TAXPRACTICE Summer 2006

SELF MANAGED SUPER FUNDS
SPECIAL REPORT

Winding up super funds

By Olivia Molina

Each year we hear about the growth of SMSFs. What we're not told is how many funds are wound up in Australia each year. Recent Tax Office figures indicate that about 200 funds are wound up each month — a small number considering the number of funds in existence.

So, why does a fund need to be wound up?

DON'T WANT RESPONSIBILITY

Trustees may believe they cannot achieve satisfactory returns, and return to retail or public offer superannuation funds. Some might not want the responsibility nor the paperwork and complexity and decide it's better that someone else manages their super instead.

There might be a matrimonial split that leads to the fund being wound up, the members may move overseas, or a member or members may die. The fund might even run out of cash and be forced to be wound up.

The reasons are varied, although, if investment management or paperwork management is the issue, there are several options to winding up the fund.

The trustees can appoint an independent trustee, and become a "Small APRA Fund", or an administrator can be appointed to handle administration and accounting. In both of these scenarios, assets do not need to be disposed, hence avoiding crystallization of potential capital gains tax liabilities.

Getting into an SMSF is easy; getting out of it is tricky.

Administratively there are a number of steps to be followed, none of which is onerous in itself, but all of which must be managed carefully, and to a plan if the end result is to be achieved with efficiency and with least cost and risk to members' benefits [see case study].

Olivia Molina is marketing manager at SuperGuardian.

Jones Super Fund

Case Study

Mr Jones and Mrs Jones are members and trustees of the Jones Super Fund. The fund comprises a mixture of investments, including shares, managed funds, and a residential rental property.

The fund is paying allocated pensions both to Mr Jones and Mrs Jones. On 29 May 2005, Mr Jones suffers a massive heart attack and dies.

Their financial advisor, Mr Smith, has called to say that Mrs Jones does not have the capacity to manage the fund any longer and wishes to wind up the fund and have her allocated pension managed by a retail super fund. It is now 15 September 2005, and the accounts for the year ended 30 June 2005 have not yet been completed.

Mr Smith would like to know what actions he must take as their financial planner, and what steps the accountant must take, in winding up the fund and transferring the balance to a retail fund.

1. CHECK THE DEED

The accountants advise that the first task is to check the deed to see what it says about the procedures regarding winding up. The deed is checked and does not specify any unusual course of action. It is important to ensure that all decisions are minuted and members notified.

As Mr Jones is deceased, who acts for Mr Jones? It is Mr Jones' legal personal representative. However, the legal personal representative must cease to be trustee once the death benefits begin to be paid, and at this point the SMSF must again satisfy the basic conditions to continue to remain an SMSF – a new trustee, or a corporate trustee should be appointed. The death benefit must be paid out within the later of six months of the date of death of Mr Jones, or within three months from the date of probate being granted.

The accountant also advises the financial planner that the pension documentation must be examined, and that there was no binding nomination on file. There is, however, a nomination of beneficiaries form, properly executed by Mr Jones, stating that he wants his member balance to pass to his wife. The pension documentation states that Mrs Jones is to be the reversionary beneficiary. At least there is no conflict here – if there were, then legal advice may be required.

2. ASCERTAIN THE WISHES OF MRS JONES

Mrs Jones has indicated that she is in no need of a lump sum, and would be happy to receive the pension that was being paid to Mr Jones.

3. ASCERTAIN THE VALUE OF THE INVESTMENTS AND FINALISE THE ACCOUNTS

In order to wind up the fund, the assets will need to be sold, and the net balances after expenses and income taxes will need to be rolled over to a retail fund, where the

ASFA welcomes insolvency reforms

The proposed employer insolvency reforms, which promise to enhance the chances of former employees being paid their super entitlements after an employer goes bust, was greatly welcomed by the Association of Superannuation Funds of Australia (ASFA).

As part of the proposed raft of government reforms announced by Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP, employees' unpaid super will be given greater priority on the creditors' list than has been the case in the past.

"ASFA congratulates the government for including this measure in the reform proposals, and for taking into account the importance of superannuation entitlements for employees who have lost their jobs through employer bankruptcy," said ASFA CEO Philippa Smith.

"We await the detail of these proposals as they affect employees' super entitlements, but on the face of it, this is an excellent first step."

SUPER GUARANTEE CHARGE

The ATO has released its super guarantee guide to help employers and practitioners comply with their obligations under the *Superannuation Guarantee (Administration) Act 1992*. The super guarantee guide provides information on calculating the superannuation guarantee charge, possible penalties and now includes information about complying with super choice requirements.

The guide explains how to complete a quarterly superannuation guarantee statement. It also shows how to answer each question and provides worked calculations of assessing superannuation guarantee charge liabilities.

pension can be resumed. One month passes and the accounts for 2005 are complete, and indicate that a tax refund of $3,450 is due to the fund. Of this, $2,000 is on the account of Mr Jones, and the balance on the account of Mrs Jones. The fund has, however, continued to grow in value, and there have been further capital gains since 30 June. As the fund is in pension phase, no income tax applies, but the fund will be due for refunds of franking credits. Had one of the members not been in pension mode, calculation of income tax would need to be made to correctly ascertain the member's balances as at the date of the winding up.

4. COMMENCE THE DISPOSAL OF INVESTMENTS

Fortunately for Mrs Jones, because the fund is in pension phase, capital gains tax of $23,000 that would have been payable on the disposal of assets does not need to be paid.

Mrs Jones, in her capacity of trustee of the fund, prepares minutes recording her decision to wind up the fund and sell the assets. She provides a letter of instruction, supported by the minutes, to her financial planner, who commences the process of disposing of the assets and converting them to cash.

5. SETTLING ACCOUNTS

It is now 12 November, and all assets have been converted to cash. Both Mr and Mrs Jones balances were within their RBL limit, so there are no issues for Mrs Jones in establishing a new pension with a retail fund. However, had one of the members balances increased in value beyond their RBL at the date of commencement of the new pensions from the retail fund, there would have been other tax considerations to manage.

The accountant advises that his fee for the preparation of accounts to 30 June will be $3,700, and that the fee for accounts to the end of November, including all advice rewinding up the fund, will be $3,500. In addition, there are audit fees to pay of $1,200, which has been agreed in advance with the auditor, in respect of both sets of accounts.

The financial planner assists Mrs Jones in setting up an interest-free bank account into which the total sum of $4,450 will be paid, knowing that the franking credit refund from the tax office in relation to both financial years will provide sufficient funds to cover all outstanding fees.

6. NEW ARRANGEMENTS

The final cheques are drawn from the fund to the new retail fund to transfer the balances to that fund.

That account is now closed, and the Tax Office is advised of the new account into which it must pay the tax refund.

The financial planner works with Mrs Jones to establish new allocated pensions, and to assist her with signing the final documents in relation to the fund, including minutes of trustees meetings and the final income tax return.

Once all accounts are paid to the accountant and auditor, the bank account will be closed.