Estate planning: Considerations for SMSFs

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Welcome

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Presenter

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Garth has worked in the Australian Superannuation industry for over 25 years with a specific focus on self-managed super funds. He provides ongoing support and training to individuals as well as to professionals working in the superannuation area, including advisers, accountants and lawyers.

Garth is a regular contributor to industry publications and to the leading professional bodies including Chartered Accountants Australia & New Zealand (CA ANZ) & CPA Australia (CPA).

Important

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In particular, you should seek independent financial advice prior to making any investment decision.

You should consider the appropriateness of this information having regard to your individual situation and seek taxation advice from a registered tax agent before making any decision based on the content of this presentation.

Any examples within this presentation are provided for illustrative purposes only. They should not be relied on.

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Webinar overview

1. **SMSF and death Benefits**
2. **Control of a SMSF: Post death**
3. **Tax outcomes and considerations**
4. **Planning: What can be done and how**

SMSF membership analysis

Members over 55	**66.3%**
Members over 65	**41.4%**
SMSFs with 1 member	**24.4%**
SMSFs with 2 members	**68.7%**

ATO data as at 30 June 2022

SMSFs and death benefits

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What you NEED to know

1. Superannuation is not an Estate Asset and hence your "Last Will & Testament" does not automatically cover your Superannuation Balances
2. Superannuation is a Trust Asset; the remaining fund Trustees decide who gets your balance on your death
3. You can "inform & instruct" the remaining fund Trustees as to who should receive your benefits on your death – restrictions on who can be nominated exist. This is done through a death benefit nomination: Non-Binding, Binding or Non-Lapsing

Non-binding nomination

Allows the member to “suggest” who should be paid their super on death. Trustees are not bound by the request

Remaining trustee have final say – and they could decide to pay the benefits to someone else if they deem appropriate

Your SMSF Trust Deed may have wording requirements on how often these nominations “may” need to be revisited to remain valid

Provides flexibility – pay the right person at the appropriate time, but can result in unintended outcomes

Binding nomination

Allows the member to request the Trustees to pay their super on death to the nominated person / people

Where the nomination is valid, the Trustees are "Bound" to carry out these wishes

Your SMSF Trust Deed may have wording requirements on how often these nominations "may" need to be revisited to remain valid (the 3 year rule on validity does not necessarily apply to a SMSF)

You must regularly review these nominations for appropriateness & validity. Consider possible changes to tax status of nominated recipient overtime

Non-lapsing nomination

Allows the member to tell the Trustees who should be paid their super on death

Where the nomination is valid, the Trustees are "Bound" to carry out wishes and the nomination remains in place until amended or updated. Check SMSF trust deed to see if the Deed allows this form of nomination

You must regularly review these nominations for appropriateness & validity. Consider possible changes to tax status of nominated recipient overtime

Death benefit agreement

More formal process for dealing with death benefits as these rules are written into the SMSF Trust Deed

Gives the greatest level of control to the members (control from the grave)

Not all SMSF Trust Deeds may allow these types of nominations – must check your Trust Deed. Most require the use of a Legal Professional (who knows SMSFs)

What you MUST be aware of

1. SMSF Trust Deeds often require "specific" wording to be used: Legal Personal Representative vs. Trustee of Deceased Estate vs. Executor
2. These various documents have specific requirements for witnessing; make sure these are met
3. Some Trust Deeds require a copy of any nomination to actually be given to all the Trustees – prepare and sign a minute on completion

Reader's question

Can any binding death benefit be permanent or does it need to be renewed every 3 years?

Phil

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Reader’s question

We're very interested to learn how to best protect and respect the different asset amounts of each side of our blended family held in the SMSF (and outside), as we are a self funded semi-retired couple in a 10 year de-facto relationship.

Generally, we want the survivor to be able to continue to live off the total SMSF income, but preserve the capital belonging to the deceased for their family, and when they die, the remaining funds to be passed onto each rightful family line based on our individual SMSF and retirement asset levels. We'll also need solid protection against any new partner that the survivor may meet, and that the estate planning is set in cement. many thanks,

Neil

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Who can we nominate?

- A Spouse - including de-facto arrangements
- A Child under 18
- A Child over 18
- An Interdependent
- A Financial Dependent (partial dependency may be enough)
- Your Legal Personal Representative (LPR) / Trustee of deceased estate / Executor etc. (check Deed wording requirements) with the benefits then becoming part of your Estate

If you want someone else to receive your Super death benefits, then you MAY need to nominate your LPR and have the benefits pass through your estate

What is an interdependent?

- Close personal relationship between two persons who live together and one or each of them provides the other with financial support, domestic support and personal care.
- Financial / domestic support can be provided by the one party (parent/child - child/parent)
- Can be met if each party provides one level of the support and the other party provides the other

Reader's question

I have read articles in newspapers the past few weeks about binding death benefits that may adversely impact me.

Is a financially independent adult child a "dependent" for purposes of receiving part of my super on my death under a binding death benefit?

If not what are the consequences?

Phil

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Reader's question

Regarding what's left in my SMSF when I die - are there any tax effective options for singles with no dependants? e.g. in leaving my estate to non-dependant relatives, or e.g. to a charity or education body.

Anne

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Making changes to your nomination?

- Follow any process required under the Deed / Constitution – otherwise your nomination (changes) may not be valid
- Refer to the existing documents to see if they set out any requirements for changes to be made
- Maintain documentary evidence of all changes – a continuous chain of documents is very important
- Before making changes, review ALL existing and prior documentation. Review:
  - What is currently in place
  - What documents have been put in place in the past
  - Your other existing Non-SMSF estate planning documentation that is already in place

Reversionary vs Non-reversionary pensions

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Reversionary pensions

When you commence a pension from your fund, you can identify (add) another person who will automatically continue to receive your pension payments after you die

- Can only nominate your spouse or minor child
- Can only usually nominate one person (get advice around multiple recipients and death benefit agreements)

As this "automatically" occurs, the remaining Trustees have no real control over the payment (certainty for the deceased member)

Reversionary pensions: Considerations

- Make sure all requirements under Trust Deed for reversionary pensions have been met
- Make sure that the “Pension Application process” aligns with the Trust Deed rules – don’t just tick-a-box
- Reassess your TBA / TBC position well within the 12-month period
- Make sure that the fund assets can continue to fund the pension payments (liquidity, cash flow etc.)

Reversionary pensions: Pros & Cons

- As benefits remain inside Super, they are protected from Estate challenges
- Benefits in the TBA/TBC assessment for recipients
- Effectively removes the ability to pay an “in-specie” death benefit
- Need ongoing review of the nomination to ensure it is still appropriate:
    - Kids get older and may no longer be tax dependents
    - Nominated person still alive?

Reversionary pensions

	Non-Reversionary	Reversionary
When is a death benefit assessed for Transfer Balance Cap?	When the new death benefit pension starts to be paid from the fund (date trustees decide to pay the death benefit pension)	12 months from the date the reversionary pension commenced (usually date of death)
How much is assessed for Transfer Balance Cap?	The dollar value of the death benefit pension that commences	The dollar value when the reversionary pension commenced (usually date of death)

Example

Greg dies on the 2nd January 2023.

He was taking a pension from his superfund that had been initially set up as a reversionary pension & nominated his spouse, Lina.

Greg had $800,000 in life insurance that was paid into the fund by the insurer on 20th March 2023

Pension Balance at date of death:	$1,350,000
Date for TBC assessment (Lina):	02/01/2024
Amount assessed for TBC (Lina):	$1,350,000
Pension balance (est.) on 02/01/2024:	$2,150,000

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Even though the pension balance at time of TBA assessment ($2.15M) is well above the allowed $1.7M TBA limit, as the pension was reversionary you need to use the balance at the date of reversion to determine the TBA effect!

Reader's question

Can the fund's scope, once initially set, be changed there after; e.g. can I enable it to receive a reversionary pension from a SMSF who have passed away?

Richard

Death benefit: Non-reversionary

If a pension was not specifically established as a Reversionary pension, then that pension ceases on the member's death

The remaining trustees will then need to consider how to pay out the deceased member's benefits and to who

- What do the Trust Deed rules require?
- Are there any Death Benefit nominations in place?

Death benefit: Non-reversionary

Considerations

Flexibility – Trustees are not bound to take any particular course of action. They can decide what is the most appropriate action at that time (depending on other nominations that may be in place)

Challenges – as there is no defined course of action, this could create an opportunity for an Estate challenge, or the surviving trustees could make other decisions that may not be in accordance with your wishes

Important

The remaining Fund Trustees can / may / will have control when dealing with member benefits post their death; it would therefore be extremely important to make sure that the right person / right people are making these decisions.

This is done through the control of the SMSF.

Control of an SMSF: Post death

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Considerations

- What the Superannuation Legislation requires / allows
- What the Trust Deed allows / requires
- What the Corporate Trustee Constitution allows / requires
- Shareholding of the Corporate Trustee
- Successor Directorship

The basics

- On death, your Trusteeship / Directorship (Corp. Trustee) will usually cease, but you remain a member of the fund
- Your LPR is ALLOWED (but not forced) to be appointed as a Trustee / Director in your place and can remain in that position UNTIL your death benefits start to be paid from the SMSF
- At that time, the SMSF will need to comply with the rules around member/trustees etc. so make sure that the fund continues to meet the definition of a SMSF post death

Control of SMSF moving forward

Shareholding in Corporate Trustee

- Who have you listed in your Will to receive / "inherit" the shares in the Corporate trustee through your Estate? The shareholder(s) can appoint themselves as the new Director(s)
- They can then participate in SMSF decisions.
- Consider including rules in your Trust Deed that may require your LPR / Executor etc. to be appointed as a Director / Trustee BEFORE any of your death benefits can be dealt with

Control of SMSF moving forward

Use of a successor Director nomination

- Consider appointing a successor Director in addition to just dealing with shareholding
- This could allow the automatic appointment of that person(s) as a Director without resolution needing to pass – essentially giving a seamless appointment
- You MUST check any Constitution wording / requirements / restrictions?
- Is this person willing to act? Will they still be willing to act moving forward? Need to review this regularly

Tax issues for superannuation death benefits

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Who and how

The tax payable on a Superannuation "Death Benefit" depends on **WHO** will receive the payment: **Dependent or Non-Dependent**

and

HOW the payment is made: A **Pension or Lump Sum**

Dependents

	Super (SIS) Dependent	Tax Dependent
	Super or SIS Dependents are eligible to receive a death benefit payment DIRECT from the Fund	Receive concessional tax treatment on death benefit payments

Dependents

	Super (SIS) Dependent	Tax Dependent
Spouse	Y	Y
Former Spouse	N	Y
Child under 18	Y	Y
Child 18+	Y	N
Financial Dependents	Y	Y
Interdependent	Y	Y

Lump Sum Death Benefit

	Tax-Free Component	Taxable Component
Paid to a dependent	Paid out Tax-free	Paid out Tax-free
Paid to a non-dependent	Paid out Tax-free	**Taxed element:** Max. 15% plus M/Care **Untaxed element:** Max. 30% plus M/Care

Death benefit pension (Income stream)

Ages	Component	Tax Outcome
Deceased member OR Death Benefit recipient are 60 or older	Tax-Free Component	No tax
	Taxable (Taxed element)	No tax
	Taxable (Untaxed)	Marginal rate less 10% offset

Must be a Dependent to receive an income stream death benefit

Death benefit pension (Income stream)

Ages	Component	Tax Outcome
Deceased member OR Death Benefit recipient are both under 60	Tax-Free Component	No tax
	Taxable (Taxed element)	Marginal rate less 15% offset
	Taxable (Untaxed)	Marginal rate no offset

Must be a Dependent to receive an income stream death benefit

Planning

The tax payable by a non-dependent (e.g.: adult children) can be reduced or even eliminated if planned:

1. **Withdraw benefits tax-free and then re-contribute these amounts:**

- Payments to you from your fund are paid proportionately from both the taxable and tax-free components. If you are over 60 these amounts are tax free
- When you re-contribute these amounts as a non-concessional amount, they form part of your tax-free component. This component is paid out tax free to non-dependents

Planning

The tax payable by a non-dependent (e.g.: adult children) can be reduced or even eliminated if planned:

2. **Withdraw benefits tax-free and keep these amounts outside super:**

- Payments to you from your fund are paid proportionately from both the taxable and tax-free components. If you are over 60 these amounts are tax free
- If you keep these amounts outside of Super, then the Super death benefits taxes do not apply!

Reader's question

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Are there any circumstances where using a re-contribution strategy is considered as tax avoidance?

Peter

Planning

Member balance equalization

- Where possible, try and maintain relatively equal spouse super balances
- When one passes away, it can allow more benefits to remain within the tax concessional super environment
- If both members have relatively even balances, they can commute (cease) their own pension back to accumulation and commence a death benefit pension

Paying out a death benefit

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Rules around payment

- Death results in the compulsory payment of the deceased member's benefits
- The deceased member's benefits must be "cashed" out of the Super system "as soon as is practicable" following death.
- Cashing refers to the payment of the deceased members benefits by way of:
  - Pension
  - Lump Sum
  - Combination of both

Transfer of assets?

If the trust deed allows, a death benefit can be paid “in-specie”

Allows a beneficiary to retain ownership of a specific SMSF asset

Particularly useful where SMSF holds the business real property of a related business! Property does not need to be sold off.

Wrap up

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Get it right!

We would all like to think that our Family are close enough to not fight over a death benefit!

However, money (and in some cases LOTS OF MONEY) can change people!

- There has been a BIG increase in legal cases relating to death benefit payments from Super
- These cases usually arise due to incomplete paperwork, deficiencies in paperwork & where the Trust Deed rules have not been met
- Further issues can arise where Super death benefits form part of an Estate where no Will exists!

Get it right!

Include your Legal adviser in the overall Estate Planning process and make sure that you cover off your SMSF in that process. It is important that your Estate Planning objectives and paperwork also take into account the Estate Planning outcomes for your SMSF

This can produce the best tax outcomes and admin efficiencies

Questions