FAMILY BREAKDOWNS & TBC ISSUES

Daniel Butler, Director, DBA Lawyers

#NC2020

Daniel Butler

Director, DBA Lawyers

Dan is recognised as one of Australia's leading SMSF lawyers complemented by his taxation and commercial expertise. He has worked predominantly in the fields of tax and superannuation over the past 36 years, is a qualified Chartered Tax Adviser, Chartered Accountant and has an MBA from the University of Melbourne. Dan is a regular seminar presenter on tax and SMSF topics and has published extensively in these areas. Dan is a member of the ATO's Super & Employment Change Committee, The Tax Institute's National Superannuation Committee, the Law Institute of Victoria's Tax Committee and is involved with a number of other tax and SMSF committees. Dan presents on the subject of Taxation of Superannuation at the University of Melbourne's Master of Laws/Tax program. Dan is also an SMSF Specialist Advisor™.

Disclaimer

These notes are for attendees who are registered for the 2020 SMSFA National Conference. They are a general guide only and only based on our views of the law as at 27 January 2020. They are no substitute for expert advice. Anyone seeking to rely on these notes should obtain expert advice to confirm particular issues especially as the law is subject to ongoing changes and substantial penalties can be imposed. DBA Lawyers is not licensed to provide financial product advice under the *Corporations Act 2001* (Cth). Copyright resides in DBA Lawyers unless another source is noted.

SMSFs & Relationship Breakdowns

- How best to minimise risk when admitting a spouse to an SMSF
- What is the best way to split super?
- How do the preservation, tax free %, TBC and other rules work?
- What are the key strategies, key traps and tips?
- Much more …
- *References to legislation will be to the SISA unless stated otherwise*

Background

- The Australian divorce rate is around 40% of marriages each year
- The average marriage lasts for 12 years
- The most common age for divorce is 45.5 for males and 42.9 for females
- No. of SMSFs = 598,429 (Mar 2019 ATO data)
- Around 70% of SMSFs have two members, ie, 598,429 x 70% = 418,900
- Most of these 2-member SMSFs would be couples
- There are no records of the number of de facto separations
- Thus, there would be quite a few SMSFs involved in a split each year

Background

- Advisers need to be wary of clients going through separation
- Advisers need to manage conflicts and not take sides, eg, wife wants to depart husband and withdraw some money from SMSF
- Advisers need to monitor for contraventions and assist with the split, eg:
  - Assets/liabilities to be valued and accounts prepared
  - Advice on commercial, super and other consequences
  - Strategic and related advice
  - Tax planning – a tax effective split!

Admitting a spouse to an SMSF

- Superannuation is property for family law splitting purposes
- Think carefully before admitting a spouse
- What consideration have your clients given to what happens on a separation?
  - What if the relationship has become so acrimonious that the parties cannot talk or cooperate, especially if contraventions of super law may have occurred?
  - Who stays in the fund, if anyone?
  - Who gets what share of the fund or specific assets, eg, business real property ('BRP')?
- We will assume that Charles' and Diana have recently separated and are splitting their super and related assets

Admitting a spouse to an SMSF

- It is easy to admit a member
- However, it is difficult to eject one
- SISR 6.28(1) provides:

… a member's benefits in a regulated superannuation fund … must not be rolled over from the fund unless:

(a) the member has given to the trustee the member's consent to the rollover; or …

- Consent can be given upfront and on a contingent basis
- What role does the deed play?

Admitting a spouse to an SMSF

- DBA Lawyers' SMSF deed has conditional membership provisions where the spouse can consent to being admitted and then ejected on, eg:
  - When the parties divorce, separate or cease to live as a couple
- This conditional membership could be bolstered by:
  - Other legal fine tuning including having an appropriately drafted constitution and shareholding structure
  - A financial agreement or superannuation agreement under the *Family Law Act 1975* (Cth) can be implemented to bind the couple to the removal of one spouse from the SMSF upon certain conditions being invoked, eg, separation, and the basis of the super split

Admitting a spouse to an SMSF

- Financial agreements under the *Family Law Act 1975* (Cth) are not that popular but consideration could be given to covering certain aspects in a financial agreement, eg:
  - The spouse operating the business gets to retain the SMSF with the BRP
  - The spouse who is not involved in the business gets to retain a larger slice of the other assets
  - *Thorne v Kennedy* [2017] HCA 49 - financial agreement not binding due to duress and other factors at [120]:

    > *… the financial agreements were "neither fair nor just and reasonable" and the entry into them involved an unconscientious taking of advantage by Mr Kennedy.*
- [Broadly, this case involved an elderly gentleman marrying a lady from overseas with limited command of the English language, who wanted to void her financial agreement]

Super splitting

- The two main methods of splitting super in an SMSF include:
  - **% Interest payment split:** a % of the member's interest is split with their spouse (ie, non-member spouse or NMS)
  - **Base amount payment split:** a specified amount of the member's interest is split with their NMS
- Broadly, the most appropriate splitting method depends:
  - If assets are increasing in value, a % Interest split may be more desirable for the NMS (this would be less desirable for the member spouse)
  - Conversely, if assets are decreasing in value, a base amount split may be more desirable for the NMS (this would be less desirable for the member spouse)
  - A base amount may prove easier if the couple's overall asset pool is known with sufficient certainty and a base amount suits both parties. Interest can also accrue on the base amount for the NMS

Super splitting

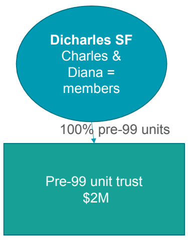
- Many incorrectly assume that the court orders/superannuation agreement effect a split
- However, a range of super splitting documents including relevant notifications, elections and trustee resolutions are also required
- DBA Lawyers' super splitting documents are tailored to each member's circumstances to implement an effective split ('base amount' or a 'percentage'). Naturally, other documents/services may also be required with a split including, eg:
  - New SMSF and new corporate trustee for the departing member (NMS)
  - Change of trustee/director/shareholder/member documents
  - SMSF deed update
  - SMSF to SMSF rollover documents
  - Other documents or services
- Refer: https://www.dbalawyers.com.au/family-law-supersplitting-kit-smsfs/

SMSF with pre-99 UT

- Example:
  - Charles and Diana are members of the Dicharles Super Fund ('Dicharles SF')
  - Two children – William and Harry
  - The fund's main asset is 100% units in a pre-99 unit trust ('UT') currently valued at $2M with a commercial building leased to an unrelated party
  - They have recently separated and have sought consent orders where Charles' interest will be split so that Diana ends up with a 50% share of his interests in the fund
  - Diana seeks your advice as to the following:
    - Can she roll over fund assets (including units in the pre-99 UT) to her new SMSF?
    - How best is her split managed?

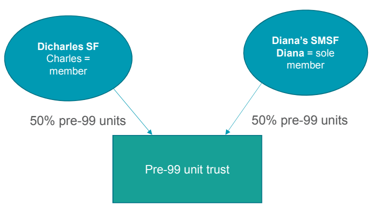
SMSF with pre-99 UT

Currently, the Dicharles SF owns 100% of the units in the UT



SMSF with pre-99 UT

Charles & Diana want to restructure and have 50% of the units via their SMSFs



TBA

POLL – Can Diana's SMSF acquire pre-99 UTs?

SMSF with pre-99 UT

Example 1 (cont):

- Even if they are still legally married, s 66(2B) of SISA provides a special carve out from the usual prohibition in s 66 in relation to acquisitions where the:
  - member and his/her spouse or former spouse are separated
  - acquisition occurs directly due to the relationship breakdown
  - asset represents the member's own interest or their NMS interest in the transferring fund
- s 71EA of SISA applies where the:
  - acquiring fund acquires an asset … from the transferring fund
  - member and his/her spouse or former spouse are separated
  - acquisition occurs directly due to the relationship breakdown
  - acquiring fund is treated to have acquired it when the transferring fund did
- Thus, Diana's SF can acquire units in the UT (see s 66(2B)) and the units do not lose their pre-99 grandfathered status (see s 71EA)

Proportioning rule

- The taxable component and tax free component are broadly calculated in respect of each superannuation interest as follows:
  - Value the superannuation interest
  - Ascertain the tax free component
  - The 'taxable component' is the total value of the member's superannuation interest less the value of the tax free component
- The proportions are calculated on commencement of a pension (including a TRIS that is not in retirement phase)
- The proportioning rule in s 307-125 ITAA 1997 is discussed:
  https://www.dbalawyers.com.au/audit/many-strategies-based-proportioning-rule/

Proportioning rule

- There is no special payment split provision in the ITAA 1997
- Returning to Charles & Diana's example:
  - Charles has $1.2M – 30% tax free or $360K
  - Diana has $800K – 40% tax free or $320K
  - A split from Charles to Diana of $200K, would take a 30% tax free proportion (from Charles) to blend with Diana's (40%) tax free proportion; resulting in a 38% tax free proportion for Diana

Proportioning rule

Charles & Diana's example:

Pre-split figures:					
	Taxable	Tax free	% tax free	Total	Split amount
Charles	840000	360000	30%	1200000	-200000
Diana	480000	320000	40%	800000	200000
Post-split figures:					
Charles	700000	300000	30%	1000000	
Diana - open balance	480000	320000	40%	800000	
+ super split	140000	60000	30%	200000	
	620000	380000	38%	1000000	
Diana's tax free is now a mixed 38%.					

TBA

Transfer balance account ('TBA')

294-80 Transfer balance debits

(1) The following table sets out when a debit arises in your *transfer balance account and the amount of the debit. The debit is called a ***transfer balance debit***.

Debits in the transfer balance account

Item	If:	A debit of:	Arises:
1	you receive a *superannuation lump sum because a *superannuation income stream of which you are a *retirement phase recipient is commuted, in full or in part	the amount of the superannuation lump sum	at the time you receive the superannuation lump sum
4	a *transfer balance debit arises under section 294-90 because of a payment split	the amount of the debit specified in section 294-90	at the time provided by section 294-90

TBA

POLL – which item ?

Under which item, ie, 1 or 4 of s 294-80, would you claim a debit when a pension is commuted to effect a payment split in an SMSF?

TBA

Transfer balance account ('TBA')

294-90 Payment splits

(1) A *transfer balance debit arises in your *transfer balance account if:
- (a) subsection (2) provides that the debit arises; and
- (b) the Commissioner is notified in the *approved form that the debit has arisen.

Payment splits

(2) A debit arises if:
- (a) a *superannuation interest is subject to a *payment split but remains an interest of the *member spouse; and
- (b) the superannuation interest supports a *superannuation income stream that is in the *retirement phase; and
- (c) as a result of the payment split, a proportion of all *superannuation income stream benefits from the income stream is to be paid to a *non-member spouse; and
- (d) as a result, the member spouse and the non-member spouse are both *retirement phase recipients of the superannuation income stream.

TBA

Transfer balance account ('TBA')

(3) The amount of the debit is:
- (a) if you are the *member spouse—the proportion mentioned in paragraph (2)(c); and
- (b) if you are the *non-member spouse—the remaining proportion;

of the *value, on the day the debit arises, of the *superannuation interest that supports the *superannuation income stream affected by the *payment split.

- Sec 294-90 is only applicable to some public sector superannuation funds and corporate defined benefit funds paying a defined benefit pension where the member's pension is split
- In most SMSF super splits, the TBA will be managed by the member commuting their pension and then seeking a debit to their TBA in the normal course. The NMS will get a credit if they start a pension in retirement phase. Refer: LCR 2016/9 at [60A]

CGT roll over

- Broadly, CGT roll over relief can apply on asset roll overs from an SMSF under s 126-140(2) ITAA 1997 where:
  - there is an interest in an SMSF that is subject to a payment split
  - the election under Part 7A of SISR is exercised to transfer or roll over benefits for the NMS
  - the SMSF transfers assets to another (transferor) SMSF for the benefit of the NMS
- CGT roll over relief in relation to the NMS' assets is also available under s 126-140(2A)
- Roll over relief results in any capital gain/loss being disregarded
- The transferor fund's cost base of the asset is inherited from the transferee fund
- Thus, a capital gain is merely deferred

CGT roll over

Return to Charles and Diana's example:

- The value of the units in the UT have increased from $600K to $1.6M
- Charles currently has $1.2M and Diana has $800K in the Dicharles SF
- Diana's SF is to end up with 50% of the units in the UT. If roll over relief is obtained:

Assume Diana gets 50% of the units in the UT as part of her split, the following figures apply:			
		50% transferred	
Market value of units in UT	1,600,000	800,000	
Cost base of units	600,000	300,000	
Increase in value of units	1,000,000	500,000	
1/3 CGT discount		166,667	
Assessable net capital gain ('NCG')		333,333	
Disregarded NCG under s 126-140		333,333	If election made

CGT roll over relief

- If there was no CGT election made:
  - then Diana's SF would obtain a market value cost base of $800K (not $300K)
  - who's fund pays the $50K of CGT (ie, $333k x 15%)?
- Depending on who you act for, you may/may not wish to elect to obtain CGT relief
- Note that CGT roll over relief merely defers the net capital gain (there is no step up in the asset's cost base)

Preservation

- Preservation – primary rule is that all benefits are preserved until a relevant condition of release is satisfied
- SISR regs 6.02 & 6.03 deal with preserved benefits. Broadly, everything in super is preserved unless it is a restricted non-preserved benefit or an unrestricted non-preserved benefit ('UNPB')
- Eg, SISR regs 7A.03B(6) and 7A.11(6) provide in respect of a payment split the creation of a new interest for the NMS:

(6) In creating the new interest:

(a) a proportion must be taken from the unrestricted non-preserved benefits, the restricted non-preserved benefits and the preserved benefits of the member spouse; and

(b) the proportion taken from each category of benefits must be the same as the category bears to the member spouse's interest immediately before the new interest was created.

Preservation

Example - assume:

- Charles (67) - 100% of his benefits are unrestricted non-preserved benefits ('UNPB')
- Diana (53) - 100% of her benefits are preserved
- Any amount split from Charles to Diana would remain UNPB

Contribution caps

- Concessional $25,000 p.a.
- NCC's currently $100,000 p.a. and 3 year bring forward rule provided the member's total superannuation balance ('TSB') is < $1.6M
- Both Charles & Diana's TSB are below $1.6M – so they can still make NCCs
- CGT small business div 152 relief $500,000 or $1,515,000 if qualify for the 15 year rule
- A super split may provide a method to boost one's super, especially where the former spouse is seeking the retain other assets, eg, the family home

Shail's case

***Shail Superannuation Fund and Commissioner of Taxation* [2011] AATA 940**

- The SMSF trustees and members were (Mr) Mustafa and (Mrs) Nuriye Shail
- In mid-2005 $3.46M was transferred to Mr Shail's bank account in Turkey
- Mrs Shail asserted this was done without her knowledge
- No condition of release was satisfied
- The ATO issued a notice of non-compliance to the SMSF trustee
- Notices of assessment were then issued for $3.06M (includes 75% penalty tax)

Shail's case

At [47] the Tribunal was referred to paragraph 2204 of *Jacobs' Law of Trusts in Australia* (5th edition) by RP Meagher and WMC Gummow which states, in part:

- *The liability of trustees is joint and several, and the persons entitled to sue in respect of loss to the trust estate caused by a breach of trust may sue any or all of the trustees. ... **Where there are two trustees and one of them commits a breach of trust, the other trustee will be liable:***
  - ***if he is personally in breach of his duty to the beneficiaries, as where he participates in the breach, or***
  - ***where he has improperly delegated the administration of the trust to his co-trustee, or***
  - ***where he has failed to exercise reasonable care to prevent his committing a breach of trust or where he subsequently approves or acquiesces in or conceals his co-trustee's breach of trust or fails to take proper action to compel his co-trustee to redress the breach of trust.*** *... These rules have been given statutory force by the Trustee legislation of all States (... Vic s 36 ...), ...*

Shail's case

- The tax assessed of over $3.06M plus GIC, despite the enormity of this impost, was held to be validly levied on Mrs Shail as an individual trustee
- Lessons from the Shail decision:
  - How many SMSFs are subject to similar risks, eg, one spouse withdrawing funds, transferring assets, etc, without the other spouse's consent?
    - What controls should be in place – bank a/c authorisations above certain limits, etc?
  - When there is a separation, potential contraventions may arise, placing the fund's complying status at risk
  - Ongoing accountability and keep a 'watchful' eye on transactions – bank apps that notify of a/c transactions in real time
  - The administrative penalty regime can result in huge penalties – insist on corporate trustees!

Other points

- On separation, a revised and updated estate/succession plan should be put in place, including:
  - Revised wills, powers of attorney and reversionary pension nominations
  - Make new binding death benefit nominations ('BDBN') or revoke existing BDBNs
  - Revise successor trustee/director/trust and appointor nominations
  - Notify relevant advisers/banks, etc, that joint sign-off required
  - Be careful where deeds and other documents may 'weight' the vote on the member's a/c balance as a contribution or withdrawal may change control
  - Are there any duty concessions from a restructure – jurisdiction specific?
  - Is there any need for a flag/freezing order/caveat, etc, to protect a member's interest in the SMSF or elsewhere?
  - Would a child maintenance trust assist?

Conclusions

- Focus on the best outcome for your client having regard to the overall position with appropriate tax attributes and value
- Make sure you are aware of how the rules apply and optimal strategies that can be put in place
- Note, the quality of the documentation get "stress" tested on death, relationship breakdowns and ATO reviews/audits
- Obtain appropriate advice and obtain lawyer input

Contact details

Daniel Butler, Director, DBA Lawyers

Ph: 03 9092 9400 E: dbutler@dbalawyers.com.au

Web: dbalawyers.com.au Twitter: @DBALawyers

#NC2020

Disclaimer

#NC2020