

Non-compliant self-managed superannuation funds in family law proceedings

by Jacqueline Campbell, Partner, Forte Family Lawyers

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Under the *Family Law Act 1975*, the Family Law Courts have power to make orders splitting superannuation so as to achieve a just and equitable outcome which might not otherwise be possible if only non-superannuation interests are adjusted between the parties. Particular problems arise however when self-managed superannuation funds are found to be non-compliant. A recent Family Court case highlights the issues.

In *Linder & Linder* [2013] FamCA 988, there were concerns about whether or not the self-managed superannuation fund was compliant. Audited financial returns had not been prepared since the financial year ended 30 June 2007.

Both the husband and the wife were trustees of the fund, but the husband gave evidence that since the inception of the fund, there had been no contribution by any employer of the wife and at no stage did she take any interest in the assets or operation of the fund.

There was a loan by the fund to a related investment trust and confusion as to the ownership of Argo Investments Limited shares. There were 4 parcels of Argo shares, some of which were held by the trustee of the fund, some jointly by the trustee and a fourth parcel held by the husband's father.

Justice Rees held that in these circumstances, it was clear that whatever may have been done, or failed to be done, in relation to the fund, the husband alone was responsible. This is of course, contrary to the liability of the trustees under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), the *Superannuation Industry (Supervision) Regulations 1994* and income tax legislation. The new penalties which apply from 1 July 2014 can be imposed on each individual trustee.

The parties appointed an accountant and auditor as a single expert to advise on whether the fund was compliant. The single expert said that the fund was at high risk of being in breach of the following sections of the SIS Act:

- Sections 35A and 35B – require the trustees to prepare and keep accounting records for a minimum of 5 years after the end of the year of income to which they relate. There were no audited financial statements prepared since 2007, nor any income tax returns - the trustees had not fulfilled their responsibilities. The penalty from 1 July 2014 is \$1,700.

- Section 52(2)(d) – requires that the assets of an SMSF must be held separately from any assets held by an individual personally from assets held by that individual as trustee.
- Section 65 – trustees must not loan monies to a member or a relative or related parties. The penalty from 1 July 2014 is \$10,200.
- The trustees had not attended to their basic duties of preparing an appropriate investment strategy (s 52(2)(f)), keeping appropriate minutes for at least 10 years (s 103) and ensuring that the fund's trust deed was kept up-to-date. The penalty for failing to keep appropriate minutes is \$1,700 from 1 July 2014.

The single expert gave evidence that the shares which appeared to be owned jointly by the parties, were not owned by the fund, despite the husband's assertions to the contrary. The trial Judge accepted the expert's evidence and found that the fund had a value of \$348,173.

The single expert concluded that the fund would probably be determined by the ATO to be non-complying in many areas. She assessed the potential taxation impost as \$343,240. This was too great an amount for attempts not to be made to rectify any or all breaches and for the trustees to try to reduce their impact. She suggested that submissions be made to the ATO regarding the sanctions and that the fund be wound up as the members had each achieved ages sufficient to satisfy a condition of release. The estimate of the cost of the work to be done was approximately \$63,000.

The husband did not accept the concerns as to the fund's non-compliant status or the financial penalties which might be imposed by the ATO as a result. He wanted the wife's interest in the fund to be transferred to him. He was prepared to indemnify the wife in respect of any financial consequences of her having been a member of the fund. He did not wish to be fettered in any way as to how he should manage the fund in the future. In those circumstances, Rees J said she could not assume that the accounts of the fund would be brought up to date in the manner suggested by the single expert and that the penalties which the single expert said had the potential to be imposed, would occur.

Based on the husband's evidence, he was likely to have access to the fund and draw a pension to supplement his income. The fund was therefore a valuable asset in his hands and the court could not assume that its current state of disarray would have the consequences that the expert predicted.

If the ATO found the fund to be non-compliant in the future, as a result of the Court's orders that consequence was intended to fall entirely on the husband, so the value of the fund was assessed without deduction for the potential ATO penalties and the costs of rectification.

The indemnity given to the wife, did not, of course protect her from the ATO finding her liable for penalties as a consequence of the non-compliance of the fund for the period in which she was a trustee of the fund. This issue was discussed in the judgment, and she received a benefit to offset this potential liability by the husband receiving the entire fund as part of his share of the assets without any deduction for the potential liabilities.

Lessons for parties with SMSFs involved in family law proceedings

For parties with a SMSF involved in family law proceedings, it is essential that advice be sought as to whether the SMSF is compliant. There are significant tax penalties and fines in the event that the SMSF is non-compliant. The Court will reduce the value of the SMSF by the costs of rectification and penalties if these will be incurred.

Failure to seek and rely on appropriate advice might mean that a party retaining the SMSF is left with a fund which has a much lower value than they believed it had.