Winding up an SMSF

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Why Wind Up an SMSF?

1. Operating the fund is no longer cost-effective
2. There are no assets left in the fund
3. The trustees are moving overseas indefinitely
4. Members getting old or frail with no ability to appoint an EPOA
5. Death of a member (usually the active member)
6. The members no longer wish to operate a fund
7. The ATO has issued a notice of non-compliance
8. Relationship breakdown, divorce or separation, and the members no longer want anything to do with each other

The SMSF ceases to be a legal entity under SIS, taxation, and trust law once the trustees or tax agent lodges the final SMSF Annual Return (SAR). It cannot be reactivated or re-established.

How to Wind Up an SMSF

1. Communicate timing expectations with trustees.
2. Identify assets with potential issues, such as frozen assets, property and insurance. Discuss with trustees.
3. Read the trust deed. It sets out rules and procedures the trustees are legally obliged to follow, such as how to distribute fund assets. Determine whether any restrictive clauses may impact the windup.
4. Organise a meeting to ensure all trustees are informed and agree on winding up the fund. Ensure all trustees sign the minutes.
5. Consider whether the corporate trustee will be wound up (commence proceedings only when the final SAR is lodged to avoid a breach of s126K SIS).
6. Trustees write to each member asking how they want their final benefit paid. Ensure member preferences are in writing and dated.
7. Where the member has met a condition of release, assets may be transferred in specie as a lump sum benefit payment. Otherwise, all assets are sold, income collected, and DRP accounts closed. Remember that the SIS and trust deed rules remain in force until the fund is closed.
8. Ensure the fund is SuperStream ready when rolling assets over to another SMSF or APRA fund:
    a. Confirm the ESA provides for rollovers and contributions
    b. Check that the ABN is still active
    c. Confirm the fund's bank account is unique to the fund
    d. Confirm the details with the trustee.
    e. Update and validate all SMSF data held with the ATO
9. Check that all previous year's financial statements, tax return, audit and other tax and compliance obligations are finalised.
10. Confirm contributions and whether to claim a tax deduction before the member's balance is rolled over and paid out
    a. Redirect employer contributions to the new fund
11. Pay the minimum pension requirements
12. Ensure that all outstanding liabilities and tax obligations are met. Make provision for all expenses such as final invoices, windup costs, asset sales, PAYG and GST
13. Determine the value of each member's benefits and fund assets and prepare a set of draft financials and
14. Transfer assets out of the fund in line with the member's written wishes
15. Arrange for a final audit after the main assets are disposed of. Ensure each member's balance is nil.
16. Lodge the final SAR answering all windup questions correctly

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What About the Bank Account?

The fund's bank account can remain open but is expected to show a $0 balance. Any accrued liabilities should offset the cash remaining in the bank account.

The SMSF auditor will request further bank statements if the cash does not reconcile.

An open bank account may also result in a management letter stating that "we are unable to verify the compliance of transactions occurring after the audit date because the bank account has remained open to receive final refunds or dividends, or to pay the final tax liability".

Cancelling the ABN

Once the final SAR is lodged, there is nothing else to do. The ATO will cancel the ABN, close the fund on its database, and send a confirmation letter to the trustees.

The ATO will cancel the fund's ABN 28 days after the lodgment of the final return, providing additional time to finalise any outstanding amounts in the fund.

Record Keeping

The trustee's responsibilities continue under s103 SIS, where they have to retain minutes of all meetings for a minimum of 10 years. Other records that must be kept include trustee changes, consents, and member reports.

SMSF to APRA Rollover

1. Identify the rollover fund.
2. Contact the fund for any additional requirements regarding information or documents (each APRA fund is different)
3. APRA funds that cannot accept electronic transfers will require rollovers by cheque from the SMSF, resulting in a breach of r6.17 SISR

Trips and Traps

Capital Gains

1. Capital gains or losses are triggered on asset disposal regardless of whether sold for cash or taken out as an in-specie benefit payment
2. Where the member is in accumulation mode, and there is a capital gain, the tax will be payable once the return is lodged.
3. No CGT is paid on disposal if the fund is entirely in pension mode. However:
   a. Commuting the pension back to accumulation before disposal will result in tax payable on any realised gains
   b. Ensure the fund remains in pension mode until windup, then withdraw the proceeds as either large pension payments or a partial commutation
   c. Pay the minimum pension so that the full ECPI can continue to be claimed
4. A CGT exemption exists where a relationship breaks down and there is an in-specie transfer from one fund to another. Note that any assets sold in the fund will incur CGT even if a result of a family law court order.

Capital & Tax Losses

Assets previously sold with unused carried forward losses in the fund will get trapped and lost in the fund on wind up.

The losses cannot be transferred to another person or entity.

Illiquid Assets

Realising illiquid assets such as unlisted shares, units, or real property can be complex, especially when the market is subdued.

Some investments may have a restriction on their disposal or redemption which means the asset is frozen.

Specific guidelines exist for frozen investments in a Managed Investment Scheme (MIS). The member may be able to withdraw their money under financial hardship if they meet the following criteria:

1. Urgent financial hardship where the member cannot pay their reasonable and immediate living expenses
2. Unemployed for at least 3 months with no other financial support except for Centrelink payments
3. Compassionate grounds
4. Permanent incapacity

The maximum paid out is $100k per calendar year. There is no obligation that the MIS responsible entity has to offer hardship withdrawals or process a member's request.

The options available to realise illiquid assets are:

1. Sell the asset and pay out the benefits, which may take a while
2. Where the member has met a condition of release, take it out as an in-specie lump sum (this does not count towards the minimum pension payment requirements)
3. Sell to a related party for a cash settlement at market value. The trustees will require a qualified, independent market valuation to satisfy r13.18AA if the asset is a collectable.

Related Party Acquisitions

Where the windup results from a marriage breakdown, an exception in s66(2B) SIS allows assets to be acquired into a new fund from a related party, including illiquid assets.

The conditions are that the member and their spouse are separated, with no likelihood of cohabitation being resumed.

The transfer of any asset in an SMSF to a new SMSF, including a life insurance policy, will not contravene SIS if it is allowed under SIS and the new trust deed.

The exception extends to units in a pre-99 unit trust that can transfer to a new SMSF with the same grandfathering provisions as the original SMSF.

Without meeting the condition of a marriage breakdown, the only assets transferable to a new SMSF are listed shares, business real property, and investments in widely held unit trusts and r13.22C unit trusts.

Reserves

SMSF 2018/1 has changed the rules for reserves. Unless the reserves were already held in the fund before the release of this ruling, the fund can generally only have unallocated contribution reserves.

Where reserves exist, the trustees must allocate them to members before the fund winds up. The allocation will count towards the member's concessional contribution cap and can give rise to an excess unless:

1. The allocations were determined on a fair and reasonable basis for every member of the fund AND
2. The amount allocated is less than 5% of the member's account balance when the allocation is made.

The member may exceed their caps where there is limited scope to fit within this criterion. The use of any unused concessional contributions caps (which accrue from 1 July 2018, regardless of the member's age) may result in a member potentially receiving a greater share without triggering an excess.

The alternative is not to wind up the fund and have a plan to deal with the reserves, such as exiting the existing members from the fund and appointing others who can use up the reserves.

Complying Pensions

Complying pensions or legacy pensions is another source of frustration. The problem is that complying pensions can be commuted in limited circumstances and have to be rolled over to another "complying pension", which must be a market-linked pension if it stays in an SMSF.

When the rollover is to an APRA fund, it has to be a complying pension with newly chosen terms.

Issues to consider on commuting a complying pension include:

1. Generating a reserve account that has to be allocated to members before winding up
2. The commutation is reportable for TBC purposes
3. The Centrelink pension may be affected

Getting SuperStream Ready

Under r6.34A SISR, the trustee must action a rollover request as soon as practicable, generally within three (3) business days. Apart from obtaining an ESA, ensuring the ABN is active and verifying the fund's data with the ATO, there are broader issues to consider:

1. If the rollover is to an SMSF, check SuperFund Lookup to make sure the receiving fund is complying (ensure all returns are lodged on time to avoid the ATO changing the compliance status)
2. If the rollover is to an APRA fund, check the requirements, as additional documents may have to be provided, such as certified copies of member ID documents and trust deeds.
3. Obtain a unique payment reference number (PRN) to accompany every transaction, including rollovers with multiple transactions due to bank withdrawal limits. Ensure the PRN and the amount match exactly to the cent.
4. If the rollover fails, the error message will not identify the problem. Communicate with the receiving fund and revisit the rollover process to ensure nothing is missed.

SuperStream Does Not Apply to all Rollovers

The following rollovers are not subject to the payment standards and do not have to use SuperStream:

1. Overseas superannuation rollovers
2. In-specie rollovers
3. Contribution splitting
4. Family law super splits

A family law split only relates to the benefit a non-member receives from a former spouse.

It does not include a rollover where the member decides to leave the fund due to a family split, which means the member can have several types of rollovers. Be careful to identify which will be subject SuperStream and which will not.

SuperStream Problems in Practice

The following issues will result in a contravention of r6.17 SISR:

1. The fund's bank limits the withdrawal amount, and the rollover takes several transactions over multiple days exceeding the 3-day timeframe.
2. An SMSF to SMSF rollover or an SMSF to APRA rollover that bypasses SuperStream
3. Exceeding the 3-day timeframe once the trustee has the name of the receiving fund, the ABN, the ESA, the member number and a legitimate request in place.

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