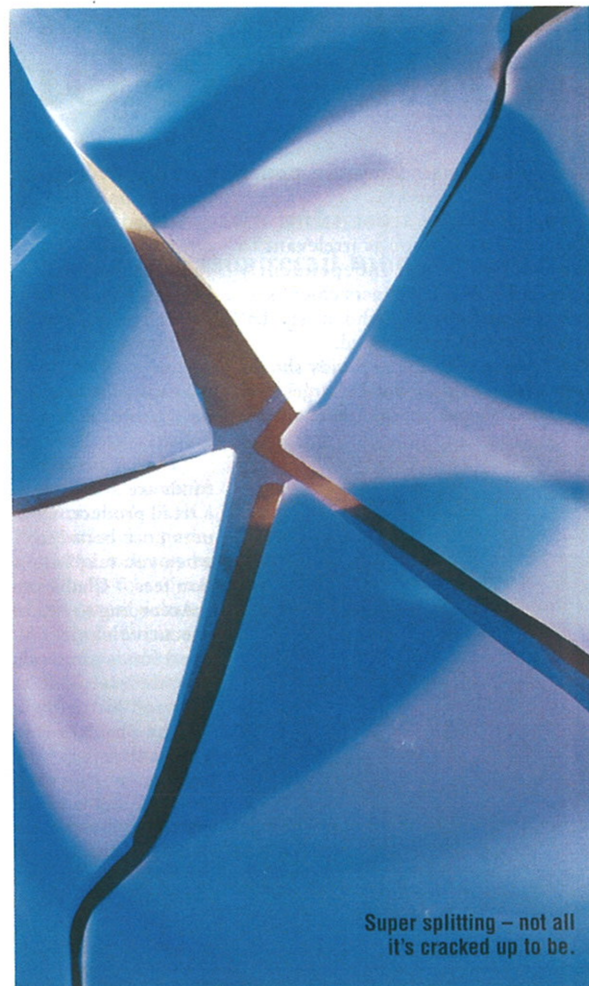
Cracks appear in super splitting law

Super splitting laws were supposed to make life easier for divorcing clients – but as NABIL WAHHAB reports, when they are reviewed in conjunction with binding death nominations, they might just have made it more complex.



Super splitting – not all it's cracked up to be.

Did you know that super splitting orders may have effect despite any other law to the contrary and therefore will normally override a binding death nomination (binding nomination)? But that a payment to a child will make a super interest unsplittable and therefore make a super splitting order hollow?

If you advise the divorced non-super client you can (and Financial Services Reform (FSR) legislation suggests you must) warn them of the risk of a child binding super benefit.

Section 90ME(2) of the Act and Regulation 13 of the Family Law Superannuation Regulations 2001 provide that after the death of a member spouse (member), a super interest reverts to a child or to a person to hold in trust and apply for the benefit of a child, either because the trustee exercises a discretion in favour of the child or because the trustee directly provides for that to happen.

The Federal Government made the decision when setting up the new super splitting laws that payments to a non-member after the death of a member spouse are unsplittable if the benefit goes to children under the age of 18 and in some circumstances children over the age of 18. This is the case, even when there is a super splitting order in place.

With careful planning you can avoid the problem. If a super fund's governing rules do not provide for the trustee to be bound by binding death notice, then the person entitled to a super split, that is the non-member spouse (non-member), may have a remedy through the Superannuation Complaints Tribunal (SCT) where they can lodge a complaint and rely upon the super splitting orders. The Tribunal's powers, however, are discretionary and the non-member may not be able to receive their entitlement under the orders.

If the governing rules of a super fund provide that trustees are bound by a binding nomination, the SCT is not available. Therefore, the non-member's interest under the super splitting orders is lost, as the payment due cannot be paid by the trustee.

This is the ultimate nightmare for financial planners and their clients, given that every client's retirement strategy will be in disarray if they lose a substantial sum of money that was anticipated to be received on retirement through a super splitting order.

There are a number of ways the non-member could be protected. They could insist, while negotiating the super splitting, that the member be restrained from giving or lodging a binding nomination in favour of the children, which in any way affects the non-member's interest under a super splitting order.

The member can still lodge a binding nomination but only in respect of their own interest. In addition, the non-member must insist that the member's estate indemnify them against any loss suffered by reason of the member lodging a binding nomination.

A more effective way of dealing with the problem is to create a new interest for the non-member or to roll out their interest into a new fund, immediately after the super splitting orders are made. A binding nomination made by the member will then not affect the non-member's interest.

In multi-member superannuation funds where the interest is an accumulation interest, it is relatively easy to roll out a non-member's interest into another fund. The same applies to self-managed superannuation funds (SMSF). However, there may be occasions where it is not possible to roll out the non-member's interest because there is insufficient cash in the fund. This may be because the majority of the super fund is made up of property through which the member runs a business, such as a factory.

In those circumstances, the property or part of it could be transferred to give effect to the orders (but query the stamp duty and capital gains tax implications) or a new interest can be created in the same SMSF for the non-member.

If the member's interest is a defined or hybrid interest, a new interest cannot be created for the non-member under super splitting orders. Neither can the interest be rolled out until such time as a condition of release is satisfied.

In those circumstances, it is crucial that injunctive and indemnity orders are included in any super splitting orders. If they are not, the non-member may end up losing their entitlement.

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TRUSTEES AND FINANCIAL PLANNERS' OBLIGATIONS

Do financial planners and super trustees have any obligation to inform the non-member who becomes entitled to a part of a member's super under family law orders, that they have received or that they hold a binding nomination from their clients in favour of the children?

Privacy legislation prohibits revealing such information. Given that this is the case, do financial planners and trustees have any obligation to suggest to the non-member that they should insist on the creation of a new interest in the same fund or roll out their interest to another fund? This is possible and perhaps solves the problem.

What about the situation where the member's interest is in a defined benefit or hybrid fund and therefore the new interest cannot be created? The client is therefore at risk of losing their entitlement under the orders if the member dies leaving a binding nomination.

In SMSFs where the trustee is generally the member or a corporate entity associated with the trustee, the trustee may neglect the creation of a new interest. The non-member's interest is therefore at risk and the Federal Government must consider this matter and legislate to impose obligations as a matter of law not obligation under super splitting orders to protect the non-member.

The non-member may be able to make a claim against the member's estate and seek enforcement of the orders if they had demanded the creation of the new interest but the request was refused or ignored by the member.

The Federal Government should revisit binding death nominations and, in particular, allow financial planners and trustees to breach their privacy obligations in order to inform non-members of the existence of binding death nominations or the fact that they have received such nominations, which will have the effect of leaving the super interest to children.

The breach will only occur in circumstances where there are orders for super splitting that have not been implemented and the member has children.

Alternatively, the Federal Government could legislate to protect a non-member's interest where a super splitting order has been made, so that such an order overrides the binding nomination.

In the future, there will be cases that will test whether trustees or financial planners breached their duty in not advising the non-member in whose favour orders have been made for super splitting, that a binding nomination has been received by the member.

Financial planners must inform and advise their clients on the importance of creating a new interest, rolling out the interest to a new fund, or for the non-member to insist on the injunctive and indemnity clauses if super splitting orders are made under the Family Law Act until such time as the issues are clarified.

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