THIRTEEN WENTWORTH SELBORNE

Superannuation & Estate Planning

Legalwise Seminars
"SMSF's: Property, Death & Taxes"
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Overview of topics

- Implications of death
- Tax implications – death and superannuation
- Death benefit nominations
- Estate planning and superannuation
- Dealing with non-complying funds

Holdings of Wealth

- Estate planning – consider:
  - Principal place of residence
  - *Inter vivos* trusts
    - therefore - limited role for testamentary trusts]
    - **BIG** issue – restructure of *inter vivos* trust for estate planning reasons]
    - Pembroke J in *Ireland v Retallack* [2011] NSWSC 846
  - Superannuation funds (SMSF)

Superannuation

- Self managed superannuation fund advantages
  - Tax benefits
  - Control
  - Market volatility
  - Fees
  - Real property
  - Gearing

Superannuation

- Concessional vs. Non-concessional
- Concessional contributions
  - *less* than 50 = $30,000
  - *greater* than 49 = $35,000

Non-concessional contributions - $180,000

- Division 293 additional tax

Gearing in Superannuation

- S. 67A Superannuation Industry (Supervision) Act 1993 (Cth)
- No prohibition from borrowing under an arrangement where:
  1. trustee of superannuation fund borrows to acquire underlying asset.
  2. Underlying asset acquired by the borrowed money.
  3. Underlying asset held on trust so that the trustee of the superannuation fund has the 'beneficial interest'.

Gearing in Superannuation

4. Trustee of superannuation fund has a right to acquire legal ownership by making further (instalment) payments.
5. Right of the lender is limited in recourse to the underlying asset (ie. taking possession or disposal).
6. If the trustee of the superannuation fund has other rights (other than possession/disposal) – the rights of the lender are limited to rights in relation to the asset.

The Relationships Required

Trust:

1. Trustee of superannuation fund – ‘beneficial interest’.
2. Bare trust relationship – Security Trustee and Trustee of Superannuation Fund to Underlying Asset.

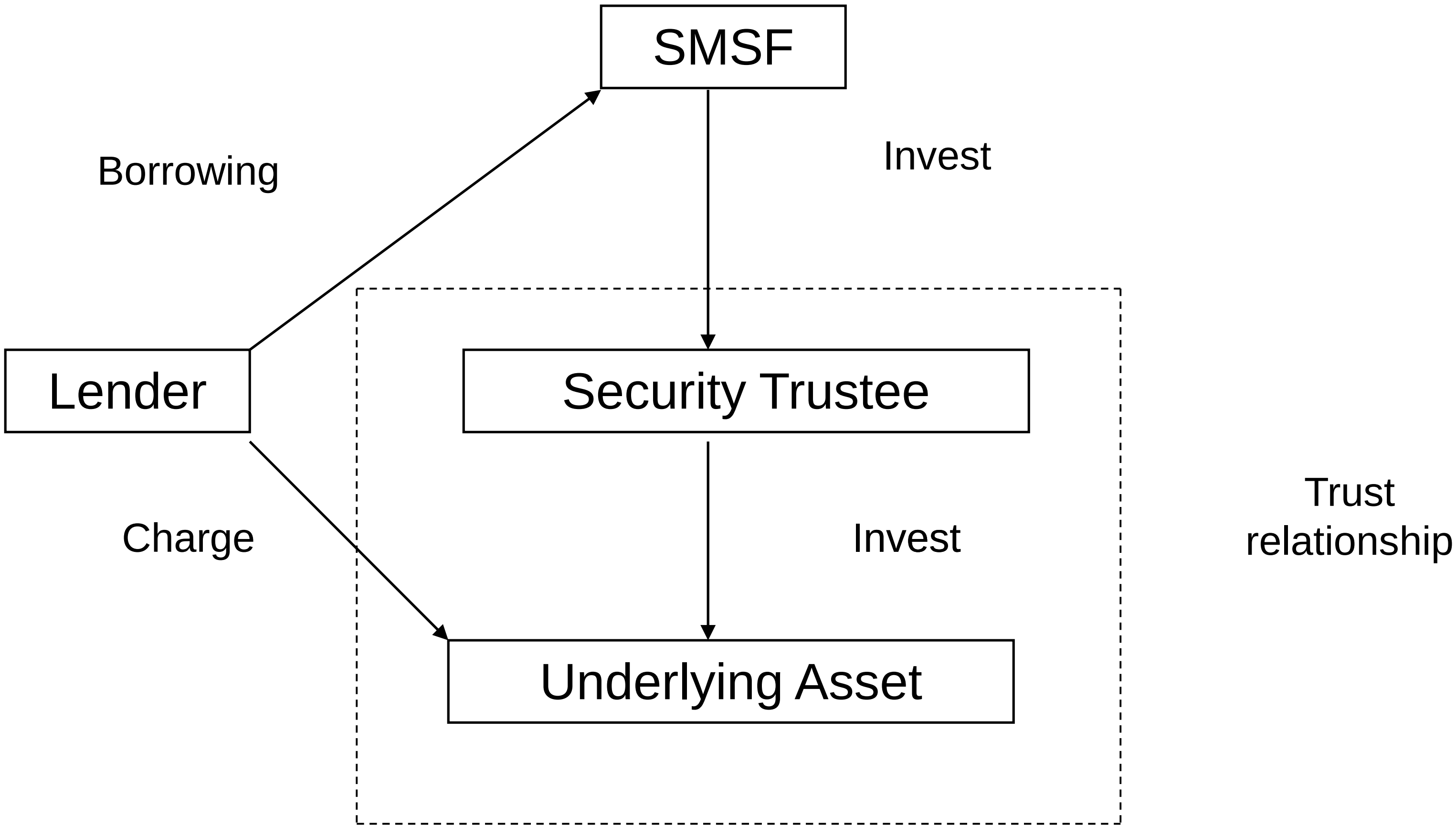
Investor & Asset

1. Trustee of superannuation fund has a right to acquire.

Borrowing

1. Trustee of superannuation fund borrows.
2. Lenders rights limited in recourse to underlying asset.
3. Rights of trustee of superannuation fund subrogated to the lender – but only with respect to the underlying asset.

Relationship



Superannuation death benefits

- Death benefit - not immediately part of estate

- When determining recipient - need to consider:
  - Nominations by member
  - Fund deed
  - Superannuation law
  - Tax law

Superannuation death benefits

<u>Lump Sum Payments</u>

- Reg 6.21 - *SIS Regulations*
  - Death - compulsory cashing event
  - Pay **'as soon as practicable'** after death
- Reg 6.22 – *SIS Regulations*
  - Pay to either / both
    - LPR
    - One or more dependants
- Disputes and death benefits
  - Notional estate – Ch 3 *Succession Act 2006* (NSW)

Superannuation death benefits

<u>Pensions</u>

- Reg 6.21(2) *SIS Regulations*
  1. Lump sum – in respect of each person ***<u>only:</u>***
     (a) a single lump sum; or
     (b) an interim lump sum and a final lump sum

  2. Pension – 1 or more, but only to:
     - Surviving spouse
     - Children under 18
     - Children under 25, financially dependant at death

Timing Issues

Lump Sum

- Reg 6.21 – cashed as soon as practicable after member dies

Commutation of pensions

- If deceased in pension mode: 3/6 month rule
- Ss. 307-5(3) convert 'superannuation death benefit' into superannuation member benefit
- Alter tax outcome
- Planning for reversionary – commute + roll-over

Income Stream – tax implications

- If income stream payable due to death and beneficiary commutes income stream ***within the later*** of 6 months from death or 3 months from grant of probate or letters of administration, the commutation is treated as a **superannuation death benefit**.
- If commuted ***outside the later of*** 6 months from death or 3 months from grant of probate or letters of administration, then treated as a **superannuation member benefit** and taxed as a **superannuation benefit**.

Superannuation death benefits

- Tax outcomes:

  1. Identity of recipient
  2. Component of benefit
  3. Method of payment
  4. If income stream - ages

Death benefits – lump sums

- Tax dependant – tax free (no limit)
  - Irrespective of ages
  - Irrespective of pay directly or estate
    - s. 302-10 ITAA 97 – actual and intended benefit

- Non-tax dependant (eg. adult children) – estate pay
  - 16.5% on taxable component (taxed element) [i.e. concessional contributions]
  - 31.5% on untaxed element
  - 0% on exempt component [i.e. non-concessional contributions]

Taxation of superannuation death benefits

Lump sum vs income stream

<u>Lump sum:</u>

- Death benefit dependent - tax free
- Non-death benefit dependant

Component	Tax treatment
Tax-free	Nil
Taxable (taxed)	15% (plus Medicare levy)
Taxable (untaxed)	30% (plus Medicare levy)

[all paid proportionally]

Strategies

1. Re-contribution
   - NCC caps
   - Contribution acceptance (>65)
   - Proportioning rules

2. Tax free withdrawals > 60

3. Minimising untaxed element

Death benefits – pensions

- Pension continued to be paid to 'death benefit dependant' taxed – ages of primary and reversionary pensioner
  - If deceased > 60, pension payments tax free even if reversionary < 60
  - If deceased & beneficiary < 60 – 'taxable component' assessable less offset
  - If beneficiary > 60 – non-assessable non-exempt income

Taxation of superannuation death benefits

<u>Income stream</u>

Taxation of pensions from a taxed fund:

Age of original owner at death	Age of beneficiary upon reversion	Taxation (taxed scheme)
Any age	60 or older	Tax-free
60 or older	Under 60	Tax-free
Under 60	Under 60	Tax-free component is tax free and taxable component beneficiary’s MTR (with 15% tax offset). Tax-free when beneficiary reaches 60

Death benefits – reversionary

- If no ‘death benefit dependant’
- No reversion possible
- Must pay out on death on last surviving spouse

- Tax treatment of non-dependants on death of parent in pension mode depends on proportion of benefits which are exempt at start of pension

Retaining funds in superannuation

- Strategy 1: receive the income as an income stream (either from the accumulation phase or continuation of income stream paid to member). If income not required, the income stream can be commuted later than 6 months from death or 3 months from probate / administration to receive superannuation benefit [not for children under 18 or 18-25]
- Strategy 2: Roll superannuation into a deferred annuity which allows nomination of a reversionary beneficiary. Therefore beneficiary can retain benefit in superannuation until member would have turned 65. A deferred annuity is one which has not yet commenced to be paid – so commutation of income within /outside 3/6 month rule applies.

Issue to consider

- **What takes priority – BDBN or reversionary pension?**
- Reversionary pension in place then BDBN made:

  1. BDBN takes precedence [contract cannot fetter trustees powers];

  2. Reversionary pension, then BDBN when reversionary dies; or

  3. Reversionary pension – all belongs to reversionary and dealt with as reversionary's

- ATO March 2010 Technical minutes – **reversionary pension**

Death Benefit - Important Factors

- Constituent documents
- Superannuation Industry (Supervision) Act
- Income Tax Assessment Acts
- Trustee obligations / powers
  [equity / legislation – e.g. Trustee Act]
- Family provision legislation

Death benefit payments

- Payment of death benefits determined by governing rules and not will: *McFadden v Public Trustee for Victoria*

- Prima facie a trustee discretion (subject to trust deed and legislation) [*Katz v Grossman*]

- In SMSF context – deed may allow members to make death benefit nominations.

Death benefit payments

- Limited to ‘dependants’:
  - Spouse (legal or de facto)
  - Child of the member
  - Person whom member has ‘interdependency relationship’
    - Close personal relationship
    - Living together
    - One or both provide financial support
    - One or both provide domestic support and personal care
  - Dependant (common law)
- Estate or LPR (subject to trust deed)

Types of DBN

(1) Nominated beneficiary

(2) Binding death benefit nominations
[binding if to dependent]

(3) Reversionary beneficiary
(income phase only)
[binding if to dependent]

(4) Beneficiary specified in trust deed

Binding death benefit nominations

SMSF Determination 2008/3:

- Reg 16.7A SIS Regs not apply
- 3 year rule not apply (subject to deed)

Implications for SMSF’s:

- Terms of deed essential
- Consider whether Reg 16.7A provided for or implied
- Deed should allow for indefinite BDBN
- BDBN should be drafted with requisite capacity and intention

Treatment of death benefits

- Three step approach:

1. **Who is the beneficiary**
   (death benefit or non-death benefit)

2. **Determine method of payment**
   (income stream or lump sum)

3. **Determine tax implications**

Superannuation proceeds trusts

- Trust established to only accept superannuation death benefits
- If there is no testamentary trust in a will
- Benefit paid directly from a fund to a trust
- Beneficiaries restricted – spouse and dependent children
- Income – all beneficiaries
- Capital – only dependent children

Wills and payment to the estate

- BDBN - member may nominate a death benefit to be paid to LPR
- No BDBN - trustee may use discretion to pay to deceased estate

IF SO:

will should make provision for such payments

Ioppolo & Anor v Conti & Anor [2015] WASCA

Issues:

1. Did the executor have to be a trustee (s.17A of the SIS Act)?

2. Did the SMSF trustee act in bad faith?

Section 35 of the Succession Act

- Unintended tax consequence

- If beneficiary does not survive deceased by 30 days, then the beneficiary is deemed to have pre-deceased the deceased
- Subject to contrary intention

Section 35 of the Succession Act

- Example - I die, then my wife dies within 30 days of my death – my wife deemed to have pre-deceased
- Effect – if no other ‘dependants’ – death benefit payments subject to tax
- **Ensure that BDBN and will specifically provides that section 35 does not apply to death benefit payments.**

Binding death benefit nominations

Constituent documents essential

Trust deed to provide:

1. What benefits can be paid?
2. To whom can benefits be paid?
3. The procedure for nominating death benefits?

Complaints procedure?

- Should your deed have a dispute resolution / complains procedure?
- SCT – not applicable to SMSF's
- Create a dispute resolution mechanism. If don't comply – breach?
- If give reasons- reviewable decision for the Courts?

Non-compliance – SMSF context

- Contravention - automatically non-complying

- S. 42A – *Superannuation Industry (Supervision) Act* – Regulator to consider:
    1. Tax implications if non-compliant;
    2. Seriousness of the contravention(s); and
    3. All other relevant circumstances.

Relief

- S. 221 *SIS Act* – relief from liability – contravention of civil penalty provision (s. 193)
  - Acted 'honestly' (not reasonably)
  - Ought fairly be excused given circumstances
- S 310 *SIS Act* – relief for 'official misconduct'
  - Negligence, default, breach of trust or breach of duty
  - Acted 'honestly' and ought fairly be excused

Penalties for SIS Act Contraventions

1. *Olsen v Early* Sunshine [2015] FCA 12.

2. *Deputy Federal Commissioner of Tax (Superannuation) v Graham Family Superannuation Pty* Ltd [2014] FCA 1101.

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