

SMSF Disaster Mitigation Strategies

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Where Disasters Happen

- Divorce
- Death
- Dispute
- Don't listen to advice
- Don't get advice
- Deliberate head in the sand

Agenda – Let's get the GOSS!!

- Deed update disaster – but worthwhile Death benefit outcome
- Death of Dad – children in dispute
- Divorce and discovery of multiple compliance issues, then dispute with business partner
- Divorce and NOT moving out of the Fund – subsequent death considerations

Deed Update Disaster



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Deed Update Disaster

- Mum and Dad fund, set up in the 90's
- Principal Employer – who must also sign off on every deed update
- Difficult to remove them under the deed, although can replace with Trustee company
- Death benefit directions hard-wired into the deed:
 - Benefits on death of first of Mum or Dad equally between the kids (all adults in their 40's), unless they were unwilling to accept, and then the Estate
 - Substantial death benefits tax
 - Substantial property investments in the Fund, so liquidity considerations
 - Upon death of the survivor, to the Estate
 - Will (one page) didn't have beneficiaries beyond the survivor, save for the grandchildren sharing in what their parent would receive, but that was only personal effects....

- Mum died – money direct to the children wasn't a great outcome (tax)
- Consideration of the children renouncing their entitlements (they were okay with that)
- Hard wiring meant benefits then paid to the Estate, where the survivor was the beneficiary
 - death benefits tax saved
 - BUT, money out of super
- READ THE DEED, READ THE DEED.....
- Upon reading the deed with the hard-wiring, nary a mention of the Principal Employer
 - Invalid deed update
 - Therefore, invalid hard-wiring
- Reverted back to the latest valid deed – Trustee discretion if no BDBN in place
- Able to retain everything in the Fund for Dad

- Able to retain all the properties in the Fund for Dad
- Sufficient cash available to pay out benefits > Dad's TBC
- Interestingly, Mum and Dad were not in pension phase, but had been pulling money out of superannuation for a few decades
- Accountant for the family for 40 plus years never advised that a pension might be available
 - Circa \$500,000 worth of missed ECPI
 - They may not have been licensed, but you then refer to someone, as you should have a basic understanding of super with respect to contributions and pensions
 - Although, Dad VERY fee conscious – possibly didn't want to pay for advice.....
 - Comprehensive EP review now occurring

Learnings....

- A basic understanding of superannuation is vital – to be able to at least refer clients to the right person to provide advice
 - Still though – you can take a horse to water..... especially if a proper DIYer
- READ THE DEED!! The lawyers that had updated this one clearly hadn't read the first.....
- Estate planning arrangements require more consideration when an SMSF is in play, and educating our clients about these considerations:
 - Whether that is before a fund is set up, or when they become your client – a health check of the Fund and the structure of it and what it all actually means
 - Or when new documents are prepared, and what it means (pension commencement is another prime time, as that is a substantial EP consideration of reversionary or not)
 - When any estate planning documents are done – *Ioppolo v Conti* and others taught us we can't do things in isolation, as they are all linked

Dad Dies, then Dispute




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Death of Dad – children in Dispute

- Fund with four members – Mum, Dad, Son 1, Son 3
- Individual Trustees 😬😬
- Son 2 in public offer fund (wasn't working in the family business at the time)
- Fund established by transfer of property from discretionary trust to the Fund via individuals for nominal stamp duty back in the early to mid-noughties
- Uneven amounts between all four members – title represented Tenants in Common interest of each of the Trustees, which was incorrect, as should have been all four of them, but the % interest recorded and managed at the Fund level
- All three sons now work in the family business, although Son 1 not much, given COVID concerns

- The Fund had two properties – both used in the business
 - substantial one, not easily split
 - less substantial one – was used to pay out bulk of Dad's benefit required to be paid to Mum as > her TBC
- Son 1 was set up in the Fund at the outset, and didn't have any understanding
 - thought his brothers would steal his entitlement
 - thought that if they were equal Directors / Trustees that that meant that they had an equal share of the Fund
 - wanted nothing to do with his brothers, but get his fair share of the estate and move his super away from the SMSF

- Children pitted against each other – told that the others had been given more than them
- Cornerstones of a harmonious relationship..... 
- Dad died, and just before he died, changed all his estate planning:
 - all properties that were in joint tenants (circa 8 of them) moved to tenants in common
 - separate Testamentary Trusts for each property, where everyone was a beneficiary
 - controlled by Dad's brother, his friend and his long-term assistant
 - kids had been promised to be looked after (although had received substantial money over time), and didn't get the properties / assets / control they were expecting
 - substantial animosity given the top point
 - lack of understanding by EVERYONE about how the properties and structures worked
 - particularly with respect to the Fund

- Son 1 especially didn't appreciate the considerations with the Fund
 - illiquid single property - can't just transfer his entitlement in cash to another super fund
 - Son 2 could rollover his public offer entitlements, but wouldn't be enough to cover Son 1's
 - so, ongoing involvement required
 - even if partial rollover and transfer of a proportion of the property to a new fund, ongoing attachment to the old fund (and family)
- Further issues with the Fund
 - Individual trustees, and all three sons were the Executors
 - Convincing State Revenue that the initial tenants in common % were now different, and that there shouldn't be any duty on the differential
 - particularly as Mum needed to receive one property out entirely
 - segregation within the Fund hadn't been accounted for along the way in the initial %, which was a duty requirement to get the concession at the time.....

- Outcome with the family negotiation:
 - sons each received a property / properties
 - adjustment made in cash after they were all independently valued
 - agreement re the distribution of wealth in the other entities – to be equal
 - acknowledgement that the Fund has the business property in it, although still ongoing considerations
 - son 1 still wants out
 - son 2 could rollover his external super money to the Fund, but still not enough
- business paid for all renovations on the Fund property as well..... an issue for another day
- remains substantial animosity
- Mum is still alive

Learnings.....

- Don't add children to a Fund
 - If you have clients with their children in their funds, do we move them out now when everyone gets along (or before it all does hit the fan)
- Pitting children against each other is not advisable
- Clients rely on us to guide them, but an education process is required with many, as they don't understand how a fund works, and therefore their entitlement or level of control
 - This is never too late
 - Get back to meeting clients to go through the year end financials? So easy to send out now with electronic signing, we don't even speak to them

Divorce Double Dispute



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Divorce Double Dispute

- Husband and Wife in a Fund
- Husband really running the show (commercial lawyer before he retired)
- Divorce property settlement happening now – wife not signing any financials until they were reviewed / vetted
- Listed portfolio for many years, some closely held Unit Trusts, and then new Unit Trust investment (2020)
 - Set up with husband's friend's SMSF 50/50
 - Purchased farming land, with a loan from the bank
 - Borrowing then paid out by the two parties equally – treated as a new loan in the U/T
 - No interest charged on the loans
 - No rent paid by the farming enterprise to the U/T (initially, rent paid to cover the interest on the bank borrowing only)

- New accountant picked up the job (old accountant wasn't getting the information out of the husband, so refused to do it) and sought to address:
 - No rent paid – by making the farming enterprise pay rent, including back rent
 - Loan refinance – by reinvesting the units at \$1 per unit
 - Issue of units in the name of each SMSF
 - Even though the refinance was by individuals
 - Treated as a borrowing from the husband to the Fund
 - Plus, new property acquired in the U/T, funded by subscription for units at \$1 each

- Areas missed:

- valuation of the property for the purpose of the issue of units – otherwise NALI considerations and risks (properties now doubled in value)
 - that the friends were actually in a partnership individually with respect to the farming enterprise, so was IHA since inception, and greater than 5%
 - not just no rent paid, but no interest on loan from individuals to the U/T – NALE risk
- Husband only wanted to use his auditor, who missed all of the above, and arguably didn't even check anything, only went off what the husband informed him

- Further:

- Auditor was strong-armed into declaring that there was a loan from the husband to the Fund to purchase the initial U/T, which needed to be fixed by repaying the husband
- Clear that the Fund had enough capital to do so from contributions made by the wife
- Husband wanted to keep the farming properties as they had increased in value substantially, and had initially made an offer for the wife just to keep “her” shares in the Fund and rollover to a new fund
- Husband has been using the homestead on the second property himself, and making the farming partnership pay for it all, so then Husband and friend now in dispute over their farming partnership, and the U/T
- SF remains unlodged for 2020/2021 and beyond – pressure being put on the wife by the husband to sign without review
- Friends’ SMSF accountant didn’t pick any issues up either – but challenge to get any info out of the husband or his accountant regarding the structure

Status

- Current accountant doesn't want to have to fix the issues (outside his area of capability)
- Husband being obstructionist, with both the wife and the friend
- Wife and husband's friend now trying together to get things moving
- To fix and allow the wife and the friend to move on and "separate" from the husband:
 - Valuations required of the properties at the various points in time
 - Issue of units at the correct pricing
 - Consideration of loans to the Fund for various transactions, or contributions and deal with excess?
 - Wind-up the U/T and vest the properties to the unitholders to address IHA issue – CGT and transfer duty considerations, but various stamp duty concessions available (in WA)
 - Achieve a correct valuation and position for the Fund, so that the husband and wife can undertake a fair property settlement

Learnings....

- Watch out for douche-bags? 🙄🙄
- Lawyers make the worst clients? 😏 Unhelpful.....
- Divorce can be very messy – duty of full disclosure, which hadn't occurred
- Beware of “friends” in business without partnership agreement, unitholders agreement
 - Assume everything will fall apart and there will be a dispute
 - Well drafted partnership / shareholder / unitholders agreement is worth it when you need it
- IHA is not limited to looking at the SMSF only – how do people more widely interact and have any business interests together
- NALI / NALE considerations – since 1 July 2018 for asset specific expenses, and even prior to then to ascertain whether CGT will apply if not acquired for market value

- education of clients about their Fund structure, assets in there, and what issues may arise
 - everything is rosy until someone behaves like the top point
 - reinvigorate annual meetings to go through the financials and outline any areas that require further review or could be of concern
- make sure you **have a good auditor – vital in the current environment** to identify the areas that can be missed as there are so many complex super issues to consider:
 - high expectations on fund accountants and advisers to know all the rules
 - new areas are very complex, and some still haven't had the ATO provide the full guidance on their position (NALI / NALE as an example continues to require adjustment / amendment)

Deficient Divorce, then Death



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Deficient Divorce, then Death

- Ex-husband and ex-wife in a Fund – split over a decade ago
- Remained together in the Fund due to illiquid commercial property
- Neither of them runs the business anymore, so passive investment, generates reasonable income
- Ex-husband died (four years ago maybe), and dispute between his new wife and his children (with the ex-wife)
- Ex-wife wants to keep the property in the Fund, and pay out his account to the wife
- Executor argy-bargy about the value of the property – some \$1.5M difference (heritage listed, but east coast valuer not factoring that into the equation)
 - Impacts the ex-wife's position as then a higher amount she has to raise to pay out his account to his estate (for then her sons to dispute with the Executor for their entitlement for not being adequately provided for)

- Looking for ex-wife to set-up new fund and acquire the property from the old fund with a combination of an LRBA and rollover
 - Stamp duty considerations
 - CGT in the old fund (pension and accumulation)
 - Funding in the new fund
- Old fund gets cashed up, can pay out the ex-husband's benefits
- Valuation consideration for the property:
 - ATO valuation guidelines – not willing buyer or seller
 - If the bank is funding LRBA, they will likely have their own take
 - “agreed” value is likely well above a market valuation acceptable by the bank

Learnings

- Wider consideration of the implications when one of them died on the fund when they divorced, rather than just keeping things together with respect to the property
- Could have undertaken an ongoing partial transfer / acquisition strategy for the property
- Divorce was perhaps the prompt to sell the asset within a short period of time so that they could achieve fund separation
- Lumpy assets in super is a challenge on death and divorce
- With the benefit of hindsight, likely an alternative scenario would have been preferred than of separation of member interests, than staying in the Fund together beyond divorce

Conclusions....



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Learnings from my war stories....

- Don't go into business (or super) with family (children, siblings) or friends
- Be a skeptic – with respect to transactions, and clients mentioning that it is “okay” and they don't need agreements between parties
 - Really scrutinize relationships between parties
- Education of clients:
 - Before they set up a fund – is it really appropriate? What is their motivation?
 - When you pick up a new client – health check to identify any issues, review the deed?
 - Ongoing / along the way – reinvigorate yearly meetings rather than electronic signing?
- Make sure you read ALL the documents, and not just those that are convenient
- Estate planning where super is involved is so much wider than BDBN
- Super and divorce is very challenging – worthwhile obtaining complete separation of assets ASAP to mitigate any ongoing involvement

Questions



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