

# Trustee Incapacity

**Webinar will commence shortly**

**Jeff Song**

**Associate**

**Townsend Business & Corporate Lawyers**

25 November 2021

## Disclaimer

This document has been prepared by Jeff Song Associate at Townsends Business & Corporate Lawyers, a law firm duly registered by the NSW Law Society.

Information in this document is based on current regulatory requirements and laws, which may be subject to change. Whilst care has been taken in the preparation of this document, no liability is accepted by Mr Song or his firm or any of their respective related entities, agents and employees for any loss arising from reliance on this document.

This document does not contain legal advice, financial product advice or a financial service of any kind. It does not take account of any person's individual circumstances, objectives, financial situation or needs.

No person or corporation can rely on the contents of this document. No act or omission should be taken or not taken on the basis of this document alone and specific legal advice should be obtained based on the client's specific circumstances before any such reliance, act or omission.

The topic for this session:

**With an ageing SMSF population what factors do we as advisers need to consider to determine whether our clients have capacity to act as a trustee?**

## Subtopics to be covered:

1. Understand the importance of trustee capacity in the context of an SMSF
2. Understand the different types of capacity.
3. Learn the basic legal test for the legal capacity of a trustee
4. Learn the things that need to be considered when assessing a trustee's capacity
5. Learn the process for assessing the legal capacity of a trustee and the types of questions to ask
6. Learn how to stress test an SMSF to discover what needs to be done to protect the fund against trustee incapacity

## Why is trustee capacity an important issue in the context of SMSFs?

- ✓ Can you trust your retirement savings with someone who lacks capacity?
- ✓ SMSFs are self managed – members lacking capacity should not manage their own retirement savings
- ✓ SMSF is a tax friendly environment but only for complying funds. Compliance requirements can be complex and losing the complying status can have detrimental tax consequences

## The three types of incapacity

Legal                      Can a person who lacks physical capacity still have legal capacity?

Mental                    Can a person who lacks mental capacity still have legal capacity?

Physical                  Can a person who lacks legal capacity still have mental capacity?

*It is mental capacity that often results in the lack of legal capacity*

# The tests for incapacity

1. Different legal definitions of mental capacity depending on whether the context is:
  - the commission of a crime
  - the making of a Will, or
  - other acts or omissions
2. The test for a trustee is the capacity to understand the nature of the transaction (ie. its broad application) when it is explained

# Capacity is a legal issue

1. The test of capacity is a legal test not a medical test
2. The person's doctor is not the person who decides
3. Medical opinion is useful evidence
4. Client's advisers need to be aware of the potential issues, discuss with family, seek legal advice

What are the things that you need to consider when you see signs of incapacity?



# Incapacity is not ‘all or nothing’

Incapacity in one area does not automatically mean that capacity is lacking in another area.

The NSW Supreme Court has found a person incapable of managing their financial affairs may still be capable of making a Will

# The presumption of sanity

- The law presumes that the trustee has mental capacity
- The onus of establishing mental *incapacity* lies on the person who alleges the incapacity
- Clear evidence is necessary - inferences, suppositions and tale-telling are not enough

## Illustrations of different levels of ‘capacity’

- A person who is incapable of managing their financial affairs may still be capable of making a Will or an enduring power of attorney
- A person who is incapable of managing their financial affairs may have mental capacity to make a simple contract
- A person may not have enough mental capacity to make a Will but have mental capacity to marry
- A person with schizophrenia with paranoia may have testamentary capacity even though his or her estate is being officially managed

Would a trustee whose estate is being officially managed have capacity to continue to act as a trustee?

# The importance of time

- Just because a person lacks mental capacity at one point of time does not mean that mental capacity was or will be lacking at another time.
- The person must have capacity at the relevant time.

# The importance of complexity

The more complex the transaction, the higher the risk that a person suffering some level of mental capacity may not be competent in respect of the transaction

## Are there doubts about your client's capacity?

- Consider all the circumstances of the particular case
  - Be alert to the danger signals
  - Apply the 6 capacity principles
1. Presume capacity
  2. Capacity is decision specific
  3. Don't assume a person lacks capacity based on appearances
  4. Assess a person's decision-making ability – not the decision they make
  5. Respect their privacy
  6. Substitute decision-making is a last resort

## The rules and questions in assessing capacity

- Ask open-ended questions (eg. “How many children do you have?”)
- Do not ask leading questions ie. a question that suggests the answer ( eg. “You have three children, correct?”)
- Frame questions to quickly identify areas of concern
- Ensure it is the person being assessed who answers the questions – see them alone but be aware of their need to have someone with them for mental health, cultural or language reasons

## Legal framework

- Section 10 of the SIS Act - a “legal personal representative” includes
  - the trustee of the estate of a person under a legal disability, or
  - enduring power of attorney
- Section 17A(3)(b) of the SIS Act provides that the fund does not fail to satisfy the definition of a self managed superannuation fund due to a legal personal representative of a member being a trustee of the fund (or a director of a body corporate that is the trustee of the fund) in place of the member during any period when:
  - I. the member of the fund is under a legal disability; or
  - II. the legal personal representative has an enduring power of attorney in respect of the member of the fund



## Legal framework cont ...

- Appointment of enduring power of attorney is the best way to resolve the issue
- How will you get the attorney appointed as a director of the trustee company if there's another member/director who won't vote them in?

## Stress test the fund for trustee incapacity

What will happen to the SMSF if a member suffers incapacity?

Check

- the fund's deed,
- the trustee company's constitution
- the enduring power of attorney
- the board's resolutions

are all in order, and

all support the appointment of the enduring attorney as trustee/director

# Townsend Business & Corporate Lawyers

Providing services across Australia

## Thank you for listening

### Jeff Song

Townsend Business  
& Corporate Lawyers  
Level 9, 65 York Street, Sydney NSW 2000  
t: (02) 8296 6222  
e: [jeff@townsendslaw.com.au](mailto:jeff@townsendslaw.com.au)  
w: [www.townsendslaw.com.au](http://www.townsendslaw.com.au)