



## Newsletter

# Self Managed Superannuation Funds and Family Law

specialising in superannuation valuations for family law purposes since 2003

### Abstract

Because SMSFs are not that common, and are subject to different compliance and valuation issues compared to other super funds, they require special care from Family Law Practitioners (FLP). SMSF splitting orders have different considerations and objectives compared to ordinary superannuation splitting orders.

An essential resource for FLPs where the property pool includes a SMSF. This newsletter is based on my address to FLPs at a LegalWise Seminar in Brisbane on 9 Sep 2010.

#### WHAT IS AN SMSF?

SMSFs are restricted to a maximum of four members and all members must also be trustees. Most have just two members. SMSFs are trust entities with 71% having individual trustees and the balance being corporate trustees.

#### Superannuation Industry (Supervision) Act 1993 (SIS)

The *Superannuation Industry (Supervision) Act* sets all the rules that a complying superannuation fund must obey (adherence to these rules is called compliance). The rules cover general areas relating to the trustee, investments, management, fund accounts and administration, enquiries and complaints and splitting requirements and processes.

#### Valuation of a SMSF for Family Law Purposes

The valuation of superannuation interests is governed by the *Family Law (Superannuation) Regulations 2001*. Regulation 22 provides that SMSFs are not subject to any valuation provisions. It is simply not possible to prescribe a standard valuation regime given the enormous diversity of SMSFs administration.

All SMSFs have assets. It is the aggregation of the value of those assets less liabilities that would comprise the value of the SMSF. However, the accounting standards and the ATO do not require SMSF assets to have a current value. It is possible for the accounts to show the original value of any property, even if it was purchased many years ago. Non-listed property trusts could be wildly out of date. A practitioner should ensure that:

- All assets are valued at the current date,
- That the value reflects market value and not so called 'assessed value'

Where a pension is being paid from an SMSF, it is the underlying value of the assets that comprise the family law value. The pension itself is not valued. This is consistent treatment with allocated pensions.

#### ISSUES IN VALUING SMSFs

##### Reserves

Most SMSF have the capacity to create reserves. The value of the reserves needs to be taken into account when assessing the individual accounts in SMSFs. Putting only the husband and the wife's account balance into the property pool could be disadvantaging your client. Ideally, reserves should be distributed to members prior to any split.



## Pension assets and Capital Gains Tax

To encourage SMSFs to pay pensions, the capital gains tax accrued on assets in the SMSF is forgiven when those assets are used to generate a pension. For this reason, the CGT liability should be shared by dividing the assets after adding back any CGT liability. It does not matter if today there is no intention of taking a pension. The point is that there is a potential to take a pension and thereby utilise the CGT that reduced matrimonial assets.

**Exotic Assets** Examples include:

- Works of art,
- Wine collections,
- Perpetual golf memberships, and
- Marina berths

Special care is required as members of the SMSF are either unable to undertake personal enjoyment of the assets (such as the marina berth) or can only do so on a commercially arms length basis (in the case of the works of art).

The value of the exotic assets uses the same valuation principles that would apply irrespective of their holdings by a SMSF. Ideally, an independent expert valuer would be jointly appointed. If there is a need for immediate liquidity, the valuation might have to have regard to a “fire sale” valuation.

In general, exotic assets have more a compliance liability than a valuation issue.

## WHAT PRACTITIONERS NEED TO KNOW WHEN SPLITTING A SMSF

Compared to splitting an ordinary superannuation interest, splitting an SMSF involves the following additional considerations:

- Capital gains tax
- Is the agreement reached consistent with asset structure of the fund?
- Cash or in species transfer
- Indemnities & complying funds
- How a SMSF is split
- What type of orders are appropriate
- Operative date - date of effect

- Compensation for delays in processing orders

Each of the above will now be discussed.

## Capital Gains Tax (CGT)

Rollover relief is available under subsection 126-140(1) of the *Income Tax Assessment Act 1997*. For example, an order that allocates 1000 BHP shares to the wife through a superannuation split will see the wife inherit the cost base of those share for CGT purposes. CGT will only be paid when those shares are sold. However, the husband may not enjoy any CGT deferral.

Tax ruling ATO ID 2006/73 is a ruling that forces practitioners to take a different approach to orders to avoid unwanted CGT.

The ruling requires practitioners to think of orders in terms of active and passive members. In the above example, the wife is the active recipient of the splitting order. She gets the rollover relief. The husband plays only a passive part and does not enjoy any rollover relief. The actual decision of the ATO is quoted below:

*“Yes. Rollover relief is available under subsection 126-140(1) of the ITAA 1997 for the proportion of the CGT asset that relates to the interest subject to the payment split, but is not available for the proportion of the CGT asset that relates to the interest not subject to the payment split.”*

In most husband and wife SMSFs, the departure of one member will require a restructure of that SMSF. It is not possible to have single member and for that member to be the trustee. A corporate trustee is required. This restructure could expose the husband to a CGT event.

Where both the husband and the wife are seeking CGT relief, it is important that both are parties to the split rather than one being a passive recipient of the remaining assets. The active participant is the party that is receiving the assets of the split. The passive recipient is the person who is giving the split and remains in the old SMSF.

CGT is not relevant where both parties agree to liquidate all assets to facilitate transfers into retail su-



perannuation funds. In such cases, the SMSF bears the CGT prior to any split taking place.

If one party has his or her settlement in cash, then that party does not need CGT deferment because all of the transferred assets will be free of CGT. However, the remaining party will bear a liability for the CGT on all of the assets that remain in the fund, that have not been corralled to pay his or her pension. CGT can be avoided by ensuring that the husband is also a party to the orders. If there were 3 or 4 members of the SMSF, there would be no need to restructure so CGT would not be relevant.

In most cases though, the orders are structured by having one party transferring his or her entitlement to themselves. This counter-intuitive move is necessary to ensure CGT is deferred by making both parties active recipients.

### **Is the Agreement Reached Consistent with Asset Structure of the Fund?**

In the past, I have been presented with an agreement for splitting the SMSF, which was not possible to achieve.

An example involved splitting the assets equally and only having an in species transfer. The share portfolio could not be equally split and it was necessary to ask an independent expert to construct two near equivalent portfolios. A toss of a coin then decided the allocation of the two portfolios.

In one case, the wife wanted the beach shack. It has been used for personal enjoyment. The wife wanted it transferred to her name – not her SMSF! Just not possible.

### **Cash or In Species Transfer**

If the departing party does not intend to establish his or her own SMSF, and preservation release conditions have not been met, then the transfer must be in cash. Retail superannuation funds will only accept cash contributions. If the costs of selling are significant, then the parties need to determine who meets those selling costs.

The SMSF may incur a CGT liability when shares are sold to provide the cash to fund the split. However, in today's depressed market conditions, it may be possible to choose shares that have minimal CGT liability. Whilst that might leave one party with CGT laden shares, the fact that he or she is using those assets to fund a pension means that the CGT may not be a relevant consideration.

It may be easier for the parties for one to take cash. They can then select shares that suit their circumstances rather than having a portfolio of legacy shares. It will certainly be easier for the SMSF administrator to transfer cash.

### **Indemnities and Complying Funds**

A significant number of SMSFs are non-complying at some stage in their life cycle. In some case, there is a knowing non-compliance. In others, it is accidental.

One of the difficulties in dealing with a SMSF is what happens if the SMSF is found to be non-complying. An adverse audit finding could have retrospective taxation consequences on the fund. Family Law Practitioners should hear warning bells where one member, usually the husband, is the sole administrator of the SMSF.

One party providing an indemnity to the other party normally addresses the liability issue. At the very least, an indemnity should be provided to the departing party as at the date of exit from the fund. An example is:

*That the husband will indemnify the wife against any liability arising in relation to the operation of the K Superannuation Fund.*

The draft indemnity does not specify a time limit. As a fall back position, you might have to add these words at the end,..." from the date of leaving the fund."

If there is no agreement that one party is to be liable for past indiscretions, then a formula should be in





inserted into the orders, which apportions any liabilities between the members.

### What Type of Orders are Appropriate?

A percentage splitting order (type b order) accompanied by a requirement to revalue prior to splitting will reflect current values. However, such an order would also pick up any contributions.

A base amount order is appropriate if the split involves an in species transfer.

A base amount order may be appropriate where the assets are cash only or if the assets are not volatile or if there is an agreement to ignore fluctuations in the asset values.

In volatile times, asset prices will rise and fall. This means that one party might lose and the other party could gain. The issue to be considered by the practitioner is how best to protect your client. Failure to do so could expose the practitioner to claims.

Explicit consideration should be given on how the orders are responsive to changes in asset values and client's expectations. A base amount order could have a formula that picks up the changes in asset values.

### Operative Date - Date of Effect

The operative date is the date which the split interest becomes payable.

The *Superannuation Industry (Supervision) Act* sets all the rules that a complying superannuation fund must obey. Whilst the obligation is firmly on the trustees, the reality is that the trustees are very dependent on the SMSF administrator – usually the SMSF's accountant. So what does the administrator/trustee have to do when a splitting order is presented?

SMSF trustees must provide the following in-

formation once an interest is subject to a payment split. (S 2.36C). And they must provide that information as soon as practicable and make all reasonable efforts to comply within one month (S 2.32).

- Contact details for the fund,
- Base amount or percentage split under the superannuation agreement, flag lifting agreement or splitting order,
- The method by which the base amount will be adjusted on an ongoing basis
- Whether the fund rules would allow the NMS (non-member spouse) to become a member of the fund and details of the fund including product disclosure statements and options available to NMS,
- The circumstances under which the NMS entitlement will become payable,
- Information about the Superannuation Complaints Tribunal,
- How the fund handles inquiries and complaints,
- Fees payable by the NMS for payment splits

Other reporting obligations to the NMS are covered under S 2.36E when a separate interest has not been created and includes an event that is likely to have a material effect on the fund. Information about binding death benefit notices is also required.

The above clearly demonstrates that the splitting of an SMSF is not for the faint hearted. The process of administering a split is quite complex, tightly regulated and is time consuming. Where an administrator has not split a SMSF before, delays often occur.

The SMSF administrator/accountant should confirm in writing that all necessary processes could be completed within the time period specified in the orders. A longer time period may be required where the splitting requirements are more complex.



A time limit of 90 days is a good starting point. The SMSF administrator/accountant should be made aware of the consequences of not adhering to the time limit specified in the order. This is covered in the next section.

### **Compensation of Delays in Processing Orders**

If the splittable interest becomes payable after the operative date, *Family Law (Superannuation) Regulations 2001* provides for the base amount to be increased – see Regulation 45D(3). The adjustment mechanism is 2.5% above the adult ordinary time earnings (AWOTE), currently about 7%. Note that this rate applies irrespective of market conditions. If the investment returns were negative for the SMSF, both parties would share that loss prior to the split. However, once orders have been served and if the split does not occur before the operative date, the application of R 45D (3) has the potential to favour one party at the expense of the other.

It is therefore in the interest of both parties to ensure that the operative date is achievable.

The application of the adjustment mechanism of AWOTE plus 2.5% is legislatively mandated so will apply irrespective of the orders. However, it is a good idea to include such a clause in the order so that there is clarity as to what will happen in the event of a delay in the execution of the order.

### **COMMON ISSUES IN SMSF SPLITTING ORDERS**

Over the last 7 years, I have reviewed many splitting orders for SMSF. Common issues include:

- Nomenclature,
- Confusion between rollovers and splitting clauses,
- Redundant clauses,
- Circular operative dates,
- No indemnity clause
- Penalties for delay in processing splits that are contrary to legislation
- Splitting orders that are inconsistent with asset structure
- No procedural fairness been given to the trustees under S 90MZD of the FLA

### **Nomenclature**

Care must be taken to ensure that the right parties are referred to in the orders. To assist that process, the following are considered essential:

#### **a. On Line Search using Super Fund Lookup?**

The web address is: <http://superfundlookup.gov.au/>

Super Fund Lookup contains publicly available information about all superannuation funds that have an Australian Business Number (ABN). You can use Super Fund Lookup to:

- Identify whether a fund is complying or non-complying, and
- Identify whether a fund has ceased to operate, and access contact details for the fund.

There is no naming convention for superannuation funds and it is possible to have the same name for multiple SMSFs. The only unique reference is the ABN number. Super Fund Lookup is therefore essential to align the name and the ABN.

#### **b. The Trust Deed**

Family Law Practitioners (FLP) should ensure that the trust deed is the most up to date version. The trust deed will confirm the name of members and trustees. A current trust deed is essential if there is a dispute over death benefits or entitlements between members.

#### **c. Financial Statements & Member Statements**

At least the last 3 financial statements should be obtained. Member statements are part of the financial statements and can be used to confirm whether the Trust Deed is up to date in respect of members.

### **Confusion Between Rollovers and Splitting Clauses**

Some orders confuse the term rollover and splitting order using the terms interchangeably. Members can rollover their own account balance to another

complying superannuation fund. No splitting order is required.

A splitting order is required when member balances is being distributed in part or full to other members. If a splitting order is required, the term rollover should not be used.

### **Redundant Clauses**

I have seen splitting orders that require parties to adhere to the Family Law Act and Regulations. Yet other clauses in orders require adherence to specific parts of the SIS Act and Regulations. Adherence to legislative requirements is not dependent on the wording in an order. The SIS regulations even make provision for non-signing of the required paper work.

### **Circular Operative Dates**

Some orders give an operative date as the date that the applies to the time for transfer of the transferable benefits. This is not at all helpful to the SMSF administrator who is looking for a specific date. Neither is it helpful in establishing whether any late payment adjustments should be made to the base amount.

### **Procedural Fairness**

This is often overlooked for SMSF but it is still required even though both parties are members and trustees.

**CHECKLIST** - Practitioners might find the following checklist useful:

1. Are the names correct and checked against Super Fund Look Up?
2. Are the assets values at current prices?
3. Have the current accounts been sighted and Auditor's report noted?
4. Are the orders consistent with the asset structure of the SMSF?
5. Is there agreement on how any unforeseen liabilities are to be shared?
6. Is there an indemnity clause?
7. Do the splitting clauses provide CGT relief for both parties?

8. Do the splitting clauses account for changes in asset values between date of valuation and operative date?
9. Is there clarity on the operative date?
10. Are the penalties for late processing of the split known to both parties and the administrator?
11. Has the administrator signed off on the achievability of the operative date?
12. Has procedural fairness been given to the trustees under S 90MZD of the FLA?

**Any questions or feedback?** Email [here](#)

### **Other Readers**

If you would your colleagues to receive this email, click [here](#) with their email addresses.

Peter Skinner  
Director  
21 Sep 2010