



SMSF dispute aftermath – splitting the spoils and what to do when court orders fail

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PRACTICAL CHALLENGES FOR SPLITTING SUPER FOR SMSF TRUSTEES/MEMBERS

SLIDE 4

General proposition

1. The particular problems for self-managed superannuation funds and family law splitting of superannuation is perhaps best summed up by the following quote:

*Members of SMSFs must also be trustees of the fund or directors of the trustee company of the fund. **If both parties to the marriage are members of an SMSF, an added layer of complexity arises as both parties must continue to be involved in the trusteeship of that fund until the parties are no longer members of the same fund. This may affect decision-making during the period between separation and settlement.*** (Wolters Kluwer Master Superannuation Guide 2020, [14-270])

2. Husband-wife funds are often the most problematic SMSFs when dealing with splitting of superannuation interests because it is no longer viable to continue together in the same fund.
3. One party may refuse to co-operate and it may prove difficult even getting to step 1 – information gathering and valuation of the interests. Superannuation compliance concerns often also emerge at this stage.

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Dealing with lumpy assets

4. Illiquid or 'lumpy' assets may also give rise to particular hurdles where it is not possible to sell a lumpy asset to allow one party to roll their interest to another fund. Advisers will need to consider strategies for dealing with those assets in a splitting of interests.
5. The expense of obtaining up-to-date valuations of real property often also presents as an immediate hurdle for the SMSF trustee.
6. An element of any strategy will be consideration of any CGT liability, noting that roll-over relief is available only when certain conditions are satisfied:
 - a. the parties are members of the same SMSF;
 - b. an interest is subject to a 'payment split';
 - c. the transfer of the CGT asset to the trustee of another fund for the benefit of the 'leaving party';
 - d. transfer is made 'in accordance' with a splitting agreement or order (per s 126-140(2B) ITAA97 or s 90XZA FLA);
 - e. transfer is because of a marriage or relationship breakdown;
 - f. as a result of the transfer the leaving member (non-member spouse or member spouse) will have no entitlement in the SMSF.
7. Strategies often involve cross-splitting between interests to address the burden of a CGT liability, though it might also be addressed by the apportionment of non-superannuation assets.
8. Related party leases of fund assets may also be in issue at this stage there is a family business leasing an asset of the fund.

SLIDE 6

The compounding problems of death or bankruptcy

9. If bankruptcy or death of one party occurs prior to the creation of a separate interest further complexities emerge.

10. A bankrupt member/trustee/trustee director will mean there is a six month window in which the fund may continue to satisfy the SMSF definition under s 17A, SISA and compliance issues begin to emerge. If the bankrupt member's interest is not or cannot be transferred out of the fund or the fund being otherwise wound up within this time-frame the Commissioner of Taxation will need to be approached – probably with undertakings to remedy non-compliance or risk penalties and adverse taxation treatment.
11. In the event of the death of a member spouse, a non-member spouse's interest will be protected only if their interest has been created as a result of a splitting agreement or order. However, a court order may prevent the trustee from dealing with the deceased member's interest without leave of the court (e.g. s 90XR(3), s 90XV(1), FLA) Also see *Arkin & Blasberg* [2019] FamCA 476 which dealt with the power of the court pending a trial to order a party to remake a binding death benefit nomination and the circumstances in which it might be proper for a court to grant a mandatory injunction to prevent the trustee from paying benefits in accordance with a binding death benefit nomination. The case demonstrates the complexity of dealing with death benefits in the context of a family law superannuation splitting order.
12. If a non-member spouse dies after the operative time for a payment split (but before a new interest has been created or their interest has been transferred or rolled over or paid) the payment split continues to operate in favour of their legal personal representative.

THE FUNDAMENTALS OF SUPERANNUATION SPLITTING LAWS

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Family law legislation

13. Superannuation splitting law is an amalgam of family law legislation and superannuation legislation – *Family Law Act 1975* (Cth) (**FLA**) (Part VIIIB – ss 90XA to 90XZH) and *Family Law (Superannuation) Regulations 2001* (Cth) (**FLSR**) and *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**SISR**).
14. Family law legislation allows for superannuation to be treated as a special type of property, allowing separating couples to value their superannuation interests

and to split superannuation payments. Though Part VIIIB of the FLA has paramount operation (s 90XB); operating despite any provision of any other Commonwealth law or the trust deed or governing rules of a fund, the split superannuation benefit will generally remain subject to superannuation law and to the provisions of the trust deed governing the relevant fund – meaning that preservation and cashing restrictions still apply and the interest and underlying assets are still subject to investment rules, requirements relating to investments, reporting requirements. (For example, see *Mackah & Mackah* [2017] FamCAFC 62.)

SIS Regulations – Part 7A

15. The SIS Regulations allow for the separation of the non-member spouse interest – so that it is segregated from the member spouse interest. The provisions also apply to de facto couples (including, recently, for separating de facto couples in Western Australia per *Family Law Amendment (Western Australia De Facto Superannuation Splitting and Bankruptcy) Act 2020* (Cth)).
16. In summary, there are three options available to a non-member spouse in respect of a splitting payment:
 - a. creation of a new interest in the fund – if available under the trust deed;
 - b. rollover or transfer of interest to a new fund – nominated by the non-member spouse or to an eligible rollover fund (if a nomination is not received within 28 days); or
 - c. cashing of the benefit – but only if a condition of release has been satisfied by the non-member spouse or the original benefit was in payment phase.
17. Standard procedures for dealing with superannuation interests between separating couples are dealt with over the next several slides.

INFORMATION GATHERING

18. Gathering information about a superannuation interest from a superannuation fund trustee involves:

- a. applying to the superannuation fund for information regarding the member spouse's interest – requires a Form 6 Declaration to accompany a Superannuation Information Request Form and the relevant Superannuation Information Form to be completed by the trustee - these forms are available via the Family Court Registrar;
 - b. a particular Superannuation Information Form being used for self-managed superannuation funds (SMSFs);
 - c. 'reasonable' fees may be charged by trustees to provide information;
 - d. trustees can use their own format to provide the information and may not complete the form provided (so long as the relevant information is given (Division 7.2 FLSR));
 - e. the trustee's information statement must be attached to applications to court for a property settlement, including applications for a consent order relating to a superannuation interest.
19. The trustee must provide the information requested (s 90XZB(3) FLA), but not the address (including postal address) of the member (s 90XZB(5) FLA). It may be provided to the non-member spouse's lawyer (if authorised).
20. Information must be provided about all interests (for example, each accumulation interests and each pension interest).
21. Trustees may be required to swear/affirm an affidavit in support of the information given and be available for cross-examination in court.
22. Information must be given at the 'Appropriate Date' (being the date of receipt of the request or an earlier specified date).

SPLITTING ORDERS AND AGREEMENTS

23. Splitting of a superannuation interest may be pursuant to:
- a. a court order following a hearing;
 - b. a court order made by consent of the parties;

- c. binding financial agreement (that must meet particular criteria, including each party receiving independent legal advice),

which are referred to in this presentation as '**splitting orders**'.

- 24. All splitting orders are official documents recognised by the family court or the federal circuit court with jurisdiction over family law matters.

SMSF TRUSTEE OBLIGATIONS ON RECEIVING A SPLITTING ORDER

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SMSF trustee obligations on receiving a splitting order

- 25. Splitting orders are not 'self-executing' and require steps to be taken by the trustee(s), including:
 - a. after receipt of a copy of the splitting orders (together with the reg 72 FLSR notice), the trustee must give each party a 'payment split notice' to notify the parties that the interest of the member spouse is subject to a split per the splitting order terms;

(NOTE: 'Cross-splitting' of interests is common for husband-wife funds – where each party is a member spouse in respect of their own interest and a non-member spouse in respect of the other party's interest – albeit they are both members of the same fund. In those cases notices would need to be given by the trustee in respect of both parties' interests.)
 - b. the trustee must also give information to the non-member spouse about the particulars of the split and other matters (reg 2.36C of SISR);
 - c. the trustee must act on the election of the non-member spouse to: (i) establish a new interest in the fund for the non-member spouse (if available under the trust deed); (ii) transfer or rollover the amount under the splitting order to a fund nominated by the non-member spouse; (iii) pay a lump sum to the non-member spouse (if eligible pursuant to preservation rules/cashing restrictions) (Part 7A, SISR).

(NOTE: The non-member spouse election must be made within 28 days from the date of the payment split notice or such longer period as the trustee allows.)

26. For base amount splits, the trustee will also need to adjust the base amount from the 'operative time' until the payment date (reg 1.03, SISR;) by interest added at a prescribed rate.
27. Percentage splits are only likely to be applied where benefits are in the pension phase (and we do not give particular consideration to these for the purposes of this presentation).

FAILURE TO COMPLY WITH SPLITTING ORDERS

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Failure to comply with splitting orders

28. A trustee failing to comply with Div 7A.2 in giving effect to splitting orders will breach an operating standard (s 34(1), SISA and reg 7A.02, SISR).
29. Each contravention attracts an administrative penalty of 20 penalty units (equating to a penalty for each trustee (or jointly and severally for trustee director) of \$4,440).
30. Failure to comply with the court orders is also problematic for individuals and trustees because they may be found to be in civil contempt of those court orders, pursuant to which the family court or federal circuit court may impose a fine or a term of imprisonment (though, the latter is unlikely unless the contempt has been contumacious or contumelious – i.e. basically wilfully disobedient or insolent reproach or abuse). (See *Vayson v Deckers Outdoor Corporation Inc.* (2011) 276 ALR 596, 640)
31. Basically, civil contempt requires:
 - a. an order to have been made by a court;
 - b. the order was sufficiently clear, such that one can be sure beyond reasonable doubt that it has not been complied with;

- c. the order was served on the relevant person (the 'contemnor');
 - d. the contemnor (here, the trustee) had knowledge of the terms of the order;
and
 - e. the trustee breached the order;
 - f. the trustee took a deliberate step that resulted in the breach of the order.
32. Even where contempt is not established, the Family Court or Federal Circuit Court exercising family law jurisdiction has power to deal with breaches of orders that fall short of contempt (Part XIII A, FLA; ss 90XR(1), 90XZE, FLA and also s 112AP, FLA -which provides the court with power to punish a person for contravention of an order made under the FLA which is a flagrant challenge to the authority of the court).
33. A court will not make an order to bind a person who is the trustee at the time of the order takes effect unless the trustee has been accorded procedural fairness before the making of the order (s 90XZD, FLA and also see *Pandelis & Pandelis* [2018] FamCAFC 66; *Palance & Marley* [2012] FMCAfam 271, [77]). Subsequent trustees are equally bound.
34. A trustee who wishes to object to the proposed terms of a court order being sought must give written notice of the objection with 28 days (r 10.16(2), Family Law Rules).

WHAT TO DO IF THE TRUSTEE CANNOT COMPLY WITH THE SPLITTING ORDER

35. Act quickly.
36. Review whether procedural fairness was afforded.
37. Ask one of the parties to apply for variation of the splitting order or trustee itself to seek to intervene for variation of the order. If it relates to a financial agreement, notify the parties that the terms of the agreement cannot be complied with setting out the reasons why.
38. An affidavit in support of a variation application is likely to be required as to reasons for inability to comply with terms of splitting order.

39. Voluntarily disclose any breach of SISR to the Commissioner with explanation for breach and steps proposed to rectify or address the breach.

Case study

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Court orders

40. Dero derivative has been frozen and cannot be split
41. Kath's fund only accepts a cash rollover, they don't accept Bitcoin or derivatives
42. Procedural fairness not undertaken
43. Could do the split in the SMSF but without procedural fairness Kath can object
44. Need to start with the end in mind
45. Interestingly the court has no authority to order how the split is made, only authority to order the split. However, frequently included as it looks official, particularly if the split is not amicable.

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Court orders #2

46. Kath gets \$42,000 and Gazza is left with \$3,000
47. Discuss base amount split versus percentage split - base amount calculated as a percentage is still a base amount not a percentage split - confusion in terminology
48. Wife is entitled to a base amount of 50% of the balance of the fund

Case study

What ifs.....? If Gazza and Kath had their own SMSF?

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Tax

- 49. Financial adviser/accountant must assist here! Family lawyers are great at many things but will generally require assistance with the application of tax in super
- 50. Again, the court has no authority to order how the split is made (in-specie or cash), only authority to order the split
- 51. May use phrases like "For the avoidance of doubt, the parties have agreed that any taxation liability of the fund shall be paid first"
- 52. CGT relief applies to split amount and NMS account balance
- 53. In practice only if splitting to an SMSF or a SAF, retail funds generally can't use a cost base that isn't at acquisition date
- 54. If the split is performed in the SMSF, that is the CGT exempt event. Any subsequent move to a retail fund is not a CGT exempt event

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Bankruptcy

- 55. If Gazza was bankrupt he is not eligible to be a trustee
- 56. Regularly see bankruptcy and divorce occur together

SLIDE 23

Animosity/disagreement

- 57. Some divorces are amicable however it is common that they are not.
- 58. If Gazza refuses to co-operate Kath may need to ask her neighbour Farooq to encourage Gazza to be more co-operative

- a. Maybe.... "I have friend. My friend go to your house, put bomb under your car and blow you sky high!"

59. Consider including requirements in court order

- a. The parties shall do all such acts and things and sign all such documents as may be necessary to forthwith execute the instructions in paragraph X to XX of these orders, including removing the wife as a member and trustee, and finalising, executing and lodging all fund tax and statutory returns.
- b. The parties shall do all such acts and things and sign all such documents as may be necessary to forthwith wind up the fund, including removing themselves as trustees, and finalising, executing and lodging all fund tax and statutory returns.

SLIDE 24

Insurance policy

- 60. Deal with insurance policy before Kath resigns as director
- 61. Could incorporate in court order but again no real power for the court to include

SLIDE 25

Death benefit

- 62. Gazza's super benefit is an interest in a trust
- 63. Family Court has no power to make orders regarding a BDBN, only to order a split
- 64. Discuss recent case