19-21
FEBRUARY
GOLD
COAST

SMSF ASSOCIATION

SMSF 2020
ASSOCIATION NATIONAL CONFERENCE

Wind up a SMSF

Peter Crump
Private Client Adviser,
AMP Advice

Peter Crump, Private Client Adviser, AMP Advice

Wind up a SMSF

Overview

Introduction

This paper considers the issues which need to be addressed when winding up a SMSF, from the perspective of both the member (or beneficiaries) and the service providers.

The need to wind up a SMSF can be brought on voluntarily by the member(s) or may be imposed involuntarily as a result of the circumstances of the member(s). The process of windup is generally within the control of the trustee(s) of the fund at that time, remembering that the role of trustee can be replaced under certain circumstances which may coincide with the wind up process.

The paper will consider the circumstances of the windup as well as the accounts within the fund at that time, to provide an extensive illustration of the considerations which need to be made to ensure the most effective outcome for the members or beneficiaries.

The paper will progressively develop a checklist to be addressed at the time of considering windup of the fund.

Various scenarios are considered to illustrate the issues to be addressed in the windup process, starting from the simple accumulation/cash scenario and progressively becoming more complex with the inclusion of market-related assets and pension accounts.

Housekeeping

In the interest of simplicity, the paper will assume that the fund has only one member at the time of windup, which makes the treatment easier to explain.

Where appropriate, the paper will use case studies to illustrate financial or tax consequences of particular scenarios.

The paper is presented from the perspective that the SMSF participants are advised, whether that is with a formal advice relationship or simply well read in relation to the issues relating to SMSF and windup.

Legal issues

This paper does not attempt to consider complex legal issues, but rather indicates areas where these will need to be considered in detail, as the author is not legally qualified to address these. These issues are worthy of a paper and conference session in their own right and have been mentioned but not discussed in detail to enable focus on and proper consideration of the procedural issues relating to the windup of the SMSF.

The windup process is governed by the trust deed of the fund, in particular whether the windup is triggered by particular events and which parties are required to either initiate authorise the completion of the windup.

For simplicity, this paper treats the windup process as if it coincided with the payment of the member's final benefits from the fund, but in practice the windup is likely to be a consequence of that and a subsequent step to the final payment of benefits.

General discussion about winding up a SMSF

Initial and ongoing discussion with members about wind up

In recent publications[1], ASIC has provided guidance on the information which it believed should be discussed by advisers with potential SMSF participants prior to the establishment of a SMSF.

Among the information recommended by ASIC the need to consider an exit strategy was included as a key requirement. This not only considered how the process would occur but also the potential cost involved in that process. By not adequately addressing the issue of exit strategy, ASIC suggested that this was a risk that was not properly and fully understood by potential SMSF participants at the time of establishment of the SMSF.
After appropriate consideration of this recommended inclusion, it highlights the need to understand how the SMSF arrangement could cease and how it would affect the strategies which were relevant at the time of its establishment.

This might initially sound commercially counterintuitive that advice would be provided that an SMSF should be established to assist the person in pursuing their overall life and commercial goals concurrently with cautionary comments about how these arrangements could or should be wound up in the event of adverse or unexpected circumstances. However, given the often significant cost involved in some SMSF related strategies, it bears consideration and merit that the participants should be availed of the potential risks which could arise if the strategies were curtailed as a result of events causing the premature completion and windup of the SMSF.
To take the ASIC guidance one further step, it would seem prudent (not only from the perspective of covering professional risk but also being of value to the participants) that regular discussion should be held with the participants about the circumstances which might cause the SMSF to cease and how this would affect underlying strategies which were reliant on the SMSF structure for their value added to the participants.

For advisers, this could involve an extension to the annual conversation to ensure that there was an appropriate (and file noted) discussion with the participants about how the fund might cease to exist and what cost and other implications might result if this occurred under various scenarios.

Ideally not only will there have been an initial and ongoing discussion with the trustee/member about the eventual exit strategy, but this would have been documented and discussed with other family members to ensure they are familiar with this process.

What could cause a windup

There are two dramatically different types of windup, being voluntary and involuntary.

The “voluntary” windup is one that is initiated by the trustee in a controlled manner, potentially based on advice, where there is every opportunity to ensure that the most appropriate financial and succession outcomes are addressed.

The “involuntary” windup is one that occurs without the trustee controlling it, such as the death or incapacity of the member, and an alternate trustee (or director) is then required to implement the windup process potentially without lead time to address enhancement or protective strategies.
Examples of the “voluntary” windup include:

[1] Report 575 SMSFs: Improving the quality of advice and member experiences, June 2018;
Information sheet 205, Advice on self managed superannuation funds: Disclosure of risks, July 2015

- member prefers to transfer to public offer superannuation arrangement, and
- member prefers to quit superannuation totally and invest funds personally.

In both of these cases, the decision is often made after an appropriate consideration period, which provides appropriate opportunity for advised outcomes.

Examples of the “involuntary” windup include:

- death of the last remaining member of the fund and no potential pension recipients, and
- incapacity of the last remaining member and the need to redeem assets to support their move to aged care.
-

In both of these cases, the decision is often forced on other family members, who may not have a full understanding of the SMSF and its original purpose, and it is no longer possible to attempt to change the tax structures within the fund to benefit the eventual outcome.

If there had been ongoing discussions about the exit strategy and these were available to family members, the complexities and considerations in the windup process are less likely to be of concern at that time.

Key steps in winding up a SMSF

In general terms, the following steps need to occur when a SMSF is wound up in an orderly manner (i.e. a “voluntary” windup):

1. external discussion occurs between the member and their adviser about potential for windup and actions involved,
2. review of appropriate documents including trust deed and related documents such as pension contracts, company documents for corporate trustee and ownership documents for assets to ensure everything is in order, and
3. member and adviser confirm actions to be taken.

At this stage, all of the discussion and deliberation has occurred “off line” and does not involve the trustee in a formal capacity. This is no different to the type of discussion which would occur if an individual was a member of a public offer superannuation fund and consideration was being given to rolling over their entitlement or paying it out as a final benefit.

4. member formally confirms with the trustee the actions required in relation to their interests in the fund and the assets in the fund, in a written notification or instruction, and
5. trustee formally acknowledges the instructions and minutes the actions to be taken.

This may occur in a staged manner where the instructions provided to the trustee are delivered in pieces so that the first set of activities is progressed from instruction to completion before the second set of instructions is provided. Alternatively, the instructions could be significantly detailed so that it was clear what needed to occur first and subsequently to ensure that appropriate sequencing of activities was followed. This is discussed later in this paper.

6. trustee implements the instructions of the member, including the preparation of appropriate documentation and actions relating to rollovers and/or pension accounts for example, and
7. subsequent to the actions being taken by the trustee, the windup of the fund should occur, this could occur contemporaneously with these actions or occur subsequent to these actions depending on the provisions of the trust deed.

Administrative issues in winding up a SMSF

From an administration perspective, the following are the major actions which are likely to be undertaken in the windup of a SMSF:

1. determine which assets will need to be sold and which assets are being either rolled over or treated as benefit payments on an in-specie basis,
2. ensure that asset sales or transfers are undertaken in sympathy with any tax management strategies which are being followed (this is discussed later in the paper),
3. treatment of any contributions in the previous year and current year for the purpose of claiming a tax deduction needs to be made, since the ability to claim a deduction is lost after the accumulation balance is rolled over or paid out,
4. ensure that any employer contributions are no longer directed to the SMSF, to avoid potential surprises in the finalisation of member balances,
5. ensure that minimum pension requirements have been met prior to the windup of the fund occurring,
6. ensure that appropriate provision is made for the expected final expenses of the fund, relating to the final administration actions and the final audit and tax return lodgement,
7. ensure that appropriate consideration is given to retaining funds for final tax liability (if any) or treatment of tax refunds from final return,
8. if the windup involves the payment of entitlements to the member, transferring ownership of the assets or transferring cash from the bank account can be undertaken to extinguish the member liability,
9. if the windup involves a rollover to another superannuation fund, it will be necessary to determine the tax and preservation components based on estimated or anticipated values, since the rollover statement will need to be forwarded to the new superannuation fund simultaneously with the cash/asset rollover,
10. provide appropriate member statements to confirm completion of payment of balances,
11. arrange for TBAR[2] to be undertaken for pensions which are rolled over, and
12. arrange for completion, lodgement and processing of final financial statements and final tax return.

The treatment of rollover balances is often a complex one, since the tax and preservation components need to be determined prospectively up to the point of transfer of the balance, often involving best estimates of the final balance of the respective accounts.

For members who have already satisfied a condition of release, the treatment of the final tax refund amount is often easily made, this being treated as a lump sum payment rather than attempting to have a secondary rollover or secondary pension amount.

If, however, the final tax refund amount is significant, consideration could be given to a secondary rollover and a second pension account being created in the new fund if the intention is to rollover to new pension arrangements.

[2] Transfer Balance Account Report

Sources of complexity when winding up a SMSF

In this section, we will make mention of the potential sources of complexity but will not go into any detail as this will be developed throughout the paper.

Taxation issues

Readers would be familiar with the significant tax advantages afforded by the Australian superannuation system. These advantages are not unique to SMSFs but they require more detailed consideration when managing a SMSF and also arranging for the windup of a SMSF.
Issues relating to taxation which are likely to be relevant in the windup process include:

- managing potential capital gains tax outcomes,
- ensuring continuation of exempt income throughout the windup process, and
- managing taxation outcomes where pension and accumulation accounts are in place.

Asset management issues

Managing asset sales or transfers in a manner which is tax effective (this overlaps with the above discussion) is an important consideration to ensure that the tax which is paid is kept at an appropriate minimum. This is not intended to be an avoidance process but a properly advised process to achieve the most favourable taxation outcome.

Another important consideration when we are dealing with “family” type assets such as commercial property is to determine which assets will be retained either within the superannuation environment or within the family group when the SMSF winds up. Further, the process by which they are retained and how they leave the SMSF is important not only from a benefit management perspective but also from the perspective of ensuring appropriate transfer of ownership.

Documentation and reporting

The windup of the SMSF must be conducted in a manner which is consistent with the provisions of the trust deed and related documents. It is therefore important that any proposed actions need to be considered with the provisions of the trust deed in mind and if there is insufficient support for proposed actions, contemplation of a deed amendment should be made prior to commencing.

Of course, this presupposes that the trust deed of the fund can be located and its legitimacy can be verified by considering the succession of trust deeds since inception. This paper will not consider actions which need to be taken in the event of either the latest trust deed not being able to be located or the latest trust deed not being legitimately founded. This is a complex legal issue.

If there is unlikely to be a dispute about the treatment of the proceeds of the fund and the wind up is undertaken consistently with taxation and superannuation legislation, comment is often made that winding up the trust can and should still occur as the parties to the trust have properly and fairly dealt with the member(s) and their entitlements. That is best left to the lawyers to more fully address.

The windup of the fund requires the lodgement of a final return to the regulator and completion of final financial statements. This is often unreasonably delayed and deferred as a result of its complexity, but completing the financial reporting is an essential prerequisite to the successful windup of the fund.

As will be discussed later in the paper, reporting of pension accounts is important where these are being rolled to another superannuation arrangement to ensure that there is no double counting of balances for the purpose of assessment against the relevant[3] pension cap.

Understanding how the fund will be treated for exemption from tax on its investment income if supporting pensions is an important consideration, as the actuarial certificate can significantly influence the tax exposure of asset sales or disposal in the windup process. This will be discussed in detail later in the paper.

The early scenarios are all based around a "voluntary" windup process, and later sections will address the additional complexity which arises from "involuntary" windup.

The easiest scenario – accumulation and cash only

Scenario description

In this scenario, the member is in accumulation phase throughout the whole financial year and assets have been held only in cash throughout the financial year. This deliberately removes any potential tax planning strategy issues and presents the simplest scenario.

This will serve as a useful benchmark scenario to illustrate the issues to be considered in windup.
This is best illustrated with a case study.

Case study 1
Harry (aged 34) is the sole member of the Royal SMSF and the sole director of the corporate trustee, having established this fund when he commenced work in the family firm. Harry had retained the assets in cash since the fund was established 4 years ago and had never followed through with his brother's suggestion that he invest in residential property. Not only has Harry become disenamoured with the potential for property investment but he is intending to live overseas in the next few years and wants to simplify his superannuation arrangements.
The fund's 2019 financial statements and tax return have been completed and lodged on time.
He has determined to rollover his superannuation balance to the Royal Mounties public offer fund.

In this case study, there are no tax planning issues, which means we can proceed straight to the procedural issues relating to the windup of the SMSF.

The accountant is able to determine the fees which will be incurred for the administration of the fund leading up to windup, preparation of the final tax return, audit and lodgement of the 2020 final return for the fund. These fees are invoiced and paid from the cash account.

It is necessary to then consider the tax which will be payable on lodgement of the final return , including the ATO levy.

The treatment of the final tax payment can be approached in one of two ways, after the majority of the funds are rolled over to the new fund.

The first would be to attempt to estimate the likely amount of tax payable based on the interest earned on the cash account for the year to date and estimated for the final period up to the transfer of the money from the fund. That amount could then be transferred to the trust account for the tax accountant for the purpose of meeting the tax liability from the final return, and the cash account is then closed. The problem with this

[3] $1,600,00 at the time of writing this paper

approach is that it relies on estimates, even if it is quite likely to be accurate, and any underestimation will require an amount to be paid from other superannuation monies. This is not preferable.

The second would be to leave behind an amount in the cash account which is expected to be more than sufficient, with a deliberate prudent margin for error, to cover the expected tax liability when it is advised by the ATO. It is possible that this small amount remaining behind might generate its own interest payment, but that amount is not likely to be material for the relatively short period of time up to the completion of the return lodgement. After the tax liability is advised and paid, the remaining balance would be rolled over to the new fund as a second rollover.

The second approach is likely to be easier to administer and is likely to be used in more complex windup or rollover arrangements also.

From an accounting perspective, appropriate provisions can be made in the final financial statements for both of these approaches.

The accountant can determine the amount to be rolled over to the new fund allowing for the above treatment of the final expenses and tax liability, and the tax and preservation components will need to be determined at the same time.

Any personal contributions made in the current financial year will need to be considered from the perspective of claiming a tax deduction. This is a significantly more complex issue than it has been in earlier years, since personal contributions are now able to be claimed as deductible even if the member is receiving employer contributions. Since the proceeds of these contributions are being rolled over, the appropriate notification of claiming a deduction and acknowledgement notices[4] need to be addressed and completed prior to the rollover occurring. To summarise, the actions and steps involved in this simplified example would be:

Preliminary – member based

1. Member to confirm new superannuation fund to be used and arrange for application forms to be lodged for new account.
2. Consider personal contributions made in current and previous financial year for the purpose of claiming as deduction.
3. Ensure the employer is advised to change the fund to which contributions are being made and confirm if contributions are already committed, for example through clearing house at the end of the quarter.

Member to trustee to member

4. Member instructs trustee to transfer their balance in the SMSF to their new superannuation fund.
5. Trustee confirms member instruction and requests member to advise treatment of personal contributions in the current and previous financial year for tax deduction purposes.
6. Trustee confirms with member that employer contributions are being directed to new fund (at member request).

Trustee

7. Trustee arranges Section 290 deduction notices if required, arranges for member to sign and trustee to acknowledge.
8. Trustee requests accountant to confirm final fees and expenses to be invoiced or provisioned.
9. Trustee determines amount to be retained in the cash account to meet final expenses and tax liability, balance will be rolled over to new fund.

[4] Refer Section 290.170 *Income Tax Assessment Act 1997*

10. Trustee requests accountant to prepare rollover documentation for transfer of majority of member's entitlement to new fund.
11. Trustee forwards rollover documentation and rollover balance to new superannuation fund, combination of paper and electronic transfer, depending on fund
12. After lodgement and completion of 2020 return, arrange payment of final tax liability and make second and final rollover payment to new superannuation fund.

While these steps may appear self-evident in this simplified example, they will be a useful benchmark when considering progressively more complex examples.

The application for the new superannuation account needs to be approached with special care where the application involves the ability for a "pull" rollover request to be submitted. In that case, the application includes the ability for the member to request that the balance of their existing superannuation fund be rolled over and appropriate authorisations are provided by the member at that time for the trustee to facilitate this.
These requests are often problematic for the SMSF trustee since the rollover may not be able to be achieved in one single payment. As a result, it is preferable that the rollover be initiated from the SMSF side on a "push" basis and not on the "pull" basis. This is even more important in the staged rollovers where consideration needs to be given to managing tax outcomes for example.

Additional complexity – pension and cash only

Scenario description

In this scenario, the member is in pension phase throughout the whole financial year and assets have been held in cash only throughout the financial year. This continues to remove any potential tax planning strategy issues.
This will build on the earlier benchmark scenario.

Case study 2
Camilla (aged 62) is the sole member of the Senior Royal SMSF and the sole director of the corporate trustee, and the fund is fully in retirement income stream phase since Camilla has been permanently retired for a number of years.
A few years ago, Camilla elected to sell down the assets of the fund which have remained in cash since then.
Camilla wishes to arrange for her full balance to be paid to her personally as she no longer wishes to retain the funds in superannuation.
The fund's 2019 financial statements and tax return have been completed and lodged on time.

This is a reasonably similar scenario to the previous one, with the exception that we have retirement income streams in place with the consequence that the fund is able to claim exempt investment income[5] under Section 295.385 of the *Income Tax Assessment Act 1997*.

We need to consider when the pension is treated as ceasing for the purpose of exemption on the investment income. Guidance on this issue was provided by TR 2013/5[6], which put an end to the uncertainty as to the period during which a pension was considered to continue, even if notification had been provided for the cessation of that pension by full commutation (benefit payment or rollover).

Of particular relevance are paragraphs 24 to 27 which are reproduced below:

[5] Exempt investment income relating to segregated current pension assets
[6] Taxation Ruling 2013/5 Income tax: when a superannuation income stream commences and ceases

24 *A request to fully commute a superannuation income stream takes effect as soon as the trustee's liability to pay periodic superannuation income stream benefits to the member or a dependant beneficiary is substituted with a liability to pay that member or dependant beneficiary a superannuation lump sum.*
25 *As the liability to pay the commutation lump sum arises as a consequence of the full commutation having taken effect, the superannuation income stream ceases before the time the lump sum payment to the member or dependant beneficiary is made.*
26 *The payment made to the member or dependant beneficiary following a full commutation of a superannuation income stream is a superannuation lump sum for income tax purposes as the superannuation interest no longer supports a superannuation income stream at the time the payment is made.*
27 *A superannuation income stream does not cease when a member or dependant beneficiary applies to partially commute some of their entitlements to future superannuation income stream benefits for an entitlement to a lump sum.*

For the superannuation interest to be considered a superannuation income stream in the year in which the fund winds up, it is essential that the minimum pension payments are made from the pension account in that year. It is only necessary for minimum pension payments to be made on a pro rata basis for the period during which the pension was in place, but care needs to be taken with this if only pro rata and not full annual payments are applied against the pension account.

Where the full balance of the pension account is being paid to the member (and not rolled over) it is significantly safer to arrange for the full annual minimum pension payment to be made as a separate and distinct action to the completion of the pension account by a full commutation of the remaining balance.
In practice, the better outcome is achieved where the pension account is treated in three separate stages:

1. arrange for minimum annual pension payments to be made, which will ensure that the exemption from tax on investment income is retained during the existence of the pension account,
2. arrange for the majority of the remaining pension balance to be paid out by means of partial commutation, which will retain the exemption from tax on investment income until that time, and finally
3. arrange for the residual pension balance to be paid out as a full commutation.

According to the provisions of TR 2013/5 this will result in the retention of the exemption from tax on investment income up until the day prior to the full commutation is effected. It is made clear that the notification itself of the full commutation does not result in immediate loss of exemption from tax on investment income, but rather the implementation of the full commutation.

While the difference in tax is likely to be relatively small in this simplified example, these actions will be seen to be of greater value in more complex scenarios.

In the case study, the full pension balance is intended to be paid out of the fund (and not rolled over), which means that the treatment of any residual balance is unlikely to cause an issue for its late payment to the member. This will not be the case if the pension account is being rolled over to another provider.

If the pension account is being rolled over to another provider, especially in the retail and public offer arrangement, it is a common procedure for the rollover amount to be placed immediately into a pension account[7]. In that case, any subsequent rollover cannot be added to the pension account which is already in place.

[7] Strictly speaking this is not possible since the rollover proceeds need to be credited to an accumulation account and the balance of that accumulation account is then used to commence a pension account. In a practical approach, the middle step of accumulation to pension is omitted for simplicity in the paperwork.

This means that it will be necessary for a second pension interested to be created if it is intended for the full balance to be rolled over to pension status.

Alternatively, it is possible to request that the new pension account not be commenced until the full rollover proceeds have been received into the fund. That can be problematic since the final proceeds from the tax return may possibly take a number of months to be received after the initial rollover amount.

If the member has passed a condition of release then the minor residual amount from the tax return could be paid to them as a lump sum payment.

These issues need to be considered in advance by the member and trustee, and often need to be pointed out by experienced advisers to ensure they are properly considered and addressed in advance.

The actions and steps are similar to those in the accumulation rollover example, but with special consideration of the pension issues as discussed above:

Preliminary – member based

1. Member to consider whether pension account is being cashed out or rolled over.
2. If rollover, member to confirm new superannuation fund to be used and arrange for application forms to be lodged for new account.

Member to trustee to member

3. For payments out of superannuation, member instructs trustee to arrange for payment of their pension entitlement from the fund, after making payment of annual minimum or estimated pro rata minimum pension payments prior to payment.
4. For rollovers, member notifies trustee of intention to transfer their account balance, after making payment of annual minimum or estimated pro rata minimum pension payments prior to payment.
5. Trustee confirms member instruction.

Trustee

6. Trustee requests accountant to confirm final fees and expenses to be invoiced or provisioned.
7. Trustee arranges minimum pension payments according to instructions.
8. Trustee determines amount to be retained in the cash account (plus a margin) to meet final expenses and tax liability, balance will be paid out or rolled over to new fund.
9. For rollover, trustee requests accountant to prepare rollover documentation for transfer of majority of member's entitlement to new fund.
10. Trustee forwards rollover documentation and rollover balance to new superannuation fund, combination of paper and electronic transfer, depending on fund.
11. After lodgement and completion of 2020 return, arrange payment/receipt of final tax liability/refund and make second and final rollover payment to new superannuation fund.
12. For rollover of pension balances, the trustee will need to arrange for TBAR lodgement for the partial or full commutation. For cashing out of pension balances, there is no need for TBAR lodgement.

The timing of the TBAR is significant from the member's perspective. In general terms, funds with only "small"[8] members at the time of commencement of a retirement phase income stream in the fund are only required to lodge the TBAR when they lodge their SMSF annual return. Funds with members with large balances at the time a retirement phase income stream commences are subject to quarterly TBAR lodgement, within 28 days of the end of the quarter in which the event occurs.

[8] Members with a Total Superannuation Balance (TSB) of less than $1,000,000

This means that, if the trustee follows their statutory reporting timeline, there is likely to be a significant delay between the partial and full commutation of the pension and its reporting. On the other side of the process, if the receiving superannuation fund is an APRA regulated fund, which is likely in most of these cases, the reporting is subject to a much shorter time frame, being within 10 days of the event of commencing the new pension. The imbalance in these reporting requirements is evident and can lead to inappropriate outcomes for ATO reporting of member pension balances against the relevant[9] pension cap.

For members with only small balances, and unlikely to be anywhere near 50% of the relevant pension cap overall, this delay in reporting is unlikely to cause a problem.

However, members with higher pension balances, especially those who have fully used their relevant pension cap will have potential reporting problems unless the SMSF TBAR is lodged promptly after each of the commutation payments. By lodging the SMSF TBAR in this prompt manner, it will avoid the member receiving an excess assessment notice and needing to deal with the ATO on mitigating the actions required to remedy an excessive outcome.

Even further complexity – market-linked investments

The discussion so far has only involved investments held in cash. This has been deliberately done to enable consideration of the underlying issues before allowing for the complexities brought about by a moving balance target and tax considerations. In this section, it is assumed that the assets are able to be redeemed at market value. In later sections, we will address assets which are illiquid and need further consideration.

Accumulation scenario - condition of release has not been met

In this scenario, the member is in accumulation phase and is unable to consider using pension arrangements in the lead up to the windup of the fund.

During the year, the fund has invested in listed shares (which are showing an unrealised gain) and cash, and continues to hold these assets at the current time.

Case study 3

We will again look at Harry (aged 34), the sole member of the Royal SMSF and the sole director of the corporate trustee. He has determined to rollover his superannuation balance to the Royal Mounties public offer fund. There is no possible strategy which can result in the exemption of any investment income from tax in the current financial year. This means that all of the investment income, both income received and realised gains, will be taxable income.

The only area of opportunity to potentially reduce the effect of tax is to consider whether any assets have been held for close to 12 months before selling them. If it is possible to wait a short time to hold the asset for more than 12 months, the 1/3rd discount will apply for capital gains tax calculation, assuming that the asset is still showing a gain. However, if the asset held is relatively small in value or the 12 month period will not occur for some time, there seems little point looking at this strategy.

Regardless of whether the listed shares are being rolled over on an in-specie basis or are being sold and the cash being rolled over, a capital gains event is occurring and will result in realised gains or losses.

---

[9] $1,600,000 at the time of writing this paper

Consideration needs to be given as to whether there are carried forward losses which have yet to be applied, which will reduce the tax effect of any realised gains in the final year.

If the assets are being sold prior to rollover, calculating the final member benefit and its tax and preservation components is likely to be a straightforward exercise after the assets have been sold. The amount to be rolled over should allow for the withholding of the expected tax and other expenses payable, since these will not be able to be recovered from the target rollover fund.

As in the previous example, leaving a prudent margin behind in the cash account will likely result in a small residual rollover amount after the tax return has been finalised.

Alternatively, if some of the listed shares are being rolled over on an in-specie basis, the amount of benefit and the tax and preservation components will need to be estimated based on the latest known value of the assets prior to the calculation being undertaken. In-specie rollovers from external funds into retail or public offer funds are unlikely to be allowed as a result of the complexities of the process, but they can occur between SMSFs. The actions involved in the windup of the fund in these circumstances are slightly expanded from the previous scenario:

Preliminary – member based

1. Member to confirm new superannuation fund to be used and arrange for application forms to be lodged for new account.
2. Member to review acquisition dates for assets to see if 12 month holding period is likely to be relevant and if so, consider deferral of instruction.
3. Consider personal contributions made in current and previous financial year for the purpose of claiming as deduction.
4. Ensure the employer is advised to change the fund to which contributions are being made and confirm if contributions are already committed, for example through clearing house at the end of the quarter.

Member to trustee to member

5. Member instructs trustee to transfer their balance in the SMSF to their new superannuation fund.
6. Trustee confirms member instruction, advises member of the need to redeem assets and requests member advise treatment of personal contributions in current and previous financial year for tax deduction purposes.
7. Trustee confirms with member that employer contributions are being directed to new fund (at member request).

Trustee

8. Arrange sale of assets.
9. Trustee arranges Section 290 deduction notices if required, arranges for member to sign and trustee to acknowledge.
10. Trustee requests accountant to confirm final fees and expenses to be invoiced or provisioned.
11. Trustee determines amount to be retained in the cash account to meet final expenses and tax liability, balance will be rolled over to new fund.
12. Trustee requests accountant to prepare rollover documentation for transfer of majority of member's entitlement to new fund.
13. Trustee forwards rollover documentation and rollover balance to new superannuation fund, combination of paper and electronic transfer, depending on fund
14. After lodgement and completion of 2020 return, arrange payment of final tax liability and make second and final rollover payment to new superannuation fund.

Accumulation scenario - condition of release has been met

The issue of forward tax planning is often overlooked with SMSFs. A fund which is in accumulation phase but which has the capacity to convert to retirement phase income stream can produce a more favourable tax outcome in the event of the completion of the fund if this forward tax planning is undertaken.

However, the commencement of a retirement phase income stream for the purpose of reducing tax on realised gains is not likely to be an acceptable planning strategy if the strategy is documented in a formal Statement of Advice. Prior to the removal of the "accountant's exemption" the commencement of a pension shortly before the closure of a fund was often undertaken without the need for formal advice documents to evidence the reason for the movement.

Most adviser dealer groups would not be likely to countenance the provision of advice which was purely intended to reduce tax and the provision of this advice would appear to be in contradiction of the FASEA[10] Code which applies to all licensed advisers as from 1 January 2020[11].
The alternative approach which was often raised, but now appears to be in conflict with the FASEA Code, is that advice was provided to commence a retirement phase income stream which would be used to support income needs or similar in the person's retirement or current life position. The public purpose of the strategy was to commence a pension to enable drawing of funds while the real purpose was to achieve a reduced taxation impost by causing the investment income to be exempt.

This strategy was often applied in an incomplete manner, with the pension commencing and a single pension payment being made prior to the commutation of the pension account. This failed the requirement that the pension could only exist if there was a liability to pay a series of payments. The fact that only one payment was made prior to the pension commuting was considered to be insufficient evidence of the intention to pay a series of payments and this strategy failed to achieve its purpose.

As a result, the conversion from accumulation to retirement income phase immediately prior to the commutation of the pension and the windup of the fund is not likely to be supported by advised arrangements. With the dual reporting requirements of the commencement of the pension and the windup of the fund, it is possible that the ATO might review these particular arrangements to determine if tax avoidance was the driving issue behind the commencement of the pension and may very well request to seek a copy of advice which was provided. This is an example of the increased data available to the ATO possibly being used by the ATO to review unregulated advice and potential tax driven strategies.

The purpose of this discussion was to raise this risk and not to advocate this as a viable strategy.

Pension scenario

In this scenario, the member is in pension phase and the fund has invested in listed shares (which are showing an unrealised gain) and cash and continues to hold these assets at the current time.

The additional feature which is drawn out in this scenario is the effect of the final pension commutation on the tax status of the fund.

---

[10] Financial Adviser Standards and Ethics Authority

[11] FASEA Ethics Code Standard 1 states "You must act in accordance with all applicable laws, including this Code and not try to avoid or circumvent their intent".

As discussed in the pension scenario earlier, paragraphs 24 to 27 of TR 2013/5 confirm that the pension status remains in place during periods of partial commutation but ceases when a full commutation is effected. This is likely to be the final day of the existence of the account, the day on which the assets are sold for the purpose of the commutation or rolled over on an in-specie basis.

The decisions about managing the partial commutation and asset disposal process are likely to be influenced by the nature of the actuarial calculation undertaken for that financial year, whether under a segregated or unsegregated arrangement. For the current financial year, this is the first year in which the choice of the actuarial method can be made, and this is likely to result in appropriate selection by trustees of the most favourable outcome for them.

In this scenario, when the only account is the pension account, it is not possible for the unsegregated actuarial approach to be used. The assets of the fund will be fully supporting pension accounts in the first portion of the year up until the day prior to the commutation, and on the day of commutation the fund will be fully supporting accumulation accounts. This scenario does not enable the use of the unsegregated approach. As a result, it is then possible to clearly identify the tax treatment of any realised gains which coincide with the final and full commutation of the pension.

Any gains which are realised prior to that date are realised when the fund is fully supporting segregated current pension assets and these will therefore be exempt from tax. Any gains which are realised as a result of the commutation will be fully taxable as realised gains.
Prudent tax management practice would suggest that assets showing an unrealised gain should be sold prior to the full commutation and partial commutations could be used to arrange for the rollover of these balances to the new superannuation fund payment as lump sums. The final full commutation would then only involve assets which were likely to produce a realised loss or a lesser realised gain relative to the other assets sold earlier to support partial commutations.

Case study 4
Charles (aged 67) is the sole member of the Talking Plant SMSF and the sole director of the corporate trustee, and the fund is still in accumulation process as Charles is still working.
Charles has determined he wants to rollover to an ethically based public offer superannuation fund. The listed shares which are held by the fund show a large unrealised gain.

By selling the listed shares and arranging for a partial commutation of the pension account to rollover the balance to his new nominated superannuation fund, the pension account remains in place after the partial commutation. At that time the only asset held by the fund is cash in the bank account and when the full commutation occurs the taxable income on that day is likely to be only the interest in relation to the final month of the account being in place.

If, however, the trustee elected to fully commute the pension account back to accumulation and had not arranged for the sale of the listed shares prior to that, the listed shares would then be held in an accumulation environment with no protection under the exemption relating to investment income from assets supporting segregated pension accounts.

This is a simple illustration of sequencing actions correctly. This will be developed further in the next section when the superannuation fund has both accumulation and pension accounts in place.

The actions remain the same as previously discussed in the pension scenario, with the exception of an additional action involving:

- For payments out of superannuation, member instructs trustee to arrange for payment of their pension entitlement from the fund, after making payment of annual minimum or estimated pro rata minimum pension payments prior to payment, and to arrange for the sale of the fund's investments prior to the pension account ceasing.

Yet further complexity – accumulation and pension accounts in place

The discussion so far has only involved a fund with only an accumulation balance or only pension balances. An increasing number of funds, especially following the changes implemented from 1 July 2017, are likely to have a combination of accumulation and pension accounts.

In these circumstances, an appropriate sequencing of activity can lead to a potentially more favourable outcome than the outcome which would occur if everything was treated at the same time.

Earlier comments have been made about the action of converting an accumulation account into a pension account specifically for the purpose of attaining a tax favourable outcome, and it is assumed that these actions will not or cannot occur in these scenarios.

The scenario is best considered where a member has a retirement phase income stream account which used their full pension cap at 1 July 2017 and also had an accumulation account in the same fund. In this scenario it is not possible for the member to attempt to convert their accumulation balance into a pension balance the purpose of achieving a more favourable tax outcome.

This is illustrated in the following case study:

Case study 5
Philip (aged 92) is the sole member of the Patient Partner SMSF and the sole director of the corporate trustee. Philip is long retired and had maintained his fund in full pension phase up until the changes at 1 July 2017 which forced him to change. At the current time, he has a pension account with a balance of $1,800,000, which was fully assessed against the $1,600,000 cap at 1 July 2017, and an accumulation balance of $600,000.
Philip has been drawing the appropriate annual minimum pension amount and has already drawn this amount in the current financial year.
The fund has the following assets:

Asset	*Market Value*	*Cost base*	*Unrealised gain (loss)*
Cash	*$200,000*	*$200,000*	*n/a*
Property	*$600,000*	*$200,000*	*$400,000*
Managed funds	*$200,000*	*$300,000*	*($100,000)*
ABC shares	*$400,000*	*$150,000*	*$250,000*
DEF shares	*$400,000*	*$200,000*	*$200,000*
GHI shares	*$600,000*	*$450,000*	*$150,000*
Total	***$2,400,000***	***$1,500,000***	***$900,000***

It is assumed that the windup occurs at the end of the financial year for convenience of numbers.

This case study brings into play the important changes which were implemented in the current financial year in relation to the actuarial certification of exempt income for funds supporting pensions and accumulation accounts during the year. By having an understanding about the two alternative approaches for the actuarial certification and confirming in advance the approach which will be taken in the final year of operation an improved position can be achieved on windup.

This is illustrated by a “worst case” scenario where inappropriate action is taken in the wind up of the fund. If the trustee arranges for the full commutation of the pension and the asset sales or disposals at the same time, and the actuarial certificate is undertaken on the “ATO preferred” basis of segregated assets, all of the realised gains will be attained in a taxable environment. In this scenario, the tax payable would be $90,000, being assessed on the $900,000 net realised gain discounted by 1/3rd. An outcome to be avoided.

The next tier of consideration is the nature of the actuarial certificate and whether it can be applied on an unsegregated arrangement over the full year. This is the standard “industry preferred” arrangement prior to the ATO intervening in recent years.

If an unsegregated approach to the actuarial certification was followed, even though the pension account is considered to have ceased on the day of commutation, the actuarial exempt proportion over the full financial year is applied to the investment income for the full financial year.

The exempt proportion is determined as:

$1,800,000 / $2,400,000 = 75%

This results in only 25% of the realised gains of $900,000 being subject to taxation. Allowing for the 1/3rd discount this results in tax of $22,500.

The final consideration is whether it would be possible to stage the completion of the accumulation account and the disposal of assets relating to the payment of that balance prior to undertaking asset sales or disposals or the remaining pension balance.

It is necessary to arrange for payment of the $600,000 accumulation balance, which could be sourced from the following asset sales:

Asset	Market Value	Cost base	Unrealised gain (loss)
Cash	$150,000	$150,000	n/a
Managed funds	$200,000	$300,000	($100,000)
GHI shares	$250,000	$187,500	$62,500
Total	**$600,000**	**$637,500**	**($37,500)**

This staged asset disposal process will result in nil taxable income during the period of unsegregated arrangements. Subsequently, the assets are disposed or are transferred as in-specie payments and are therefore treated as lump sum payments and partial commutations, but not triggering full commutation process.

Provided that all of the assets are disposed of during the retention of the pension and prior to the full commutation, there will be no tax payable on the realised gains if the actuarial certification follows the “ATO preferred” approach of segregated asset periods. Under that approach, the period up until the completion of the accumulation account operates on an unsegregated arrangement with an exempt proportion applying, the period during which the fund was only supporting pension assets and liabilities will be automatically 100% exempt and the period during which the fund was only supporting accumulation balances (i.e. the full commutation day) will be automatically fully taxable.

This scenario illustrates the value of understanding how tax will apply and how the tax outcome can be influenced by staging the sequence of events, especially the completion of the accumulation balance or sale of assets with significant realised gains prior to the full commutation event.

Unfortunately, this type of staging is not always possible in the event of the "involuntary" windup of the fund. While the trustee and the member are likely to be the same people, it is important to consider who initiates the request for this staging process. The initial payment of the accumulation balance should be requested by the member and is therefore recommended that the member control the staging instruction.

The following actions are therefore added:

Preliminary – member based

- Member to discuss with tax accountant or administrator opportunities to sequence the completion of the accumulation and pension accounts and for targeted asset disposals to achieve superior after tax outcome

Member to trustee to member

- Member to instruct the trustee for the sequence of events and preferred asset sales associate with these events
- Trustee to confirm and document member instructions
- Prior to proceeding, trustee to confirm approach for actuarial certificate which is compatible with requested sequencing

And yet more complexity – illiquid assets

Additional complexity results from a fund where the assets are concentrated and illiquid.

It might be possible for a staged disposal of the asset on a proportionate basis, but if we are dealing with property that can result in significant delays and problems. For the purpose of illustration, it will be assumed that a single (and not staged) disposal is the only available outcome.

Case study 6

Elizabeth (aged 88) is the sole member of the Boss SMSF and the sole director of the corporate trustee. Elizabeth is concerned about her life expectancy and the potential for tax to be paid by her children on payment of her death benefits.

As a result, she intends to arrange for the assets in the fund to be transferred to her personally and for the fund to be completed. She has a pension account with a balance of $1,800,000, which was fully assessed against the $1,600,000 pension cap, and an accumulation account with a balance of $200,000.

Elizabeth has been drawing the appropriate annual minimum pension amount and has already drawn this amount in the current financial year.

The fund has the following assets:

Asset	*Market Value*	*Cost base*	*Unrealised gain (loss)*
Cash	*$100,000*	*$100,000*	*n/a*
Property	*$1,900,000*	*$1,000,000*	*$900,000*
Total	***$2,000,000***	***$1,100,000***	***$900,000***

The first observation is that it is not possible to fully pay out the accumulation account as the liquid assets are insufficient to do so. The second observation is that it would be possible to pay out the majority of the pension account, including the transfer out of the property, without stopping the ongoing pension. The pension would only be fully commuted after the property had been transferred out and the remaining balance was nominal.

In this scenario, the tax optimisation process still results in tax being payable, but an improved tax outcome relative to the default option.

Under the default option, if the accumulation and pension accounts are paid out simultaneously under a full commutation of the pension, the two alternative actuarial certification options will produce different outcomes. The less preferred option is if the actuarial certificate follows the segregated arrangement and the full commutation of the pension and payment of the accumulation account then results in the assets being realised in a fully tax exposed period. The preferred option is if the actuarial certificate follows the unsegregated arrangement for the full financial year, in which case the exempt proportion of 90% will significantly reduce the amount of tax payable.

Alternatively, if the actuarial certificate follows the segregated approach, undertaking a partial commutation of the pension and payment of part of the accumulation balance will result in the assets being disposed during the significantly exempt period.

This means that communication between the member, trustee, accountant/administrator and actuarial provider is important to ensure that the tax outcome is favourably managed.

Involuntary windup

The most common reason for the "involuntary" windup is the death of the final member of the fund. In this case the replacement trustee or trustee director is charged with the responsibility of paying out the death benefits in a manner which is consistent with the trust deed and legislation.

Where the death benefits can be paid as ongoing pensions, the windup process can be delayed and managed effectively, even if the resulting pension recipient prefers not to continue with the fund.

Where the death benefits are unable to be paid as ongoing pensions, such as the situation where the nomination does not allow pension payments or legislation prohibits it, such as not having any tax dependants, it will be necessary for the benefits to be paid from the fund.

There still is opportunity for management of the tax outcome if appropriate advice is provided.

Fortunately, the pension account is treated as if it continued despite the death of the pensioner and therefore remains eligible for exemption from tax on investment income, provided that the death benefit is paid as soon as practicable, which is generally within 6 months of the date of death.

This means that there remains significant tax advantage if the death benefit payments can be appropriately sequenced in a similar manner to the voluntary windup.

This sequencing is impaired by the requirement[12] that the death benefit must be cashed as either a single lump sum or two lump sums, the first being the interim amount and the second a residual amount. This means that, to comply with legislative requirements, it is still possible to make the payment in two stages to achieve an improved tax outcome.

As in the previous examples, this is likely to occur only in circumstances where the fund or trustee are being advised about potential ways of achieving the death benefit payment.

[12] Regulation 6.21 Superannuation industry (Supervision) Regulations 1994

Fund cessation – consequences

The cessation of the fund brings a few further consequences which need to be addressed, some in advance. Discussion has already occurred about the need to ensure that any future employer superannuation contributions are directed to a different fund by the employer election form and the clearinghouse process.

The accountant or administration provider will need to ensure that a final tax return is lodged with the ATO to confirm the completion of the fund, which will then remove the fund from the regulated records.

Finally, if the fund has been using a special-purpose corporate trustee, the company may no longer be needed by the individual or family and could then be deregistered if it is no longer required. If the deregistration is not undertaken, the company will continue to incur annual ASIC costs, even if it is no longer serving the purpose as trustee of the superannuation fund. This is a small item but often overlooked in the windup process.

Final checklist

For completeness, the checklist below is intended to address all scenarios and is an amalgam of the checklists that have been developed through the paper.

Preliminary – trustee based

0. Trustee to review trust deed to confirm requirements for windup and pre-windup processes.

Preliminary – member based

1. Member to confirm new superannuation fund to be used and arrange for application forms to be lodged for new account.
2. Consider personal contributions made in current and previous financial year for the purpose of claiming as deduction.
3. Ensure the employer is advised to change the fund to which contributions are being made and confirm if contributions are already committed, for example through clearing house at the end of the quarter.
4. Member to consider whether pension account is being cashed out or rolled over.
5. Member to review acquisition dates for assets to see if 12 month holding period is likely to be relevant and if so, consider deferral of instruction.
6. If rollover, member to confirm new superannuation fund to be used and arrange for application forms to be lodged for new account.
7. Member to discuss with tax accountant or administrator opportunities to sequence the completion of the accumulation and pension accounts and for targeted asset disposals to achieve superior after tax outcome.

Member to trustee to member

8. Member instructs the trustee for the sequence of events and preferred asset sales associate with these events.
9. Trustee confirms member instruction and requests member to advise treatment of personal contributions in the current and previous financial year for tax deduction purposes.
10. Trustee confirms with member that employer contributions are being directed to new fund (at member request).
11. For payments out of superannuation, member instructs trustee to arrange for payment of their pension entitlement from the fund, after making payment of annual minimum or estimated pro rata minimum pension payments prior to payment.
12. For rollovers, member notifies trustee of intention to transfer their account balance, after making payment of annual minimum or estimated pro rata minimum pension payments prior to payment.

Trustee

13. Prior to proceeding, trustee confirms approach for actuarial certificate which is compatible with requested sequencing.
14. Trustee arranges Section 290 deduction notices if required, arranges for member to sign and trustee to acknowledge.
15. Trustee requests accountant to confirm final fees and expenses to be invoiced or provisioned.
16. Trustee arranges minimum pension payments according to instructions.
17. Trustee determines amount to be retained in the cash account (plus a margin) to meet final expenses and tax liability, balance will be paid out or rolled over to new fund.
18. Trustee arranges sale of assets according to staged instructions, especially where pension account is being finalised.
19. For rollover, trustee requests accountant to prepare rollover documentation for transfer of majority of member's entitlement to new fund.
20. Trustee forwards rollover documentation and rollover balance to new superannuation fund, combination of paper and electronic transfer, depending on fund.
21. After lodgement and completion of 2020 return, arrange payment/receipt of final tax liability/refund and make second and final rollover payment to new superannuation fund.
22. For rollover of pension balances, the trustee will need to arrange for TBAR lodgement for the partial or full commutation. For cashing out of pension balances, there is no need for TBAR lodgement.
23. On closure of fund, consider deregistration of special-purpose trustee company.
24. Ensure bank account closures are completed.

Concluding comments

The purpose of this paper was to consider the procedural issues to be addressed by members, service providers and trustees of superannuation funds in relation to the windup process. While the windup of the fund is a consequence of the extinguishment of all member balances, the focus was on how the balances were to be treated in the lead up to the windup process.

The process of completion of a SMSF needs to be addressed with care and consideration to ensure that unexpected and unnecessary tax or cost outcomes are avoided.

As ASIC has noted, there should be a greater discussion occurring with existing SMSF participants as well as new SMSF participants about how the SMSF will wind up on either a voluntary or involuntary basis and what action or steps could be undertaken along the way to ensure this is done in the most cost and tax effective manner.

By being appropriately informed and advised, we can assist our clients to achieve not only a favourable outcome by using an SMSF but also a favourable outcome on reflection when the SMSF has completed.