Unit trusts and superannuation – does the look-through approach exist?

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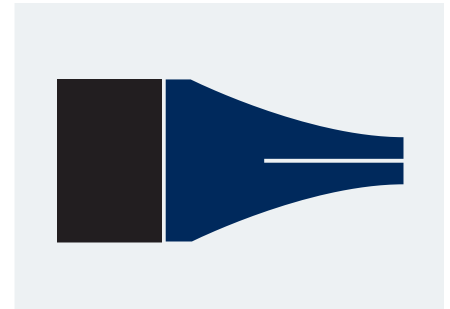

This article examines whether the misdeeds of a unit trust trustee can be attributed to its unit holding superannuation fund. That is, does the "look-through approach" exist?

Introduction

Based on the principle of the separation of legal entities, it would not be expected that the actions of the trustee of a unit trust (or other trust) would be imputed on its unit holders. But does that hold true under the superannuation system? For instance, can the actions of a unit trust trustee cause its unit holding superannuation fund trustee to breach the superannuation laws? Or, to put it more succinctly, does the "look-through approach" exist?

Investments in unit trusts

The *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA) and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) govern the actions of trustees of superannuation funds. They do not govern the acts of entities that those funds invest in, such as unit trusts. For instance, there are prohibitions against the trustees of superannuation funds from borrowing,[1] acquiring assets from related parties,[2] and giving financial assistance to members,[3] but there are no such prohibitions on the entities that superannuation funds invest in. Rather, the SISA and the SISR restrict the ability of superannuation funds to invest in such entities. For example, under the in-house asset rules, a superannuation fund is generally limited to investing in related unit trusts up to the 5% in-house asset limit.[4]

There are some circumstances in which the trustee of a superannuation fund can invest in a unit trust, such as when the investment is below the 5% in-house asset limit, or when the trust is an "unrelated trust"[5] or a "pre-12 August 1999 unit trust",[6] or the unit trust satisfies the requirements of reg 13.22C SISR.

Of the types of trusts that a superannuation fund trustee can invest in, only the "regulation 13.22C trust"[7] regulates what actions the trustee of a unit trust can and cannot do. Even then, a breach of those requirements is not attributed to the superannuation fund trustee, but rather it simply causes the units invested in that trust to be treated as in-house assets.

For the other types of permitted unit trusts, there are no restrictions on their trustees' activities. Therefore, the trustees of such a unit trust can borrow and deal with related parties without causing the superannuation fund trustee to breach the SISA and the SISR. That is, unless the look-through approach applies.

A recent case and the look-through approach

Despite the SISA and the SISR not governing the actions of trustees of unit trusts, there have been instances where the judiciary has appeared to take a look-through approach to attribute the misdeeds of the trustee of a unit trust on the trustee of the superannuation fund.

A recent example of this approach is *Montgomery Wools v FCT*[8] (*Montgomery Wools*). In *Montgomery Wools*, the trustee of the superannuation fund invested in a pre-12 August 1999 unit trust which in turn held a commercial property from which a related entity operated its business. When the related party ran into financial difficulties, the trustee of the unit trust agreed to allow the commercial property to be used as security for the related party's business operations.

Strictly, the actions of the trustee of the unit trust, including giving security over its only asset for the benefit of a related party, should not cause a breach of the SISA or the SISR. This is on the basis that the untoward actions occurred at the unit trust level and not the superannuation fund level. The Administrative Appeals Tribunal (AAT) found that the trustee of the superannuation fund breached the sole purpose test by acquiescing to the charge being granted over the unit trust's asset and by not terminating the unit trust to protect its interests. As the following comments show, the AAT went further by implying that, given there was a common director (Mr Montgomery) in the superannuation fund trustee, the unit trust trustee and the business operating related party, the superannuation fund trustee was an active participant in the actions of the unit trustee:

> "The [superannuation fund] did not have the power under the Trust Deed to direct the investments of the [unit trust] but it did have the power to terminate and give reasonable directions in relation to the assets. As such, the breach of [the sole purpose test] arguably occurred as early as October 2000 when Montgomery Wools, as trustee of the [superannuation fund], acquiesced in the [unit trust] providing such security. Montgomery Wools also acquiesced to the sale of [the commercial property] and the sale proceeds being applied to the [related party's] debt in 2004. It has failed to demand payment of the loan from the [unit trust] or to insist on interest being paid. Importantly, it has failed to terminate the Trust Deed to take control of the [unit trust] investment. Mr Montgomery was, and is, the controlling mind of both trustees at all relevant times and the [superannuation fund] owned all of the units in the [unit trust]. In these circumstances it could be said that Montgomery Wools, as trustee of the [superannuation fund], was an active participant in the decision making and agreed to the various transactions, including the sale of [the commercial property] and the proposal to the [bank]. These transactions were for the benefit of the [the related party] and were intended to be so."

This decision does not establish the look-through approach as a legal principle, but it does show a willingness of the AAT to use the commonality of control of a superannuation fund and a unit trust to make a finding that the actions of the unit trustee can cause the superannuation fund trustee to be in breach of its obligations.

Other cases

There have been a number of cases over the years that have considered the interactions between the trustees of a superannuation fund and the unit trust. Some of these decisions have displayed a look-through approach and some have not. A selection of those cases is examined below.

Swiss Chalet case

The *Swiss Chalet* case[9] is arguably the most famous case on the breach of the sole purpose test. The case included an examination of three "personal-use" assets. Two of those assets were held by the superannuation fund through other entities, including a golf club membership held by a company and a Swiss chalet which was held through a unit trust. The AAT took a somewhat inconsistent approach when referring to the actions of these entities as it switched between the actions of the superannuation fund trustee and the entities themselves. Implicitly, the AAT seems to have taken a look-through approach and attributed the entities' misdeeds to that of the superannuation fund trustee. This appears to be based on the commonality of control between the superannuation fund trustee and the entities.

Case X60

Case X60[10] is an example of where the look-through approach was not applied. In that case, the superannuation fund trustee invested in three different unit trusts that themselves had invested in various property developments. In addition, the fund trustee made some interest free loans to those entities. Here, the AAT looked at the investments and actions of the superannuation fund trustee, rather than attributing the actions of the unit trust trustees to the fund trustee.

It is possible that this finding was influenced by the fact that there were two other arm's length investors in the unit trusts, and so, unlike many of the other cases examined in this article, there was no commonality of control between the superannuation fund trustee and the unit trust trustees.

ZDDD

ZDDD and FCT[11] is another case involving a pre-12 August 1999 unit trust. Here, the trustee of the unit trust made large interest-free loans to the members of the superannuation fund who were experiencing financial difficulties. The AAT did not examine the SISA provisions in any detail, although the Commissioner submitted that the superannuation fund trustee indirectly breached s 65 SISA by acquiescing to the unit trust trustee providing financial accommodation to the superannuation fund members. In addition, the Commissioner argued that the superannuation fund trustee breached s 109 SISA on the basis that it invested in a related party that made investments on a non-arm's length basis. Both of those arguments are only valid if a look-through approach is taken. Ultimately, the AAT appeared to accept this approach when it made the following comments:

> "The contraventions identified by the Commissioner are serious. They go to the heart of prudential regulation of superannuation funds as the provisions breached are designed to ensure the assets of a superannuation fund are preserved for retirement benefits. In the present case, the key issue of concern is that the assets of the Properties Unit Trust were used by Mr and Dr K for their own benefit. This would not have been a problem, but for the fact that the units in the Properties Unit Trust were the sole asset of the Fund and this has been the case since the fund was established in 1997. Mr K now accepts these were not 'technical breaches'.
>
> The related party dealings in the Properties Unit Trust from 1999 to 2004, but especially in 2005, has affected the value of the Fund, which has not increased in value since this time. Moreover, there has been no income generated from the investment.
>
> The Fund has been exposed to greater risk because the investment in the Properties Unit Trust is not documented, there is no security and, for the reasons set out above, may not be recoverable.
>
> I accept that the Fund was not set up as a 'sham' to improperly gain tax concessions, but the use of the funds and assets through the Properties Unit Trust from 1999 to 2005 provided a mechanism for the 'early release' of benefits before retirement with no consideration of the effect on the Fund by the trustee or its directors."

Interhealth

In the *Interhealth* case,[12] misdeeds occurred at both the superannuation fund level and the unit trust level. In relation to the misdeeds of the unit trust trustee (and in particular its controller), the Federal Court did not take a look-through approach. Rather, in relation to the unit trust misdeeds, the superannuation fund trustee was found to have breached its duties by not taking actions (as sole unit holder in the unit trust) to liquidate its position in the unit trust and call for the payment of unpaid present entitlements.

Trevisan

Trevisan v FCT[13] takes a different slant on the look-through approach. In this case, an investment in the unit trust was found to be an investment in the underlying assets of the unit trust (real property) and therefore not an investment in a related party. This was based on the authority *of Charles v FCT.*[14] Its validity is probably now in doubt, given the decision of *CPT Custodian v CSR.*[15] In any event, the in-house asset rules have been subsequently altered so that they now catch a wider range of investments in related trusts.

Lock

Lock v FCT[16] is another example of the look-through approach operating on the basis that the superannuation fund acquired an interest in the underlying property of the unit trust. Here, such acquisition was found to breach the prohibition against acquiring assets from a related party under s 66 SISA.

Allen's Asphalt

Allen's Asphalt Staff Superannuation Fund v FCT[17] is a non-arm's length income/special income case. These cases do not normally involve a look-through approach as the legislative provisions contain a statutory look-through approach where the activities of the unit trust trustee, or the nature of a superannuation fund's interest in the unit trust, can trigger the provisions. However, in an interesting twist, in *Allen's Asphalt*, the taxpayer (being the superannuation fund trustee) tried to argue that the look-through approach applied to effectively ignore the existence of the unit trust. As the following extract shows, the court rejected that approach in favour of treating each trust as a separate personality:

> "The taxpayers say that there was relevantly no arrangement for the purposes of s 237(7) because there was no arrangement involving more than

> one party. The taxpayers say that there was an arrangement of sorts but it was only a series of unilateral steps by Mr Allen. They argue, it seems, that it does not matter that, both at the time the trust structures that facilitated the making of the distribution were put in place, or at the time when Mr Allen caused the distribution to be effected from the Hybrid Trust to the Fixed Trust to the Super Fund, Mr Allen was acting as the director of the trustee of the Hybrid Trust, as director of the Fixed Trust, and as a trustee of the Super Fund. This is a remarkable submission; it cannot be accepted. It could be accepted only if one were to ignore the separate legal personality of the corporate trustees involved and treat as shams the carefully orchestrated series of trust structures and sequence of distributions. And that is a course which the taxpayers do not invite the Court to take."

Allen's Asphalt therefore supports the position that each entity must be looked at separately as they each have their own separate legal personality.

Conclusion

It appears clear from the cases examined in this article that the look-through approach is not an established legal principle. However, it also appears clear that the AAT and the courts are prepared to apply a look-through like approach when considering whether a superannuation fund trustee has breached the superannuation laws, especially where there is commonality of control. This approach is particularly relevant when the AAT or the courts have considered whether a superannuation fund should have exited an investment in a unit trust, or otherwise exercised its powers as a unit holder, as a result of the misbehaviour of the unit trust trustee.

A take-home message for superannuation fund trustees is that they should not believe that, just because their investment in a unit trust is not an in-house asset (for example, where the unit trust is a "pre-12 August 1999 unit trust" or an "unrelated trust"), such an investment cannot cause them to breach the superannuation laws. This is especially so where the unit trust trustee is dealing on a non-arm's length basis and there is commonality of control.

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References

1 S 67 SISA.
2 S 66 SISA.
3 S 65 SISA.
4 That is, the value of the units must not exceed 5% of the value of the superannuation funds total assets. See Pt 8 SISA.
5 That is, a trust that is not a related trust (for the definition of "related trust", see ss 10(1) and 70B to 70E SISA).
6 See ss 71A to 71E SISA.
7 That is, a trust that satisfies the requirements of reg 13.22C SISR. In order for the units in such trusts not to be an in-house asset, the activities of such a trust are severely restricted. See reg 13.22D SISR.
8 *Montgomery Wools Pty Ltd as trustee for Montgomery Wools Pty Ltd Superannuation Fund and FCT* [2012] AATA 61.
9 *Case* 43/95, 95 ATC 374.
10 90 ATC 438.
11 [2011] AATA 3.
12 *FCT v Interhealth Energies Pty Ltd as Trustee of the Interhealth Superannuation Fund* [2012] FCA 120.
13 *Trevisan & Anor (Trustees of Forli Pty Ltd Superannuation Fund) v FCT* [1991] FCA 172.
14 *Charles v FCT* [1954] HCA 16.
15 *CTP Custodian Pty Ltd v Commissioner of State Revenue (Vic)* [2005] HCA 53.
16 *Lock v FCT* [2003] FCA 309.
17 *Allen (Trustee), in the matter of Allen's Asphalt Staff Superannuation Fund v FCT* [2011] FCAFC 118.