following indicators:

- any contraventions of the SISA
- the circumstances surrounding the contravention
- considerations other than the individual's compliance with the SISA which go to establishing the character and repute of the person
- non-compliance with other taxation laws
- whether the individual has been subject to sanctions under any other relevant laws. (Relevant laws in this instance would generally include those laws dealing with financial responsibilities, honesty and business transactions)
- the association the individual has with other trustees of the SMSF and the impact this relationship has on their ability to perform their duties as a trustee, and
- all the circumstances of the case including the reasonably assessed honesty, competence, diligence, knowledge, ability, soundness of judgment, reputation and character of the individual.

9. Review rights

The decision to disqualify is for an indefinite period, subject to any applications the individual makes to have the decision revoked under subsection 126A(5), or reviewed under section 344.

Both the decision to disqualify under subsections 126A(1), (2) or (3) and the refusal to revoke the disqualification, are reviewable decisions.[18]

A request to reconsider must be made in writing, setting out the reasons for making the request, and must be made within 21 days after the person receives notice of the decision, or within such further time the Regulator allows.

10. More information

For more information on:

- Accepting an undertaking from a trustee, refer to Law Administration Practice Statement PS LA 2006/18 *Self-managed superannuation funds – enforceable undertakings* PS LA 2006/18
- Issuing notices of non-compliance, refer to Law Administration Practice Statement PS LA 2006/19 *Self-managed superannuation funds – notice of non-compliance* PS LA 2006/19

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[18] Sections 10 (definition of 'reviewable decision') and 344