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Winding down

SMSF growth on the turn



Closing a self-managed super fund can be a tricky process. PHIL JAQUILLARD looks at the many steps involved

Each year we hear about the growth of self-managed super funds (SMSF). Early last year the Australian Taxation Office (ATO) confirmed that there were 300,000 funds in existence in Australia, and that the rate of growth, which had been as high as 2,000 to 3,000 funds per month, had slowed in recent times.

What the statistics don't tell us is how many funds are wound up in Australia each year. At a recent conference, a spokesperson from the ATO indicated that about 200 funds are wound up each month – a very small number indeed considering the number of funds in existence.

To begin, let's have a look at the reasons why a fund may need to be wound up. Perhaps the most obvious one is that the members just don't want to be in a self-managed fund any longer.

The number of funds established in Australia in the last five years rose due to what many believed was a reaction to low or negative investment growth during the late 1990s. If that is the case, then we might expect the converse to be true – that is, if trustees cannot achieve satisfactory returns, they might just be inclined to return to retail or public offer superannuation funds. Or, with the responsibility of managing a fund, and the associated paperwork and complexity, some might find that it is not for them, that indeed they made a mistake in setting it up, and that they wish for a simpler life with having someone else manage their super for them.

There might be a matrimonial split that might give rise 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.

As you can see, 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 crystallisation of potential capital gains tax liabilities.

I have set out below a case study to illustrate what happens when a fund is actually wound up.

Case study

Mr 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 May 29, 2005, Mr Jones suffers a massive heart attack and dies.

Their financial planner, 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 September 15, 2005, and the accounts for the year ended June 30, 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.

STEP ONE: Check the deed

The accountant advises 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

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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 a 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.

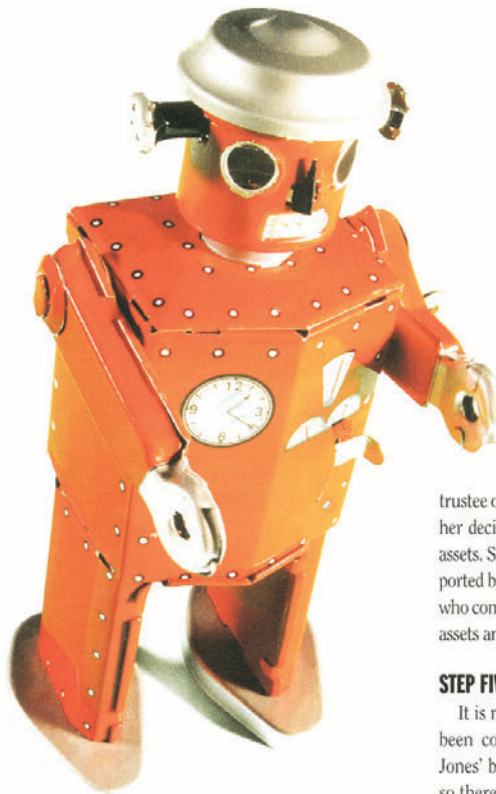
STEP TWO: Ascertain the wishes of Mrs Jones

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.

STEP THREE: 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

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after expenses and income taxes will need to be rolled over to a retail fund, where the 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 June 30. 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.

STEP FOUR: 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.

STEP FIVE: Doing the books

It is now November 12, 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 member's 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 June 30 will be \$3,700, and that the fee for accounts to the end of November, including all advice re winding 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.

STEP SIX: Transfer the assets

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

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That account is now closed, and the ATO 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, which include:
→ minutes of trustees meetings; and
→ final income tax return.

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

In summary

Like many things, getting into something is easy, but getting out can often be tricky. The same is true for SMSFs. As you can see, there are lots of steps required, and care and planning are essential if the process is to run smoothly. The above example is actually very straightforward, and most will be more difficult than this.

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.

As usual, if unsure, get professional advice, and don't be afraid to get legal advice where issues of law arise. ✨

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