SuperGuardian

Superannuation
Administration made simple!

Should adult children be members of your SMSF?

There is enthusiasm within the current Government to increase the number of members within an SMSF from four (4) to six (6). Whilst the current limit remains at 4, some trustees may be asking themselves if it would be beneficial to add their adult children as members of their SMSF or if this is a strategy to avoid. Under the SMSF governing rules, with the exception of single member funds, all members must be either individual trustees or directors of the corporate trustee of their SMSFs and vice-versa. Hence, in terms of being members of SMSFs and running SMSFs, the same rules and responsibilities apply to children and parents alike.

What are the advantages?

There are a number of advantages for having adult children as a member(s) f their parents' SMSFs including:

- SMSFs are great vehicles for building wealth and can boost the financial literacy of all members, regardless of age, when operated properly. Introducing SMSFs to children in their teens when they commence work and start receiving super can been a trigger for these younger members to be more involved in the investment of their super savings. These members may already be ahead when it comes to savings and wealth creation by simply having engagement with their super at an earlier age. However, children aged under 18 cannot be trustee of the fund or director of a corporate trustee until they turn 18.
- Having children in a SMSF may give the Fund the opportunity to diversify its investments. Consider whether it is necessary that children's benefits are segregated from the assets of their parents within a Fund. If so, separate bank and investment accounts would be involved and the SMSF accountant or administrator must have the skills and systems to handle segregated investments.
- Potential savings in overall administrative costs. This would depend on the investments and transactions made in the SMSF amongst other factors.
- Helping with any liquidity issues of the SMSF. The cashflow generated from children's contributions or rollovers into the SMSF could be used to meet certain liabilities such as pension requirements, or finance limited recourse borrowing arrangements. This is less likely if the assets are segregated.

Allowing for the inter-generational transfer of fund assets where possible. Depending on the capacity of the children to contribute and the timeframes involved, the need to sell fund assets on your death may be eliminated or significantly reduced.

What are the disadvantages?

There are a number of disadvantages for having adult children as a member(s) of their parents' SMSFs including:

- Including children as members and trustees of your SMSF puts them in a situation where they have access to the resources of the fund. This access had dire consequences in the Triway Superannuation Fund which was established with three members: Mum, Dad and Son. The son had a drug addiction and withdrew monies out of the SMSF without his parents knowledge. Once discovered the parents were complicate in trying to cover it up. This left the parents with a non-complying SMSF and no super.
- In case of divorce or separation, nothing is beyond the reach of the family court – including the assets of the family super fund. This means that even if the spouse/de facto of your adult child is not a member of your SMSF, they still may have an entitlement to some of the funds in the SMSF, which will be intrusive on the fund's operations
- There would be a greater need to develop a workable dispute resolution mechanism for the fund should the need arise.

- Your children would be privy to information about your SMSF entitlements and any arrangements you have put in place (e.g. individual member balances, any reversionary pensions, binding death benefit nominations).
- Investment strategies would need to be reviewed frequently as trustee decisions must be made in the best interests of all beneficiaries and not just in the best interests of the beneficiaries with the majority balances in the SMSF.
- Control is probably the most important factor when ensuring the wishes of a deceased member are carried out correctly when it comes to estate planning. In the case of Katz v Grossman, the trustees of the SMSF were a father and daughter. The father completed a non-binding nomination requesting the trustee to split his super balance 50/50 to his daughter and son upon his death. The son was not a member or trustee of the SMSF at the time of his father's death and the daughter appointed her husband as the replacement trustee and proceeded to pay 100% of her father's benefits to herself. The Court found in her favour – as trustee her (and her husband) had discretion as the nomination was not binding on the trustee.
- Adult children are likely to have different risk profiles to their parents which means that their investment strategies may differ from their parents. While adult children and parents can run separate investment portfolios and allocate earnings to the specific account balance(s) supported by a particular portfolio, this brings additional administrative complexities.

There is no definitively right or wrong answer. Every family is different and every child within a family is different. It is important to ensure that only the right people are invited to join the family super fund. If an adult child is not great at managing their own personal finances, then chances are they will not work well within an SMSF environment and it may be better for them to keep a retail or industry fund.

Given the number of cases where adding adult children as members or trustees of an SMSF has caused issues for the exiting members/beneficiaries, it is not a decision to be made lightly.

If you would like to discuss this fact sheet further, please don't hesitate to contact us on **1300 787 576.**