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Newsletter

Self Managed Superannuation Funds and Family Law

specialising in superannuation valuations for family law purposes since 2003

Abstract – This newsletter is to assist Family Law practitioners to appreciate the special considerations that apply to SMSFs when splitting super. To treat a SMSF in the same way as ordinary super is a high risk strategy.

Just click here to send a question. There is also a superannuation tip specifically directed to the new regime from 1 July 2007.

What is a SMSF?

A SMSF is a fund that meets the definition in S 17A of the Superannuation Industry (Supervision) Act, - namely

- It has 4 members or less
- No member is an employee of another member of the fund, unless they are related
- Each member is a trustee
- Trustees receive no remuneration for their services as trustees.

There are approximately 350,000 SMSFs with about $250m in funds under management. Only retail funds are larger in dollar terms although the average account is much smaller than SMSFs. They have been the fastest growing segment now for over a decade. SMSFs are still relatively rare – out of 12 superannuation cases, only 1 would be in a SMSF. Lack of familiarity can expose the practitioner to unintended consequences.

Why SMSFs?

The popularity of SMSFs is due to the freedom for members to control their own affairs. Freedom is modified by the "in-house asset rules" which restricts the amount of the fund's assets that may be invested from related parties. Furthermore, the SMSF has to pass the "sole purpose test" which is designed to ensure that the superannuation fund only provides retirement benefits. SMSFs are not able to provide personal benefits to members prior to retirement.

Valuation of SMSF

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. In effect, they are unregulated. It is simply not possible to prescribe a standard valuation regime given the enormous diversity of SMSFs.

Nearly all SMSFs maintain a separate account for each member. The contributions are tracked to each member and the asset value of each member is separately maintained. So in a SMSF, each member would have their own account balance reflecting contributions into that account.

All SMSFs have assets. It is the aggregation of the value of those assets that would comprise the value of the SMSF. Such aggregation would normally be found in the financial statements 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 10 years ago. Share prices 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'

Orders should not have any clauses that require the parties to confer on accounting issues such as a valuation of a property. The accounting issues should be finalised prior to any orders. Many orders have come unstuck because of failure to resolve accounting issues. By finalizing the accounts first, the orders become more procedural and the likelihood of a successful conclusion is materially enhanced.

Adjustments to Valuations

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. Any splitting order should also take into account any reserves.

Pension assets

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. Most practitioners ignore this fundamental and important aspect of a SMSF.

The accounts of a SMSF show the CGT liability accrued as at the operative date. For example, if the SMSF had assets of $1.2m and a $100,000 CGT liability, the assets in the accounts would be $1.1m. However, as member A can elect to take a pension benefit, the CGT liability would be forgiven. So if the split occurred before the pension was created and some time later, member A created a pension, a windfall gain of $100,000 would be given to member A. For this reason, the CGT liability should be shared by dividing the assets after adding back the 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.

Interest

Interest is often overlooked and can be a significant amount. In most cases, the accounts are used at the balance sheet date to split the superannuation. Take a typical SMSF with a balance sheet date is say 30 June 2006. If the orders were for a base amount and were written in February 2007, a period of 7 months has elapsed since the value was determined. The non-member spouse should be given interest for this period. The interest can be a proxy for what the assets have earned in this period or a fresh set of accounts can be completed to coincide with the order date.

Alternatively, a percentage order could be made and this would automatically capture interest. However, care needs to be taken to ensure that the assets reflect market value at the date of the orders.

Capital Gains Tax and Orders

Most practitioners assume that CGT is deferred as a result of the splitting order. Following a recent tax ruling, this is only half true. Many practitioners have unwittingly exposed their client to CGT.

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

The ruling involved two members of SMSF 1, X and Y. A payment split under S 90MT(4) of the FLA 1975 was made in favour of X over Y's superannuation interest in SMSF 1. Y was forced to restructure with the departure of X from the fund. Y set up SMSF 2. (X was not a member, obviously). The assets that remained after the split were transferred from SMSF 1 to SMSF 2.

Issue

Is rollover relief available under subsection 126-140(1) of the *Income Tax Assessment Act 1997* when the trustee of a SMSF, to which both spouses belong, transfers a CGT asset to another SMSF, to which only one spouse belongs, because of a payment split under the Family Law Act 1975?

Decision of the ATO – a quote

"*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.*"

Discussion

Where the husband and wife are the only members of the SMSF, a marriage breakdown should result in the departure of one party from the SMSF. The remaining member has no choice but to restructure the SMSF. In many cases, the trustee is a corporate trustee with the husband and wife being the sole directors with equal shareholdings. The remaining party often restructures to a sole director trustee company. The restructure is a CGT event.

In nearly all cases, a simple splitting order will give one party CGT relief but will impose a CGT event on the other. This is because one party is a passive party to the splitting order. This can be avoided through cross splitting orders.

It also follows that without a splitting order, each party would be liable for CGT if they each left the SMSF.

Check List for SMSF Orders

- If corporate trustee, has directorship been terminated?
- Have shareholdings been transferred?
- Has corporate property been recovered?
- Has a RoCS search been instigated to ensure correct ABN etc?
- Are indemnities in place for the offices held by the leaving party?
- Do the assets reflect current market prices?
- Have reserves been taken into account?
- If a base amount is being used, does it have an interest component?
- Do the orders leave one party with a CGT event?
- Do the orders remove the entirety of the departing spouse's interest in the SMSF?
- Has a time limit on the transfer of assets been specified?
- Are the assets to be transferred in species or in cash?

- Has the SMSF administrator agreed with the timetable?

Superannuation Changes

The new superannuation regime from 1 July 2007 will require a rethink of what happens to your death benefit when you die.

Non-dependant children inheriting taxable superannuation components will pay tax at 16.5%. Tax free components include pre 1983 and after tax contributions. The issue is how to increase such components.

Amalgamating two or more funds can increase your tax exempt funds if the start date differs between funds. When amalgamated, the earliest start date prevails increasing the amount of pre 1983 funds. For members under 65, they can withdraw the tax free threshold and recontribute that amount as an undeducted contribution.

Another strategy, if you are over 60, is to withdraw funds and give it to the adult children before you die. This would avoid the 16.5% tax, - and enhance your popularity!

Feedback

Please email me any feedback or topics you would like covered in future newsletters.

Curriculum Vitae - click here to view my CV or past newsletters.

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Other Readers

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