Newsletter

FAMILY LAW and SUPERANNUATION –AN INTRODUCTION

Abstract

Welcome to 2012! This newsletter is designed to provide an introduction to selected aspects of superannuation and family law. It is specifically directed to the newly graduated family law practitioner (FLP). Those FLPs who have not dealt with defined benefit superannuation funds may also find this newsletter useful.

28 Dec 2002

Prior to this date, it was not possible to split superannuation. On this, date Part ViiiB was inserted into the *Family Law Act (FLA)*. Prior to this amendment, superannuation was treated as a financial resource, which was unfair to the party with little or no super, particularly when super was the major asset. The FLA was again amended in March 2009 to extend coverage of the super splitting laws to same sex and defacto couples.

FLPs may come across orders made prior to Dec 2002. These invariably incorporate a formula for dividing the super once the member has accessed it. The super can be divided at that point, as it is no longer in the superannuation environment. These orders require careful interpretation as the question of taxation, partial preservation, and pension implications is rarely addressed.

Another issue prior to Dec 2002 was the lack of a valuation methodology for defined benefit schemes. Most new FLPs would not have come across a defined benefit scheme so this is a good moment to describe the different types of superannuation.

Types of Superannuation

Superannuation can be thought of as having 3 parents. The first is the Government. It contributes super to lower income employees (referred to as co-contributions). The second is the individual. He or she can contribute to a superannuation fund. The third is the employer. Most superannuation comes from the employer through a 9% compulsory superannuation guarantee charge (SGC). This will increase to 12% by 2019.

Superannuation is dichotomised into a growth phase and payment phase. The growth phase occurs when contributions are being made during a person's working life. The payment phase refers to super being consumed. Most often this occurs as a consequence of retirement but it can also occur earlier in the event of permanent incapacity or death.

Super entitlements can be determined by reference to contributions made or by application of a set of factors, or a combination of both. When a superannuation benefit is determined by contributions, it is the contribution level and earning that aggregates to the benefit. It is similar to a bank account. This type of super accumulates with interest and is mostly referred to as an accumulation account. FLPs will encounter these types of account in 4 out of every 5 cases. They are relatively straightforward with the account balance being the asset value for family law purposes.

The other types of super benefits are determined by using a set of factors, e.g. age, member contribution level, length of service, salary, and are collectively referred to as defined benefit schemes (DB). In these schemes, the employer guarantees the retirement amount and therefore assumes the investment risk. This is the reason for the significant decline in the numbers of these funds over time. These schemes are complex and the complexity is even greater when a pension is offered. FLPs will need the assistance of a professional super valuer to derive the asset value of a defined benefit superannuation account.

How do you tell the difference between an accumulation account and a DB account? An accumulation account will not have any reference to super salary.

Because super is compulsory, FLPs need to match superannuation with employment history. It is easy to intentionally omit a superannuation account from the asset pool. However, the omission might be unintentional as there is about $13 billion in lost or unclaimed superannuation.

Why is Superannuation Popular?

Compulsion and tax breaks combine to drive up super balances so that over time, it will become the single biggest asset class. The SGC is compulsory and applies to all employees earning more than $450 per month. The tax breaks are so huge that superannuation concessions amount to one of the largest Government "outlays". The Government limits the quantum of tax concessions to individuals by setting an annual limit on the amount of super contributions that will be taxed concessionally. Penalties apply if super is contributed above these limits.

When Can Super be Accessed?

Super is regulated by the SIS Act – Superannuation Industry Supervision Act. A SIS condition of release has to be satisfied before super can be accessed. The most common release condition is reaching preservation age and retiring from the workforce. Preservation age is age 60 for those born after 1964. For those born before 1960 preservation age is 55 and transitional provisions apply for those born between 1960 and 1964.

FLPs should note that super is classified as preserved, restricted non-preserved and unrestricted and non-preserved. It is the latter category that is important to FLPs. Unrestricted non-preserved super can be accessed at any time.

Super and Taxation

Most superannuation benefits are tax free from age 60. For some Commonwealth Government schemes, including military schemes, taxation does apply as these schemes are unfunded, i.e. the Commonwealth does not pay its employer contributions into a fund but rather pays its share of the benefit when it is claimed. In circumstances where one party retains his or her super from these schemes and the other party retains real assets, such as a house, the tax on the super should be taken into account.

Note that substantial taxation does apply to those who access super prior to preservation age using conditions of release such as hardship or compassionate grounds.

Is all Super Splittable?

Not all superannuation can be split. FLPs should be aware of the following exceptions:

- Temporary income streams such as pre-assessment payments made pending determination of permanent incapacity claims.
- Small accounts, i.e. those with a balance of less than $5000.
- Reversionary (ie super that has reverted to a beneficiary due to death of the member) payments to children.
- Overseas superannuation entitlements (these can be valued and counted as a financial resource).
- Compensation type income streams such as veteran affairs pensions.

Family Law Valuation (FLV) Issues

The most common problem for FLPs is explaining to clients why it is necessary to value defined benefit super schemes but not accumulation schemes.

FLVs have a dual purpose. The first is to allow comparisons against real assets and the second is to be able to compare different superannuation schemes.

The FLV of accumulation schemes is simply the balance shown on the statement issued regularly to members. Defined benefit schemes also issue statements, which may show the current balance as a lump sum, but this is only a promise to at retirement. This is why FLP should never use the statement value of a DB scheme for asset purposes.

Payment Phase – Defined Benefit

When a pension is being paid from a defined benefit fund, it is more obvious that a valuation is required. Firstly, there is no member statement that gives a competing value. Secondly, it is more intuitive that a fortnightly pension has a capitalized value many times greater than the annual pension being paid. The FLV of a pension is the net present value of the expected future income stream.

Growth Phase – Defined Benefit

It is in the growth phase that defined benefit schemes present the greatest challenge to FLPs. In the growth phase, there is a member statement. There is a value on that member statement. How is that value different from a FLV? Why shouldn't the member statement value be used?

A member statement (MS) shows the value of the superannuation entitlement that has accrued to the date of that MS. What can the FLP expect to see on a defined benefit MS? Let's assume that a person has a superannuation salary of $60,000 and has been in the fund for 10 years and that the member accrues 20% of salary each year, or .2 of salary expressed as a multiple. After 10 years, the multiple would be 10 x 0.2 or 2.0. The MS would show a value of $120,000 (ie the super salary of $60,000 by 2.0).

In a defined benefit scheme, that $120,000 is not payable now. It is a promise to pay on retirement. Just as with the pension, a dollar today is valued more highly than a promise for a dollar at some time in the future. That future date is the retirement date, which under the Family Law Regulations is deemed to be age 65. The FLV takes that promise to pay into account and discounts the MS value. The FLV is a discounted net present value of future income.

A MS can be said to be looking backwards as it shows what has accrued over the employment history of the member. On the other hand, the FLV projects forward to the retirement date and shows the present day value of the accrued entitlement that would be payable over the lifetime of the member.

FLPs should now appreciate that there is little relationship between a MS value and a FLV for defined benefit schemes.

Death and Resignation Benefits

The FLV is sometimes compared against the death or invalidity benefits as justification for not using the FLV where it is less than the MS value. However, the FLV measures the here and now. An invalidity benefit is not relevant if the member is not an invalid. Some FLPs argue that if the resignation value is higher than the FLV, then the FLV should not be used. However, the member has not resigned. If he or she were to resign, then it would be relevant.

Why Should a FLV be Obtained for a Defined Benefit Scheme?

As has been discussed, the FLV for a defined benefit scheme bears little resemblance to the member statement value. Without a FLV, it is not possible to ascribe a correct value to the superannuation asset. Furthermore, it is not possible to meaningfully trade off between superannuation schemes and between superannuation assets and real assets. Without a FLV, FLP mistakenly use the MS balance. This is a high risk practice.

Beware of Non Separate Interests. DB schemes are either separate interest or non-separate interest schemes. It is not possible to split a non-separate interest scheme benefit until a payment is made. This may not occur until the member is over 65.

DB schemes that are a non-separate interest scheme need quite different considerations and communications with the client. These issues are outlined in my March 2011 newsletter.

Trustees do not disclose in the superannuation information form whether the scheme is a non-separate interest scheme. This is a major deficiency and calls for heightened awareness on the part of FLPs. A negative answer to the question, “Can I roll out the split interest?” is one of the best indicators of a non-separate interest.

Measurement of Superannuation Brought into the Relationship

Superannuation brought into the marriage is often overlooked. This needs to be valued and adjusted so that it is comparable with the super at the end of the relationship.

Orders

A splitting order can be either for a base amount - S90MT(a) or a percentage split - S90MT(b). A base amount specifies a dollar amount whereas a percentage split specifies a percentage figure.

Some FLPs will slip in a percentage split order when it is advantageous for their client. It is advantageous where the super has grown either through investment returns and/or through contributions, or because it is a DB fund.

At the other extreme, some FLPs insert a base amount and do not address the change in value from the time the valuation was obtained to the date the orders were served. For example, assume the base amount was $100,000. Given the protracted nature of some cases, this figure may relate to a valuation obtained in 2008. Today, through investment returns, that amount could be valued at $135,000 or $75,000, depending on whether the value was obtained before or after the global financial crisis. FLPs need to be cognizant of the current value of the base amount.

Self Managed Super Funds (SMSF)

These require special considerations – see my newsletter on SMSF of Sep 2010.

Any questions or feedback? Email by clicking here.

Other Readers

If you would your colleagues to receive this email, click here with their email addresses.

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