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SUPER

Exit strategy

There are important tax implications in the way self-managed funds are wound up, reports **Barbara Drury**.

Peter Smith* was a semi-retired doctor with his own self-managed super fund when he was diagnosed with terminal cancer. Peter became aware that his wife, Judy*, would be better off financially if he wound up the fund but he died before he could complete the paperwork, leaving Judy $50,000 worse off.

A RetireInvest planner, Rod Dunn, says the anti-detriment provisions of the tax act allow the beneficiaries of members of some super funds, but not self-managed funds, to recoup contributions tax paid during the life of the fund.

In the case of Dunn's client Peter, rolling his self-managed super into a retail fund before he died would have meant Judy receiving about $450,000, instead of the $400,000 she ended up with.

This is a rare case but it serves as a reminder that before leaping into self-managed super it is important to know how to get out with a minimum of fuss and with your wealth intact.

According to figures from the Australian Taxation Office (ATO), which regulates the sector, about 200 self-managed funds are wound up each month. But with more than 300,000 funds in existence, many people will need to go through the winding-up process at some point.

Colley warns that all records relating to super funds, unlike income tax records, must be kept for at least 10 years.

Phil Jaquillard, of fund administrator SuperGuardian, says there are a number of administrative steps to follow when winding up a fund. These must be carefully managed to ensure the least cost and risk to members' benefits.

Wind-up costs will vary enormously depending on your circumstances.

There is the cost of an audit, fees to accountants to prepare final accounts and often fees to other professionals to ensure the documentation is in order. Jaquillard estimates the minimum cost is about $1000 to close a fund with little but cash in it and no outstanding tax issues. In more complex cases, especially if capital gains tax (CGT) is payable, costs can go much higher.

The most common reason for winding up a fund is the death of a member or members but divorce, moving overseas or a lack of funds may also trigger the decision to fold.

Graeme Colley, the technical specialist with ING-owned Super Concepts, says there are two administrative areas which cause the most problems: poor record-keeping, and income or expenses, often tax-related, coming into the fund after it has closed.

Colley says poor record-keeping can lead to stamp duty and CGT headaches. He refers to a client who had property that was never recorded in the name of his fund, even though money relating to the property had been paid out of it. When the fund was wound up he had to consult lawyers about the stamp duty implications, which added to his costs.

Colley warns that all records relating to super funds, unlike income tax records, must be kept for at least 10 years.

Jaquillard says that, when winding up is caused by the death of a member, it is important to understand the difference between a binding and non-binding nomination of beneficiaries because both can be problematic, depending on your family circumstances.

A binding nomination ensures your assets are distributed according to your wishes, and must be put in writing and witnessed. However, if your nomination is not updated when you divorce or your circumstances change in some other way, it can create more problems than it solves.

A non-binding nomination expresses your intentions but can be overturned by the fund trustee.

Jaquillard says divorce doesn't necessarily trigger a wind-up. The balance due to one partner can be paid into another super account or it can be kept within the fund and paid out on retirement. However, there can be CGT implications if assets need to be sold or transferred out of the fund.

There will also be CGT to pay if you have to sell assets to wind up your fund before reaching the pension phase. If the assets have been held for more than 12 months you pay 10 per cent CGT, or the full 15 per cent if the assets have been held for less than 12 months.

Similarly, the death of a member doesn't mean a fund must be closed. A self-managed fund could be used by up to four family members in perpetuity, with professional trustees appointed if desired.

Despite the many benefits, Jaquillard says self-managed super is not for everyone. Someone who is not in good health and whose spouse has no interest in taking over the running of the fund on their death or disablement should probably not take the self-managed route.

Insufficient capital is another good reason to desist. Most experts advise you should have at least $200,000 before considering your own fund.

Dunn says self-managed super is also not suitable for anyone planning to live overseas. The regulations stipulate that trustees can only be away for only two years or lose their compliance status. Even those who do have the time and the will may need professional advice. Such a person was the client who came to Jaquillard saying he was ready to start a pension from his self-managed fund and had sold all the fund's assets in preparation. "We told him he didn't have to sell the assets and that he now had a tax bill he wouldn't otherwise have had," Jaquillard says.

** Not their real names*

The key ... unlocking your fund can increase payouts to your beneficiaries. Photo: Tamara Dean

HOW TO WIND UP A FUND

Mr and Mrs Jones* are trustees of their own self-managed super fund. The fund is paying allocated pensions to both when Mr Jones dies. Mrs Jones doesn't want to manage the fund on her own and decides to wind it up and start a pension with a retail super fund. She and her financial planner start the wind-up process, which goes like this:

- Check the trust deed. This will specify any unusual course of action regarding the winding-up of the fund. Because Mr Jones was a trustee, a new trustee should be appointed. Death benefits must be paid out to Mrs Jones, the sole beneficiary, within the later of six months after death or three months after probate is granted. Probate documentation should be checked to see if there is a binding or non-binding death benefit nomination. If there is conflict between potential beneficiaries then legal advice may be required.
- Ascertain whether the beneficiary wants a lump sum or pension.
- Value the fund's assets and finalise the accounts. In this case, the net proceeds after tax and expenses are to be rolled over into a retail fund where a pension will be resumed.
- Disposal of assets. In this case the beneficiary is in pension phase, so no capital gains tax is payable. The trustee prepares minutes recording her decision to wind up the fund and sell its assets. She provides a letter of instruction supported by the minutes to her financial advisers, who begins selling assets and converting them to cash.
- Do the books. Once the assets are converted to cash, fees are paid to the accountant for the preparation of accounts and advice about winding up the fund. There is also an audit fee, which brings total fees to $8400. A bank account is set up, into which fees and any outstanding tax refunds are paid.
- Transfer the assets. Final cheques are drawn to transfer the fund balance to the new retail fund. Mrs Jones signs off on minutes of trustees' meetings and the final income tax return. The fund is closed and the Tax Office is advised of the new account into which it must pay any tax refund. Once all fees are paid, the bank account is closed.

Source: SuperGuardian