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Superannuation in Family Law: where are we at?

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The Full Court of the Family Court of Australia has now provided some guidance and answers to burning questions in relation to consent orders under Part VIIIB (the new Part) of the *Family Law Act* 1975 (the Act) and associated Regulations and Superannuation Legislation dealing with superannuation interests in family law.

Since the implementation and operation of this new scheme, not unexpectedly procedural and legal issues have arisen. These issues have led to uncertainty, particularly in relation to consent orders pursuant to Section 79 of the Act.[1] Many of these issues have now been clarified by the Full Court of the Family Court in the decision of *Hickey & Hickey & Anor*[2] *(Hickey).* The Full Court has also made several other important statements of law that, not surprisingly, are largely common sense.

However, there are other issues which have not been resolved or addressed by the Full Court in *Hickey* which will be left to the discretion of the Family Court on a case by case basis, or left to Registrars to determine when asked to make Orders by consent, or for parties to negotiate, or the trial judge to decide.

The purpose of this article is to provide an overview of the new scheme and review the first decisions of the Court considering and using the new scheme including *Jovanovich & Jovanovich,*[3] *Levick & Levick,*[4] *Crown & Yarnold,*[5] *Cahill & Cahill*[6] and *Gardner & Gardner*[7] and the Full Court decision of *Hickey.*

The new scheme has created flexibility to achieve just and equitable outcomes and the article will consider some consequences for both parties and practitioners.

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Overview of the New Scheme

The Family Law Legislation Amendment (Superannuation) Act 2001 which came into force on 28 December 2002, stipulating that superannuation now be treated as property.[8] The new scheme enables the Court to make orders in relation to superannuation interests of the parties to a marriage, in particular orders splitting superannuation payments between the parties.[9]

The new scheme provides that the trustee of superannuation funds must be given procedural fairness[10] and may be bound by the orders of the Court.[11] The trustee is required to provide detailed information about the superannuation entitlements to both member and non member spouses.[12]

The Family Law (Superannuation) Regulations 2001 provide the machinery for the operation of the new scheme and the mechanism for the valuation and splitting of superannuation payments once an order is made. The Regulations for the determination of the valuation of superannuation interests are comprehensive and complex and set out circuitous formulae for defined benefit funds and accumulation funds in both the growth and payment phases.

The *Superannuation Industry (Supervision) Amendment Regulations* 2001 (No. 3) complete the scheme and provide for the creation of new interests, rollover or transfer of benefits and ultimate payment of superannuation.

The new scheme now enables parties and trustees for superannuation funds to achieve a clean break for most superannuation interests consistent with the aims set out in Section 81 of the Act.[13]

Flexibility

In *Hickey* the Full Court recognised that previously there were difficulties relating to the manner in which the Court could deal with superannuation interests in property settlement proceedings and the ability of the Court to make orders binding on trustees of superannuation funds.[14]

The new scheme allows the Court greater flexibility in achieving just and equitable outcomes for separated parties because the superannuation interest can be split and the trustee of the superannuation fund will be bound by the orders.[15] It is particularly helpful with respect to the immediate splitting of accumulation superannuation funds between separating parties. However, while an interest in an accumulation fund can be split and become payable to a non-member spouses' superannuation fund as they may direct upon the making of the order, the new scheme cannot assist with the payment of defined benefit funds immediately, as they are not payable until the condition of release is met (which may be, for example, retirement or resignation of the member).

The new legislation is not so helpful for defined benefit funds. These funds are linked to the retirement salary of the member and by their very nature cannot be split or paid until the member retires, resigns or otherwise meets the conditions of release.

Defined benefit funds can be valued pursuant to the Regulations but are not immediately payable into another fund under the new scheme. In these cases it would seem prudent for practitioners

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and parties to continue including injunctions in the orders for property settlement, like those that were included in all orders made pursuant to Section 79 prior tot he operation of this new scheme. The injunction restrains a party from dealing with their superannuation member interest pending retirement, resignation or meeting such other conditions of release.

Valuations

Before making a splitting order, the Court must make a determination of the amount (value) of an interest in accordance with the Regulations or by such other method as the Court considers appropriate.[16]

Interestingly, in the case of *Gardner,* Burr J felt obliged to make his own determination of the values of the superannuation fund despite the agreement between the parties as to the lump sum values. His Honour bravely and accurately performed the valuation of the defined benefit superannuation fund in accordance with the Regulations on his own.[17]

Prior to the Full Court's decision in *Hickey,* there was some confusion about whether or not it was necessary for the Court to determine the amount of a superannuation interest in accordance with the Regulations. In the case of *Crown & Yarnold* there was an appeal against property orders made by a Federal Magistrate and exercised by a single Judge in accordance with the determination of the Chief Justice that found that before making a splitting order, (albeit 100% to the member and 0% to the non-member) in relation to a superannuation interest, the Court must determine the overall value of the interest in accordance with the Regulations. For a time and until the pronouncement of the Full Court in *Hickey*, there was uncertainty expressed by the Registrars of the Court and practitioners about whether or not a valuation and Superannuation Information Form (SIF) was required to be filed, even though it was clear that this was an additional and unnecessary expense to the parties and not envisaged or anticipated by the new scheme.

The Full Court in *Hickey* upheld the decision of *Jovanovic* which was cited as authority in *Gardner* and it is now clear law that a valuation in accordance with the Regulations is not required if each party is to retain their own existing accumulation superannuation entitlements and orders are made by consent.[18]

It seems logical that in most cases member statements will be sufficient evidence of the value of accumulation funds in the growth phase, if there is no splitting order sought or made by consent. However, the Court has not been so clear about whether or not a valuation of a defined benefit fund is needed even where the parties, by consent, do not seek a splitting order. Presumably not, but query the same especially if at least one party is unrepresented.

Super to be included in the pool?

Once the superannuation entitlements are valued in accordance with the Regulations, (if necessary) it then needs to be negotiated or decided by the Court whether or not the superannuation interest should be included in the pool of property available for division between the parties.

The Court in *Cahill* found that even though the Regulations provide a method of valuing a pension as a lump sum, the lump sum valuation of the future entitlement to receive a fortnightly pension (which could not be taken as a lump sum at any time) was artificial and complete fiction. Coleman J in *Cahill* found that the new scheme does not detract from the Court's duty to do justice and equity to litigants appearing before it as directed by Section 79 of the Act and on that basis, the Court treated the pension as a guaranteed income stream within the context of Section 75(2) rather than as an asset.

Burr J, in the case of *Gardner,* adopted as 'sensible and appropriate' an agreed submission to consider a superannuation interest, which had accumulated subsequent to separation, within the context of Section 75(2) rather than as an item of property to be included in the pool.

Competing proposals - to split or not?

Where a property settlement matter is not resolved by consent orders and the matter proceeds to a trial in the Family Court, there may be a contest about how to deal with the superannuation. Since the operation of the new scheme this has become a negotiating point between the parties.

A member spouse may seek to retain all their superannuation entitlements and offer to provide the non-member spouse with current non-superannuation assets while the non-member spouse may seek a splitting order. Similarly, a non-member may not seek a splitting order but seek other non-superannuation assets instead and the member may be keen to split their superannuation interests so they may be able to retain other current non-superannuation assets to re-establish themselves.

Where the parties cannot agree how the property, including superannuation, is to be divided, it will be for the Court to determine whether or not a non-member's spouse's entitlement should be satisfied from currently available assets, or whether the superannuation fund ought to be the subject of a splitting order. By necessity, the Court will be required to weigh up the level of complexity and the uncertainties contained within the proposals of each party to decide between the competing proposals and wishes of the parties.

In the case of *Gardner* Burr J upheld the wife's suggested approach to make an order splitting the pension payment and lump sum when they fell due. His Honour found that the husband's approach was complicated and uncertain and so it was inappropriate to exercise direction in favour of his approach. By comparison, His Honour found that the wife's approach was consistent with the level of simplicity and precision envisaged by the amendments and new scheme.[20] This may lead one to the conclusion that a splitting order is to be preferred over an order preserving one party's superannuation

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entitlements intact where there are competing proposals by the parties.

This will continue to be an issue between negotiating parties and ultimately the priority of the wishes of the parties will be left to the Court to exercise its discretion by considering whether the orders are just and equitable in the circumstances. Already, as demonstrated by Moore J in the case of *Levick*, this has increased the focus on and weight to be given to the consideration of what is just and equitable in the circumstances by the Court.

Just and equitable

The Full Court in *Hickey* expressly confirmed the four-step approach to property settlement[21] and highlighted in particular the fourth step of ensuring a just and equitable outcome for the parties.

After making findings regarding the identity and value of the property, the contributions to the marriage and future needs of the parties (known as Section 75 (2) factors), the Court is then required to consider the effect of those findings and resolve what order is just and equitable in the circumstances.

In the case of *Levick*, Moore J demonstrated that it is open to the Court to separate the non-superannuation assets from the superannuation and order that a non-member receive their property settlement entitlement partly by way of a splitting order and partly by way of increasing entitlements in other non-superannuation assets. Her Honour used judicial creativity on the basis of considering what is just and equitable to balance the competing priorities of the parties to achieve a satisfactory outcome which would not have otherwise existed or been available prior to the operation of the new scheme. The Court held that the wife's entitlement could be satisfied from some non-superannuation assets up front and a percentage of the husband's superannuation entitlement.

The fourth step may be increasingly exercised to justify the reasoning of the Court in deciding between the competing wishes and priorities of the parties about the division of property. The Court and practitioners should embrace the opportunity to analyse all possible outcomes and consequences of the parties.

Splitting orders

The Full Court in *Hickey* has found that if superannuation interests are unaffected by the order for property settlement, there is no splitting order and it is not possible to have a zero percent splitting order.

Therefore, if by consent each party retains their own superannuation entitlements but gives one party a greater share of the non-superannuation assets by way of adjustment, it is not a splitting order. It is just an order like any other order pursuant to Section 79 of the Act for property settlement.

'Catch all' type orders can include superannuation

Historically, practitioners, parties and the Court have included a paragraph in property settlement orders made pursuant to Section 79 of the Act that seeks to declare that each party will otherwise retain all other assets in their sole name and possession.

This issue was considered at length by the Full Court in *Hickey* and it held that the Court may include in an order pursuant to Section 79 of the Act, a paragraph or clause of the 'catch all' type which may include superannuation in circumstances where one or both parties shall retain their own superannuation interest.

The 'catch all' type order included as a clause or paragraph of an order resolves the ownership of chattels in the possession of the person as collectively (altering title in some cases and confirming title in others) because it is part of an entire order which adjusts the interest of the parties in the whole of their property.[22] The 'catch all' type order may include superannuation because the effect of Section 90MC is that in proceedings in relation to property under Section 79 of the Act, a superannuation interest is to be treated as property irrespective of whether or not a splitting or flagging order is proposed.[23]

Further, the Full Court in *Hickey* has maintained that it is desirable to provide certainty and assurances to parties that all the property has been dealt with, including superannuation interests and to resolve any doubt arising from any preliminary distributions. It follows that the mandatory obligation under the new scheme in relation to procedural fairness to the trustee and the determination of the amount (value) in accordance with the Regulations do not apply unless a splitting or flagging order is sought or made.

Registrars can make Orders pursuant to Section 79 including superannuation

It has also been confirmed by the Full Court in *Hickey* that Registrars have the jurisdiction to make orders pursuant to Section 79 of the Act by consent which include superannuation interests relying upon Order 36A of the Family Law Rules.

The principles to be applied by the Registrars and Court in making an order pursuant to Section 79 of the Act by consent, depend on the circumstances of each individual case but are upheld by the Full Court as identified in *Harris v Caladine* (1991) FLC 92--217.[24]

Tax on superannuation - how is it taken into account?

Taxation on superannuation is another complexity to be faced by the Court and practitioners. The tax components and burden are split between the parties according to the percentage split, or

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shared equally in the same proportions.[25]

There is no tax payable in respect of undeducted contributions. 5% of the pre-July 1983 component is taxed at the marginal rate and the post-July 1983 component is taxed at 16.5% (15% plus Medicare levy of 1.5%) up to the Reasonable Benefit Limit ('RBL'), if taken after the age of 55 years. The RBL for lump sum superannuation is $562,195, and pension $1,124,384. If taken prior to the age of 55 the whole component is taxed at 20% plus Medicare levy of 1.5%. Any benefit over the RBL is taxed at the highest marginal rate plus Medicare levy (48.5%).[26]

The Full Court has set out in *Rosati & Rosati* (1998) FLC 92-804, that typically the taxation will be taken into account where it is a realisation cost pursuant to orders for property settlement, is inevitable or probable or alternatively may be taken into account as a Section 75(2) factor.[27]

In *Levick* Her Honour took into account the tax-free threshold and then applied a 15% plus Medicare levy tax payment on the balance in her calculations. Moore J in *Levick* expressly states that the time delay before being able to access superannuation needs to be taken into account by the Court. However, unfortunately, Her Honour did not indicate what weight is to be given to it.

Given the uncertain and prospective nature of tax payable on future superannuation entitlements by both members and non-members, the Court may struggle to accurately take account of the same. The tax will depend upon the income earned in the year it is received as well as whether it is taken as a lump sum or pension.

The tax concessions available for pre-1983 superannuation provides opportunities for tax planning for the benefit of both parties. It is also a negotiating tool to resolve the matter for the benefit of both parties. This is especially so where there is a larger pool of property including the superannuation.

The taxation on superannuation will often require expert advice given the possible hidden liabilities including the surcharge tax and other detailed taxation knowledge required in considering the consequences of splitting orders for the parties.

Further, corresponding amendments have been made to the taxation legislation with respect to Capital Gains Tax. Rollover relief is available for in specie transfers for self managed superannuation funds.[28]

Are Superannuation Agreements binding?

Clearly, under the new scheme, orders with respect to superannuation are binding on trustees of superannuation funds.[29] Once procedural fairness has been forwarded to the trustee, it is bound by the order.[30] However, there is no corresponding section in the Act that relates to Superannuation Agreements.

The service of the Superannuation Agreement on the trustee enlivens the trustee's obligations under the Act but importantly, the operative time cannot be retrospective without the prior agreement of the trustee.[32]

The Superannuation Agreements would appear only to 'trigger' the operation of the new Part but of itself may not bind a trustee. It may be open to a trustee to refuse to be bound by a Superannuation Agreement, so as a matter of course it would be appropriate to include the trustee in the negotiations of any Superannuation Agreement and confirm their willingness to give effect to the Agreement prior to its execution.

And finally...

The Court has indicated that at this stage, it does not intend to publish all judgments relating to the application of the new scheme, on the basis that it wishes to monitor and ensure a consistency of approach to the issue of superannuation.[32]

Acknowledgement

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(Endnotes)

[1] *Family Law Act 1975 s 79.*
[2] *Hickey & Hickey & Anor [2003] FamCA 395 Nicholson C J, Ellis and O'Ryan JJ.*
[3] *Jovanovic & Jovanovic unreported, Family Court, Chisholm J, 24 January 2003.*
[4] *Levick & Levick unreported, Family Court, Moore J, 31 January 2003.*
[5] *Crown & Yarnold unreported, Family Court, May J, 27 February 2003.*
[6] *Cahill & Cahill, unreported, Family Court, Coleman J, 7 March 2003.*
[7] *Gardner & Gardner unreported, Family Court, Burr J, 28 March 2003.*
[8] *Family Law Act 1975 s 90MC.*
[9] *Family Law Act 1975 s 90MT.*
[10] *Family Law Act 1975 s 90MZD(1)(a).*
[11] *Family Law Act 1975 s 90MZD and Hickey [2003] FamCA 395, 11 & 25.*
[12] *Family Law Act 1975 s 90MZB.*
[13] *Family Law Act 1975 s 81.*
[14] *[2003] FamCA 395, 7.*
[15] *Family Law Act 1975 s 90MZD and Hickey [2003] FamCA 395, 11 & 25.*
[16] *Family Law Act 1975 s 90MT(2).*
[17] *[2003] FamCA 395, 26, 30 and 31.*
[18] *Ibid 14.*
[19] *Ibid 14, compare with approach taken in Cahill unreported, Family Court, Coleman J, 7 March 2003.*
[20] *Gardner & Gardner unreported, Family Court, Burr J, 28 March 2003*
[21] *[2003] FamCA 395, 16 and 22.*
[22] *Ibid 395, 11 and 25.*
[23] *Ibid 36.*
[24] *Income Tax Assessment Act 1936 s 27ACA and s 27ACB.*
[25] *Berman 'Practical Implications of Super Reform', June 2003, 19.*
[26] *Ibid 26.*
[27] *Bourke, above n 68, 29.*
[28] *Family Law Act 1975 s 90MZD.*
[29] *Ibid s 90MZD.*
[30] *Bourke, above n 68.*
[31] *Watts, Watts McCray Lawyers, Fiji, 8th Australian Family Lawyers' Conference, June 2003.*