

SPLITTING SELF MANAGED SUPERANNUATION

Stephen Bourke¹

1. Introduction

Since the commencement of the super splitting amendments to the *Family Law Act 1975* in 2002, the major case law has centred on cases where the superannuation is superannuation in defined benefit plans.² There are only a handful of cases dealing with self managed superannuation.³

The reasons that SMSFs do not feature in the reported cases seem to be twofold. First, there are over 27 million superannuation accounts in Australia and over 600,000 SMSF member accounts.⁴ Data on memberships is scant but it shows at a broad level that SMSF membership represents a small percentage of overall superannuation membership. In other words, most people have superannuation in the non-SMSF sector (and often more than one superannuation account) and these proportions are reflected in the reported cases.

Second, it may be that these cases are the cases that tend to settle because the parties (or more often the husband) do not want the financial statements of the SMSF exposed to public scrutiny. The fear of being reported to the regulator becomes a compelling reason to settle. When parties find their personal relationships in turmoil, there is also a likelihood that other aspects of their lives will be in turmoil. Hence, their business structures and their SMSF might also be in disarray along with other aspects of their lives. If their SMSF is in disarray, it seems there is an imperative to

¹ Stephen Bourke is a Director in the recently established boutique firm, Certus Law, specialising in superannuation, trusts and estate planning. He also consults to other practitioners through the consulting practice, SuperSplitting.

² See *Coghlan and Coghlan* (2005) FLC 93-220; *M v M* (2006) FamCA 913.

³ See, for example, *SHL & EHL* [2006] FamCA 1287.

⁴ Speech by Ian Read, Assistant Deputy Commissioner for Taxation to the Taxation Institute of Australia, 9 November 2007. Copy available at that ATO website - ato.gov.au/super.

have it sorted out quietly before the ATO finds out. And these cases avoid contested hearings.

2. What are SMSFs?

Let us start with a broad sketch of the SMSF sector. In June 2008, Australians had invested \$1.17 trillion in superannuation savings.⁵ The largest proportion of the nation's superannuation savings is held in the SMSF sector, with 30.6% held in that sector.⁶ There are now in excess of 387,000 SMSFs in Australia⁷ and in 2007, the new SMSF registrations peaked at 3,600 per month.⁸

In terms of average balances, the ATO report that amounts now held in the SMSF sector show average member balances well in excess of the non-SMSF sector. At the lower end of the spectrum, the industry sector has an average account balance of \$15,100 while the SMSF sector has an average account balance of \$342,500.⁹ This is in most part due to the demographic of those with an SMSF – older, self employed or in the draw down phase, having rolled the balance from another sector to an SMSF.

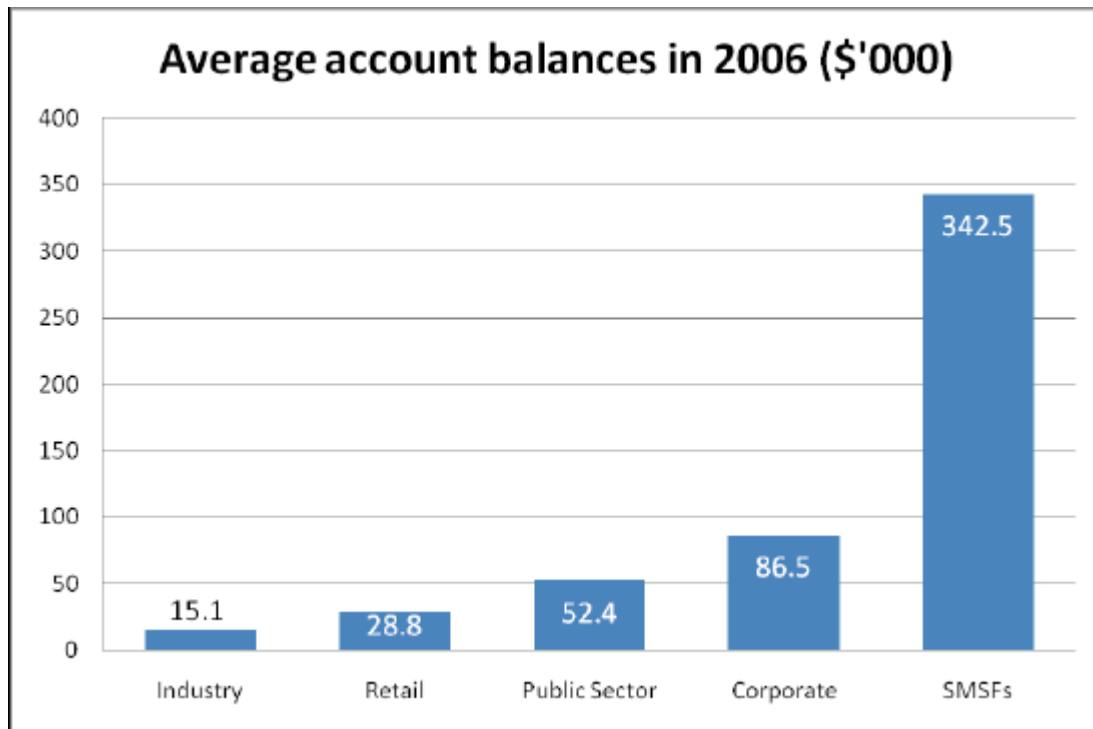
⁵ Quarterly Superannuation Performance, APRA, September 2008, p.5.

⁶ *ibid*

⁷ At September 2008, the Australian Prudential Regulation Authority reported there were 387,936 SMSFs.

⁸ Read, *op cit* p1.

⁹ Read, *op cit* p3. (The writer acknowledges the permission given by the ATO to reproduce the graph).



Source: APRA 10 Year Report - 2007

Self managed superannuation suffers from what might be described as “super schizophrenia”. While the trust structure is the form adopted as the means of regulation,¹⁰ it is the only structure through which an SMSF can be established. However, it is an unusual form of trust.

An SMSF is an express trust created by way of declaration of trust. A declaration of trust creates a trust where the legal owner of trust property makes an equitable declaration of trust over that property. This is in contrast to a trust by transfer where a settlor transfers property to another as trustee of the trust. SMSFs are established by way of a declaration of trust rather than by way of settlement of trust.¹¹ Thus in an SMSF, the members have a trust relationship with themselves and the ATO has recognised this peculiar situation with its delightfully named publication “Its Your Money, But not Yet”.

¹⁰ See s.19 of the *Superannuation Industry (Supervision) Act 1993*.

¹¹ See the classic statement by Turner LJ in *Milroy v Lord* (1862) 4 De GF & J 264 at 274 – 275 for the requirements to establish a trust.

Trust law tells us that a trust, where the beneficiary and the trustee are the same person, is not, in truth, a trust.¹² In the SMSF context, the trustee/member relationship is dealt with in s.17A of the *Superannuation Industry (Supervision) Act 1993* and it provides the statutory conditions for establishing a self managed superannuation plan.

The statutory conditions for self managed superannuation can be divided into two categories – single member plans and multi member plans. For multi member plans, the upper limit for the number of members is four.¹³ S.17A(1) of the *Superannuation Industry (Supervision) Act 1993* provides:

17A Definition of self managed superannuation fund

Basic conditions—funds other than single member funds

- (1) Subject to this section, a superannuation fund, other than a fund with only one member, is a ***self managed superannuation fund*** if and only if it satisfies the following conditions:
 - (a) it has fewer than 5 members;
 - (b) if the trustees of the fund are individuals—each individual trustee of the fund is a member of the fund;
 - (c) if the trustee of the fund is a body corporate—each director of the body corporate is a member of the fund;
 - (d) each member of the fund:
 - (i) is a trustee of the fund; or
 - (ii) if the trustee of the fund is a body corporate—is a director of the body corporate;
 - (e) no member of the fund is an employee of another member of the fund, unless the members concerned are relatives;
 - (f) no trustee of the fund receives any remuneration from the fund or from any person for any duties or services performed by the trustee in relation to the fund;
 - (g) if the trustee of the fund is a body corporate—no director of the body corporate receives any remuneration from the fund or from any person

¹² *Re Heberley (deceased)* [1971] NZLR 325 at 333 “No man can be a trustee for himself alone”
Per Turner J.

¹³ S.17A of the *Superannuation Industry (Supervision) Act 1993*.

(including the body corporate) for any duties or services performed by the director in relation to the fund.

Where the SMSF is a multi-member SMSF (ie it has 2 to 4 members) each member must be a trustee and each trustee must be a member. If the trustee is a body corporate, each member must be a director of the body corporate. A member cannot be the employee of another, unless they are related (such as in a family business). These membership/trusteeship rules are designed to ensure that the decision-making of the SMSF involves all members.

The most common form of SMSF is the two member SMSF. Practitioners will immediately recognise these SMSFs as being the husband and wife as the two members. While the law is designed to give all members involvement in the decision-making, in practice, there will typically be an active member/trustee and a non-active member/trustee. Does that mean that the non-active member/trustee can escape responsibility if the management of the SMSF results in a loss?

In *Vivian (in her capacity as Deputy Federal Commissioner of Taxation) v Fitzgeralds*,¹⁴ the husband and wife were members and trustees of an SMSF. The fund was established in 1993 with a corporate trustee. It acquired real estate but the land title register did not record that the company held the property in its capacity as trustee for the SMSF.¹⁵ In separate proceedings, the company was ordered to be wound up and the parties sought advice as to whether the real estate could be used to satisfy the debts of the company. They were advised it could. They sold the land to pay the debts of the company.

The ATO took a different view. The real estate was an asset of the SMSF. It could only be dealt with under the terms of the *Superannuation Industry (Supervision) Act 1993*. Selling the land (even though it was on the advice of the legal, financial and accounting advisers) and using the proceeds to pay the debts of the company was a breach of the sole purpose test.¹⁶ The husband was the active trustee and the wife

¹⁴ [2007] FCA 1602 (15 October 2007) (Corrigendum 23 October 2007 [2007] FCA 2110 (31 October 2007)).

¹⁵ Queensland and the Northern Territory are the only two jurisdictions which permit the registration of title of real property on the register. The other jurisdictions will provide for a Registrar-General's caveat where the real property is held by the registered title holders on trust.

¹⁶ S.62 of the *Superannuation Industry (Supervision) Act 1993*.

simply signed the documents placed before her. In proceedings for an administrative penalty, Logan J commented on the obligations of the trustees and said:

45. Having regard to the agreed summary, and the particular commercial pressure described, it does seem to me that Mr Fitzgeralds was the more culpable of the two trustees. It is, though, quite unacceptable for a fellow trustee to be a passive participant in a breach of trust by another trustee no matter what the matrimonial pressures might be.

His Honour then imposed a penalty of \$20,000 on the husband for his role and a penalty of \$10,000 on the wife for signing the documents.

Single Member SMSFs

There are special rules for single member SMSFs because a person cannot be a trustee for him/herself.¹⁷ S.17A(2) of the *Superannuation Industry (Supervision) Act 1993* provides the rules:

Basic conditions—single member funds

- (2) Subject to this section, a superannuation fund with only one member is a ***self managed superannuation fund*** if and only if:
 - (a) if the trustee of the fund is a body corporate:
 - (i) the member is the sole director of the body corporate; or
 - (ii) the member is one of only 2 directors of the body corporate, and the member and the other director are relatives; or
 - (iii) the member is one of only 2 directors of the body corporate, and the member is not an employee of the other director; and
 - (b) if the trustees of the fund are individuals:
 - (i) the member is one of only 2 trustees, of whom one is the member and the other is a relative of the member; or
 - (ii) the member is one of only 2 trustees, and the member is not an employee of the other trustee; and
 - (c) no trustee of the fund receives any remuneration from the fund or from any person for any duties or services performed by the trustee in relation to the fund;
 - (d) if the trustee of the fund is a body corporate—no director of the body corporate receives any remuneration from the fund or from any person (including the body corporate) for any duties or services performed by the director in relation to the fund.

¹⁷ *Re Heberley (deceased)* [1971] NZLR 325 at 333

For a single member SMSF, the trusteeship arrangements fall to one of two options. First, if the trustee is a corporate trustee, the member may be the sole director or there may be two directors. Where there are two directors, the directors may be related but if not related, the second director must not be an employee of the other director.

The second option is personal trusteeship. In this situation, the member will be a trustee but there must be a second trustee. That trustee may be a relative but if not related, the second trustee must not be an employee of the first trustee.

Summary of Membership/Trusteeship Requirements for an SMSF

The membership/trusteeship requirements for an SMSF are as follows:

1. Each member must be a trustee of the fund;
2. Each trustee must be a member of the fund;
3. If the trustee is a corporate trustee, each member must be a director of the corporation and each director must be a member;
4. No member can be an employee of another member, unless they are relatives;
5. For single member funds:
 - a. there can be a single director corporation;
 - b. in the case of individuals there must be two trustees:
 - i. one being the member and other being a relative of the member; and
 - ii. the two trustees are not in an employer/employee relationship.

These conditions do not apply for the larger superannuation funds or indeed in the small APRA funds as they already operate on an arms length member/trustee relationship.

3. SPLITTING AN SMSF

While there are increasing numbers of self managed superannuation funds, there is little by way of authoritative statements about how to treat this form of

superannuation under the powers conferred on courts exercising jurisdiction under the *Family Law Act 1975* to split superannuation.

The Requirements of the Family Law Act

To state the obvious, the overriding requirement under the *Family Law Act 1975* is that a Court exercising jurisdiction shall not make an order unless it is satisfied that it is just and equitable to make the order.¹⁸ In making that order, the court is required to take the matters in s.79(4) into account.

This has led to a wealth of case law where it is now firmly established that the matters to be taken into account have a retrospective element and a prospective element. The retrospective analysis of how the parties have arrived at the point they have reached on the day of hearing is through the lens of s.79(4)(a) (b) and (c). The prospective analysis of the parties general economic position is seen through the lens of s.79(4)(d) to (g) and importantly s.75(2).¹⁹ As long ago as 1979, the Full Court put it in the following terms:

[the provisions of s.79] have a retrospective and a prospective element. They look back to see how the property was acquired, who contributed to it and in what form. They look ahead to ensure that the Court considers the means and needs of each spouse and of the children.²⁰

The Family Court and other courts exercising jurisdiction under the *Family Law Act* operate on the basis of:

- jurisdiction – the authority to decide matters; and
- power – the ability to alter the obligations between the parties including to alter the interests of the parties in the property of that party or property jointly held. The exercise of that power can be at large or it can be qualified.²¹

¹⁸ S.79(2) of the *Family Law Act 1975*.

¹⁹ It may be that a future change might be to have a list of factors for determination of matters under s.79 and a separate list of factors for determination of matters under s.74. (1979) 35 FLR 458 at 477.

²⁰

²¹ For a discussion on the distinction between jurisdiction and power see *Harris v Caladine* (1991) FLC 92-217 esp at 78,493).

It has been said elsewhere that in relation to superannuation:

- jurisdiction is conferred through s90MC²²;
- power is the power to alter the entitlement of a member (who is a party to the proceedings) to a payment of their superannuation and is conferred by s79; and
- the operation of that power is not at large. The power provides for the court to bind third party trustees but only to split payments and the power is not a power to split the underlying interest. The operation of the s.79 power in relation to superannuation is governed – and circumscribed - by Division III of Part VIII B.²³

It may be thought that s.90MT is the source of power. But that cannot be. The manner in which the sections in Part VIII B are drafted (in particular s.90MS), do not make any reference to the fundamental requirement of justice and equity. On any analysis, s.90MT is an enabling provision with respect to s.79 in the same way as s.80 is an enabling provision for s.79 and other powers under Part VIII.²⁴

If it is right that the source of the power to make orders in relation to superannuation is s.79, then the terms of that provision must apply. No order in relation to superannuation can be made unless it is just and equitable and in making an order, the court must have regard to the matters in s.79(4). While the case law suggests that the provision should be approached on the basis of a series of interrelated steps²⁵, problems do emerge if the determination adopts a rigid compartmentalised approach.

The question for a court determining an application under s.79 is therefore to **evaluate** entitlement by reference to the matters in s.79(4) and then determine **how** that entitlement is to be met. This includes matters where the application includes

²² Operating with the definition of *matrimonial cause* in s4 and with s31(1)(a) and with s39(4) of the *Family Law Act* 1975.

²³ Part VIII B and s.90MT in particular has the character of an enabling provision in the same way that s.80 is an enabling provision and not a separate source of power (see *Davidson and Davidson (No 2)* (1994) FLC 92-469).

²⁴ *Davidson and Davidson (No 2)* (1994) FLC 92-469.

²⁵ See *Hickey and Hickey* (2003) FLC 93-043.

superannuation, whether held in the SMSF sector or otherwise. The property of the parties at the time of hearing is within the authority of the court to make an order which alters the interests the parties may have in the property and this would include entitlements in an SMSF.

What are the requirements for proceedings involving an SMSF?

Documents

When splitting a self managed super fund, whether by way of settlement or whether you are preparing for trial, the following documents will be necessary to ensure all aspects of the SMSF are considered:

1. The trust deed: The trust deed should be obtained and the practitioner should be satisfied that the document is the most recent and up to date copy of the deed. For trial, a properly notarised copy of the deed should be obtained. With the multiple changes in deeds, it is all too common for parties not to know what state the deed is in. Good record keeping of the deed and all its changes is essential so that when a copy is put into evidence, the court can be certain that it is reading from the right copy of the deed.
2. RoCS Search: The Court has jurisdiction and power over all forms of superannuation, whether the superannuation is complying or non-complying and indeed whether it is regulated or non-regulated.²⁶ The jurisdictional preconditions are:

Is there a member?
↓
With a superannuation interest?
↓
In an eligible superannuation plan?

²⁶ S.90MD of the *Family Law Act 1975*

However, while the jurisdictional reach is wide, it is necessary for the court to be made aware as to whether the fund has been declared a non-complying fund. Hence the relevant extract from the Register should be put into evidence or the certificate under s.40 of the *Superannuation Industry (Supervision) Act 1993*.

An additional reason for including the extract of the Register is to ensure that the Court order is drafted so that it applies to the right fund. There is no naming convention of superannuation funds and in the self managed sector, there will often be identically named funds. For example, there are ten self managed superannuation funds with the identical name the Judge Superannuation Fund and two self managed super funds with the name the Judge's Super Fund. The only distinguishing feature is the ABN.

3. Last three years financial statements: Rule 12.02(b)(ii) of the *Family Law Rules 2004* requires "financial statements for the 3 most recent financial years". This may be difficult to comply with where the SMSF has fallen into disarray and the financial statements are not up to date.
4. Member Statements: These will be an integral part of the financial statements and are also required by Rule 12.02(b)(ii) of the *Family Law Rules 2004* as well as the 3 most recent tax returns, profit and loss accounts and depreciation schedules (if any).

Where it is sought to rely on the evidence of the history of superannuation to advance an argument about the contributions made to the superannuation fund at the commencement of the relationship, the financial statements of the fund at that time will be required. However, the difficulty faced is that the record keeping of the SMSF may be incomplete. What are the formal record keeping requirements? The *Superannuation Industry (Supervision) Act 1993* provides the following:

- accounting records that explain the transactions and financial position of the fund - 5 years;

- annual operating statement and an annual statement of the fund’s financial position - 5 years;
- minutes of trustee meetings (where matters affecting the fund were discussed), records of all changes of trustees and member’s written consent to be appointed as trustees – 10 years;
- annual returns lodged - 5 years;
- reports given to members - 10 years.

While some clients may have retained records over and above the formal requirements, there will be many clients who have not. And there may be clients who have not meet the formal record keeping requirements at all, making the argument to be advanced more difficult because of the absence of evidence.

Valuation issues

The Family Law Act prescribes a number of methods to obtain the value of superannuation for the purposes of family law property proceedings.²⁷ However, when it comes to self managed superannuation, we find this form of superannuation is exempt from the methods prescribed in the *Family Law (Superannuation) Regulations 2001*.²⁸

The courts are therefore required to determine a value by whatever method it considers appropriate.²⁹ In one of the earlier cases, the following was stated:³⁰

Although there may be a perception that the value (in this case, the agreed value) of the superannuation is somewhat “artificial”, the fact of the matter is that this court has been legislatively directed to treat superannuation as if it were property. The prescribed valuation process takes into account a number of actuarial factors, adjustments or considerations. It provides no less an indication of the true “value” of the item than does the valuation process that is applied to other items of property – such as a business or residential or commercial real estate. Indeed, the valuation process as it applies to superannuation is arguably fairer and more reliable than that which may apply to certain other items of property. There is always the possibility that the sale price of a business, a work of art or real estate (for example) will be

²⁷ See generally Part 5 of the *Family Law (Superannuation) Regulations 2001*.

²⁸ R.22(2)(b) of the *Family Law (Superannuation) Regulations 2001*.

²⁹ S.90MT(2) of the *Family Law Act 1975*.

³⁰ *OSF and OJK* (2004) FLC 93-191

very different from the value attributed to it during the course of property settlement proceedings. The sale price might be higher or lower than that indicated by the valuation – or higher or lower than the agreed value or the value determined by the court after hearing evidence from competing expert valuers. Or a party may find that he or she cannot find a buyer for the item of property at all. Such considerations have never prevented courts from determining the value of all types of property in a multiplicity of contexts.

The question of the value of entitlements in an SMSF has not been authoritatively considered by the Full Court and there have only been a handful of reported cases where the superannuation was superannuation in an SMSF. The following is submitted as relevant to the value of a member's entitlement in an SMSF in accordance with s.90MT(2)(b) of the *Family Law Act 1975*:

1. Valuation of the superannuation should be the value at the date of hearing.³¹
There is no compelling reason to depart from this general rule. The court has jurisdiction and power over the property of the parties to the date of hearing and this includes superannuation and superannuation in the SMSF sector. In practice, however, it will be some weeks (or perhaps months) prior to the hearing that the values will be obtained. In many cases, the value of the superannuation will be agreed between the parties. The court will have the trust deed, member statements and the financial records of the superannuation fund and these will often provide the basis for the agreed value. Whether the value at earlier dates is to be obtained and admitted into evidence will depend on the case to be advanced. However, it is clear that value at other dates is a matter of judicial discretion and goes to the exercise of discretion under s.79(4)(e) of the *Family Law Act 1975*.³²
2. The valuation of the investments of the SMSF should be an up to date valuation so that it will be reflected in the valuation of the entitlements of each of the members in accordance with the *Superannuation Industry (Supervision) Act 1993* and associated regulations. The power of a court exercising jurisdiction under the *Family Law Act 1975* is a power to split payments arising from an entitlement. It is not a power to split the assets or investments within an SMSF. However, the value of the assets or investments of the

³¹ *Woodland and Todd* (2005) FLC 93-217 and *Omacini and Omacini* (2005) 93-218.

³² See *Omacini and Omacini* (2005) 93-218 at p79,617.

SMSF will need to be updated because those values underpin the value of the member entitlements.

3. The value of each member's entitlement should be referable to the amount reported in the financial statements being the amount to pay member entitlements. The financial statements of an SMSF report the amounts of the investments of the SMSF and deduct liabilities (including unpaid taxation liabilities). The amount in popular accounting packages is reported as the "amount to pay member entitlements". This amount is then allocated to each of the members in accordance with their respective entitlements and reported in their member statements.
4. If there is a dispute about the value of the investments in the SMSF, these should be valued in accordance with the accepted principles of valuation of the assets concerned. The three most common forms of investment in SMSFs are real estate, shares and cash. Real estate should be valued in accordance with the accepted principles of real estate value and likewise for shares. There may be collectables and other less common forms of investments which may require expert evidence about the value of investment such as artwork, golf club membership or perhaps antiques.
5. Where there is a question of non-compliance of the SMSF, there may be a higher penalty tax liability to be taken into account.³³ However, if the liability has not been formally imposed, it may be matter of judicial discretion as to how to split the entitlement to allow for a greater or lesser proportion of the liability to fall on one party or the other based on the evidence of culpability for non-compliance.
6. Unrealised capital gains should be considered in accordance with the principles of *Rosati's case*³⁴ noting that rollover relief is available for transfer of investment assets from one SMSF to another SMSF³⁵ and that unrealised capital gains become exempt if the realisation occurs when the member entitlement moves into payment after age 60.³⁶ Failure to make submissions regarding CGT may result in a reduction in the entitlement of the member who remains in the fund.

³³ S.288A of the *Income Tax Assessment Act 1936*.

³⁴ (1998) FLC 92-804

³⁵ S.126-140 of the *Income Tax Assessment Act 1997*.

³⁶ S.288A of the *Income Tax Assessment Act 1936*.

In most cases, value will be agreed and objectively ascertainable from the financial statements of the SMSF. However, the financial statements are prepared on an annual basis and if the matter is to proceed to trial, an updated set of financial statements may need to be prepared, even though it is not at the end of the financial year. Practitioners should note that it is a requirement of the ATO (the ATO regulates the SMSF sector) that real estate and other valuations be conducted annually for investments in an SMSF.³⁷

Type of Order

There is no specific SMSF power for the court to split superannuation held in that form of superannuation. Therefore, reliance must be placed on the powers for superannuation generally. These are the powers exercised in accordance with s.90MT of the *Family Law Act 1975*.

It will be remembered that s.90MT provides for two types of orders - the type (a) order, exercised in accordance with s.90MT(1)(a) of the *Family Law Act 1975* and the type (b) order, exercised in accordance with s.90MT(1)(b) of the *Family Law Act 1975*.³⁸

In deciding which order to select, the question must be asked what is the effect of the alternative types of order and what outcome is sought? The type (a) order is the base amount order. S.90MT(4) of the *Family Law Act 1975* provides that before making an order in accordance with s.90MT(1)(a), the court must allocate a base amount. The base amount is allocated by the court in accordance with its discretion under s.79 – assessment of contributions and adjustments in accordance with s.79(4)(d) to (e).³⁹ Once the base amount is determined, the usual payment splitting order would be made.

³⁷ ATO Superannuation Circular 2003/1

³⁸ The type (c) order has no relevance to the SMSF sector and the type (d) order is an order to enforce.

³⁹ *Coghlan and Coghlan* (2005) FLC 93-220; *M v M* (2006) FamCA 913.

The alternative is the type (b) order. The type (b) order is an order which specifies a percentage that applies to each splittable payment made to the member by the trustee. On its face, it is a simpler order than the type (a) order but the percentage will apply to the total amount determined to be the member entitlement.

The operation of each of the orders under the *Family Law Act 1975* is the first instalment in a more complex story. The court's power under the *Family Law Act 1975* in relation to superannuation is limited to a payment splitting power for constitutional reasons.⁴⁰ However, the complex constitutional picture is completed by the amendments under the *Superannuation Industry (Supervision) Regulations 1994*.

SIS Regulations

Once a payment splitting order (whether it is a type (a) or a type (b) order) is made under the *Family Law Act 1975*, the trustee of the SMSF has further obligations under the *Superannuation Industry (Supervision) Regulations 1994*. After service of the order, the trustee is required to provide to the non-member spouse three options in relation to the superannuation entitlement:⁴¹

1. To create a new interest in the SMSF: This option requires the trustee to take the non-member spouse's benefit and create a new interest in the SMSF. This might be an unwise course following separation and divorce but it is nonetheless available. Where the non-member may already have an interest in the SMSF, the creation of a new interest is a precursor to consolidation of the split interest with the existing interest.

⁴⁰ The restriction on the court's power as a power to split payments made to the member overcomes the difficulties in the court making substantive orders against third parties to the marriage and also the just terms requirement (pl 51(xxxi) of the Constitution) where a court order may affect the entitlement of another member of the superannuation plan who is not a party to the marriage.

⁴¹ R.7A(5), (6) and (7) of the *Superannuation Industry (Supervision) Regulations 1994*. It should also be noted that there is now a parallel pathway in the SIS Regulations whereby an intermediate interest can be created, called a ***non-member spouse interest***. The parallel pathways seem to offer alternatives with no real indication about the reasons for there being two alternative pathways. The main difference between the alternative pathways is that, before the three options are offered to the non-member spouse, one pathway creates an intermediate interest and the other pathway does not.

2. To rollover or transfer the interest: This option requires the trustee to offer a rollover or transfer to the non-member spouse in the amount of the new entitlement of the non-member spouse. The effect of the rollover or transfer would be reduce the overall amount in the SMSF and have the amount transferred to another complying superannuation fund.
3. To pay a lump sum: This option is only available where the non-member spouse has met a condition of release under the *Superannuation Industry (Supervision) Act 1993*.

Each of the options requires the trustee to pay an entitlement to or on behalf of the non-member spouse. How is this entitlement calculated?

The answer is in the definition of **transferable benefit** in r.1.03 of the *Superannuation Industry (Supervision) Regulations 1994*.⁴² It provides:

transferable benefits, in relation to a superannuation interest that is subject to a payment split and in relation to the non-member spouse in relation to that interest, means benefits that are equal to:

- (a) if the payment split is a base amount payment split and an adjusted base amount applies to the non-member spouse when the benefits are transferred — the adjusted base amount less the amount of any fees payable by the non-member spouse in respect of the payment split; or
- (b) if the payment split is a base amount payment split and an adjusted base amount does not apply to the non-member spouse when the benefits are transferred — the base amount allocated to the non-member spouse, within the meaning of regulation 45 of the *Family Law (Superannuation) Regulations 2001*, less the amount of any fees payable by the non-member spouse in respect of the payment split; or
- (c) if the payment split is a percentage payment split:
 - (i) for an entitlement, in respect of an accumulation interest in the growth phase that is not a partially vested accumulation interest, to which subparagraph (ii) does not apply — the amount in relation to the interest at the time when the benefits are transferred, determined in the way in which a court would determine an amount in accordance with regulation 28 and subregulation 31 (2A) of the *Family Law (Superannuation) Regulations 2001*, multiplied by the specified percentage, less the amount of any fees payable by the non-member spouse in respect of the payment split; or
 - (ii) for an entitlement in respect of an interest in a self-managed superannuation fund — the amount in relation to the interest at the time when the benefits are transferred, determined by a

⁴²

See also r.7A.03B(3) of the *Superannuation Industry (Supervision) Regulations 1994*.

method that a court might use if the court were acting under paragraph 90MT (2) (b) of the *Family Law Act 1975*, multiplied by the specified percentage, less the amount of any fees payable by the non-member spouse in respect of the payment split; or

- (iii) for an entitlement in respect of any other interest — the amount in relation to the interest at the time when the benefits are transferred, determined in the way in which a court would determine an amount in accordance with the relevant method in Part 5 of the *Family Law (Superannuation) Regulations 2001*, multiplied by the specified percentage, less the amount of any fees payable by the non-member spouse in respect of the payment split.

The operation of the definition is best illustrated and explained by way of example:

The Parties have a Self Managed Super Fund and the Husband decides to use the \$1m transitional window (which expired on 30 June 2007). He makes the contribution to his super and the financial statements are prepared for 30 June 2007 and show the following member entitlements:

➤ Husband:	\$1.5m
➤ Wife:	\$0.5m
➤ Total:	\$2.0m

The assets in which the trustees have invested are:

➤ Shares:	\$1.5m
➤ Real Estate:	\$0.48m.
➤ Cash:	\$0.02m.

He is 61 years of age and she is 41 years of age and two children were born during their five year marriage.

Let us suppose that the court determines that a split of the SMSF to equalise the member entitlements is the just and equitable outcome. How might this be achieved?

If we use a type (a) order with an operative time four days after service of the order on the trustees, what would be the combined effect of the powers under the *Family Law Act 1975* and the operation of the *Superannuation Industry (Supervision) Act 1993*? If the Court accepts the financial statements at 30 June 2007 and allocates a base amount of \$500,000 to the wife, it would seem that the husband's entitlement would be reduced from \$1,500,000 to \$1,000,000 and the wife's entitlement increased from \$500,000 to \$1,000,000. But is it?

The husband's present day entitlement (and indeed the wife's present day entitlement) will not be the amount at 30 June 2007. Let us further assume that the investments

increased by 8% in the six month period to 31 December 2007 but then fell by 4% to 30 June 2008, giving us an overall increase of 4% since 30 June 2007.

In reality, the entitlements of the parties would be as follows:

➤ Husband:	\$1,533,584
➤ Wife:	\$ 511,195
➤ Total:	\$2,044,779

And the effect of the court order allocating a base amount of \$500,000 with an operative time four days after service would be:

➤ Husband:	\$1,033,584
➤ Wife:	\$1,011,195
➤ Total:	\$2,044,779

The difference is an amount of \$22,389 and this is part of the husband's entitlement. In other words, it is not a 50/50 split but a windfall of \$22,389 to the husband. Let's move the operative time to 30 June 2007.

We now have to factor in the prescribed interest rate of 6%.⁴³ The result would now be:

➤ Husband:	\$1,011,249
➤ Wife:	\$1,033,530
➤ Total:	\$2,044,779

The wife is now ahead by \$22,281. The reason for this difference that the base amount has been adjusted by 6% but the fund has only earned 4%.

Lesson: Take account of the adjustments in advice to the parties in working out the split.

Is there a way to achieve the outcome desired with the shifting share prices? Yes. The order should be a cross splitting order using the type (b) order with the operative time as the date of transfer of the transferable benefit. This outcome cannot be

⁴³ See *Family Law (Superannuation) (Interest Rate for Adjustment Period) Determination 2007*.

achieved by superannuation agreement because of s.90MH of the Family Law Act which fixes the operative time at four days after service of the Agreement on the trustees.

4. Interaction with Part VIII AA

It might be thought that Part VIII AA could be used to provide a simpler and more streamlined means to split superannuation in an SMSF. Part VIII AA of the *Family Law Act 1975* gives the Court wide powers over third parties to the marriage. Putting to one side the controversy as to whether this power will survive a constitutional challenge,⁴⁴ it seems to allow the court to make a wide range of orders over third parties.

If the SMSF has a corporate trustee, it would be a third party to the marriage. Suppose the court decided to employ the third party powers and order the third party to split an entitlement and then transfer a range of assets to a new fund or to the non-member spouse directly. Do the third party powers allow for this?

On its face, yes. However, to do so would be putting the trustee of the SMSF in a situation where if it observed the terms of the court order, it would become a non-complying superannuation fund and if it did not, it would be in breach of the court order. Why would the fund become a non-complying superannuation fund?

We know the supersplitting amendments to the *Family Law Act 1975* under Part VIII B only give the court the power to split payments, not the power to split the underlying interest. When the payment splitting power in accordance with Part VIII B is employed by the court, it gives rise to other obligations on the part of the trustee under the *Superannuation Industry (Supervision) Regulations 1994* including the obligation to split the underlying interest. In other words, the outcome of splitting the underlying interest occurs in stages – first a payment splitting order is made, second the service of this order creates trustee obligations under *Superannuation Industry*

⁴⁴ Special leave has been given in *Spry v Kennon* [2008] HCATrans 130 which raises this question.

(Supervision) Regulations 1994 and third, the payment splitting order is negated where the SIS obligations are fulfilled.⁴⁵

If the split is put into effect through these stages, no breach of superannuation law occurs. However, if the split is ordered under any other head of power (such as Part VIII(A)), the provisions in the *Superannuation Industry (Supervision) Act 1993* do not operate⁴⁶ and the trustees would be in breach of the sole purpose test. In addition, the relevant tax provisions would not operate⁴⁷ and the split would not attract CGT rollover relief.⁴⁸

Lesson: Do not use Part VIII(A) to split the underlying interest in an SMSF.

However, Part VIII(A) does have its usefulness as an adjunct to the super splitting amendments in Part VIII(B). There are occasions where the trusteeship arrangements may involve parties who are not parties to the marriage. For example, there may be a four member fund with two brothers and their respective wives. Each would be trustees or directors of the corporate trustee. It would be sensible practice, especially if the split is particularly contentious, to join the trustees who are not parties to the marriage for the purposes of securing compliance with procedural orders.

This can be illustrated by the following example. Suppose the court makes an order that alters the entitlement of a non-member spouse and that spouse elects to transfer entitlement to a complying industry or public offer superannuation fund. This would mean sale of investments to secure the cash to transfer the entitlement. A meeting of trustees occurs and there is no agreement as to how which assets are to be sold and when the sale is to occur. It might be that the trustee meeting concludes that the sale should be delayed until the equities market recovers. In the meantime, the separated parties remain at the trustee table trying to make decisions about the ongoing management of the SMSF. Procedural third party orders can be a useful adjunct in these circumstances to order the sale of assets for the rollover of the entitlement.

⁴⁵ See Division 2.2 of the *Family Law (Superannuation) Regulations 2001*.

⁴⁶ See r.7A.01 of the *Superannuation Industry (Supervision) Regulations 1994*.

⁴⁷ S.27ACA and s.27ACB of the *Income Tax Assessment Act 1936*.

⁴⁸ S.126-140 of the *Income Tax Assessment Act 1997*.

Tax Implications

S.126-140 of the *Income Tax Assessment Act 1997* was originally enacted to provide for rollover relief from CGT liability in circumstances where there was an *in specie* transfer of investments from the trustee of one SMSF to the trustee of another SMSF as a result of a splitting order or agreement. In other words, CGT rollover relief applied where there was an order or agreement in accordance with Part VIII B of the *Family Law Act 1975*. However, the rollover relief was limited to the investments referable to the split. Rollover relief was not available for the circumstances where the superannuation interest in an SMSF was not the subject of a splitting order or agreement but each party was simply keeping their own entitlement.

60% of SMSFs are two member funds, typically husband and wife. They will both have an entitlement. In these cases, the court might order a split of an entitlement and then ignore the existing (usually smaller) entitlement of the non-member spouse.⁴⁹

The *Tax Laws Amendment (2007 Measures No 5) Act 2007* amended s.126-140 of the *Income Tax Assessment Act 1997* to provide an extension of rollover relief. Rollover relief now applies in circumstances where one member is to transfer entitlement from one SMSF to another complying superannuation fund, whether the transferee fund is an SMSF or a larger fund, and the trustees of the first fund transfers a CGT asset to the second fund. It should be noted that the amendment requires the transfer to be made to another complying superannuation fund whereas previously s.126-140 provided that the transfer was to another SMSF.

The question of objectively determining compliance seems to be answered by s.995(1) of the *Income Tax Assessment Act 1997* which defines complying superannuation fund as a fund within the meaning of s.45 of the *Superannuation Industry (Supervision) Act 1993*. A fund within the meaning of s.45 of the *Superannuation Industry (Supervision) Act 1993* is a fund in which a notice has been given under s.40 that the fund is a complying superannuation fund. Practitioners

⁴⁹ The non-member spouse is only a non-member with respect to the member's interest that is the subject of the order. The non-member spouse may be a member in their own right with his or her own entitlement. Both need to be considered in splitting an SMSF.

should ensure that the most recent compliance notice is available and that the fund is listed on the Register of Complying Super Funds.

The preconditions that need to be satisfied to attract CGT rollover relief in circumstances where each party is keeping their own entitlement are:

1. The parties are members of an SMSF;
2. The trustee of the SMSF transfers a CGT asset to another complying fund for the benefit of the leaving party;
3. The transfer is “in accordance with an award, order or agreement mentioned in subsection (2B)”;
4. As a result of the transfer, the leaving party will have a nil entitlement in the SMSF;
5. If the transfer is in accordance with the terms of a superannuation agreement or corresponding state or territory agreement, then the transfer is because of marriage breakdown or relationship breakdown.

If these conditions are not satisfied, then CGT Event E2 (transferring a CGT asset to a trust⁵⁰) would occur and CGT would be payable. The amendments apply to CGT events that occur after 1 July 2007, regardless of when the order or agreement was made.

In circumstances where the leaving party is transferring their own entitlement, either with or without a split from the member remaining in the fund, the court will not be exercising its s.79 power to alter interests in the property of the parties in relation to the leaving party’s own entitlement. In other words, no splitting order is made where one party is simply rolling over their own entitlement.

It would not be strictly necessary to make any order under s.79 because there is no alteration in the property of the parties. However, it has been recognised that it may be done as a comfort to the parties⁵¹ and if the parties were unclear about what was

⁵⁰ S.104.60 of the *Income Tax Assessment Act 1997*.

⁵¹ See the discussion in *Hickey’s* case (supra) especially at p78,387 where the court said that the value of such orders is “to appease concerned parties”.

required, they may still remain as members/trustees of the same fund and, in most cases, this would be undesirable following a breakdown in the personal relationship of the parties.

The Court is able to order the parties to do all things within their control and this would include a rollover of their entitlement from the fund to another fund.⁵² Trust deeds will typically have a provision enabling a member to withdraw their entitlement from the fund at any time. For example, a clause from a well known deed is as follows:

“the Trustee may upon receiving a written request from the member transfer the whole or part of the member’s benefit to another regulated fund.”

The leaving member may exercise this option and make a request to the trustees to transfer the whole of the member benefit to another regulated fund. To ensure that CGT rollover relief can be obtained for the leaving party’s own entitlement, the order or agreement should state expressly that the rollover of the leaving party’s entitlement is required under the order or agreement. Failure to do this may trigger CGT Event E2.

Recent Case – Conflict Between Court Order and Superannuation Law

Pera and Pera [2008] FamCAFC 87 (27 June 2008) is a recent case and it illustrates the difficulties in dealing with self-managed superannuation. Orders (made by consent) included the following:

- 1) That the husband retain for his own use and benefit the Pera Executive Benefits Superannuation Fund (Order 4(b));
- 2) That the wife retain for her own use two paintings by Rosemary Ryan (Order 11);
- 3) That the wife transfer the Telstra shares to the self managed superannuation fund (Order 12); and

⁵² *Law-Smith v Seinor* (1989) FLC 92-050.

- 4) That any dividends received by the wife in relation to the Telstra shares (while they were held in her name) be paid to the husband (Order 12).

A dispute arose about the implementation of the order. The orders provided that the wife "retain ... two paintings" but the evidence was that these and other paintings were investments of the SMSF. The other paintings she had in her possession were to be delivered to the trustees of the superannuation fund. The wife refused. She also refused to transfer the shares registered in her name to the superannuation fund. In proceedings for enforcement the husband sought that the wife comply with the Orders and deliver the paintings as well as transfer the Telstra shares to the superannuation fund.

It was argued on behalf of the wife that the Court had no jurisdiction to make Orders about the assets of the superannuation fund without the trustee being joined as a party to the proceedings. It was further argued that the proper forum to deal with issues in relation to the assets of the superannuation fund was by a civil action seeking declaration of ownership of property.

In dismissing the appeal, the Full Court found that the Orders made by consent did not amount to a splitting order and that the proper interpretation of section 79 of the *Family Law Act 1975* is that section 79 only applies where there is an alteration of an interest in property (see *Mullane v Mullane* (1982-1983) 158 CLR 436 at 445 and *Hickey & Hickey* (2003) FLC 93-143).

The Full Court noted that it was constrained in determining some questions in that it did not have the benefit of full argument on the application of a number of relevant cases. It inferred that the parties intended that the superannuation be treated as "property" by incorporating in the orders, orders in relation to assets of the superannuation fund. The Full Court concluded:

"It appears to us arguable that, having regard to the Order which provided for the wife to receive the Paintings Z and A (assets of the superannuation fund), Order 11 of the Orders *altered* the interest of the husband in the superannuation fund, as did Order 12 which required the wife to transfer one thousand Telstra shares to the superannuation fund". (paragraph 48)

The Court concluded therefore that it had jurisdiction to make Orders altering or declaring the parties' property interests. The Court found that the order did not affect

the trustee and it was therefore unnecessary to join the trustee. While the conclusion regarding jurisdiction is clearly correct, the treatment of the investment property of the superannuation fund appears to have been on the basis that the property held within the superannuation fund was because the parties chose to deal with it in that way.

If this were the case, it would be contrary to superannuation law.

The Full Court (nor the Trial Judge) did not have the benefit of argument in relation to the legal concepts for compliance with the *Superannuation Industry Supervision Act 1993* (the SIS Act) in relation to self managed superannuation. The retention by the wife of the two paintings in her possession was, in effect, a transfer of the paintings from the trustee of the self managed superannuation fund directly to the wife. The evidence was that the paintings were investments made by the superannuation fund. This raises the following contraventions of the *Superannuation Industry (Supervision) Act 1993* and *Superannuation Industry (Supervision) Regulations 1994*:

- a) Section 52(2)(d) of the SIS Act – a covenant requiring the superannuation trustees to keep the money and assets of the superannuation entity separate from their personal assets;
- b) Section 52(2)(e) of the SIS Act – a covenant requiring the superannuation trustees "not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers".
- c) Section 62 of the SIS Act – this is the sole purpose test which requires trustees to maintain the assets of the superannuation fund for the sole purpose of providing retirement benefits for the member(s);
- d) Section 71(1) of the SIS Act – this is the in-house asset test which requires that no more than 5% of the fund's investments can be loaned to or invested in a related party; and
- e) Section 109(1A) of the SIS Act – this requires that the dealings in the investments be dealing on a arms length basis.

The Order requiring the wife to transfer the Telstra shares to the superannuation fund was an Order for delivery up of the shares to their rightful owner (the trustee of the superannuation fund). However, the Order also required that any dividends from the Telstra shares received by the wife should be paid to the husband. If this were to be a transfer to the husband in his personal capacity rather than as a director of the corporate trustee, it would amount to a further breach of the in-house assets test as well as the sole purpose test because the dividends should have been paid to the trustees of the superannuation fund and retained by the fund for the retirement benefit of the member.

There may also be CGT issues in relation to the transfer of ownership of both the paintings and the Telstra shares but this was not addressed in the reasons.

It is not clear what the position of the parties would be if the ATO prosecuted the parties for contravening superannuation law because the contravention would have occurred to comply with the order of the Family Court. Contraventions of superannuation law can result in penalties at the top marginal tax rate applied to the sum of the total value of the assets of the fund (s.295-325 of the *Income Tax Assessment Act 1997*). In other words, the loss to the members of the SMSF in penalties would be close to half of the value of the investments of the fund.

This case highlights the technical difficulties that arise in the self-managed superannuation context. Care should be taken in relation to the treatment of any superannuation interest, and in particular superannuation interests, held within a self managed superannuation fund.

Conclusion

The key to success in any area of law is to understand the context in which the law is being applied. For family lawyers, the successful practitioners understand company law, trusts, bankruptcy and the many areas of law that intersect with family law. For superannuation, and in the case of self managed superannuation, it is no different. The key to success in managing your client's case in self managed superannuation is to understand the subject matter itself. When self managed superannuation is

understood outside the context of the Family Law Act, its application within the context of the court's jurisdiction and powers under the Family Law Act will fall into place.

* * * * *