Successful Succession: Superannuation and Estate Planning

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Agenda

- What happens to your super when you die?
  - Who, what, when…..
- What determines the above?
  - Fund documentation
- What if beneficiaries aren't happy with their lot?
  - Mitigating disputes
  - What are the risks when one member of a couple dies?
- Strategies to consider.

Who, What and When

Who

- Only certain people are eligible to receive a **benefit directly** out of super when you die
  - Spouse
  - Child (of any age)
  - Dependent or Inter-dependent
  - Your Estate / Legal Personal Representative
- Need to watch out:
  - Siblings are ineligible
  - Grandchildren are ineligible

  Unless you can argue that they are financially dependent on you
- Only way to benefit non dependants is via the estate
  - Is there a likelihood of the estate being contested?
  - Who are the intended beneficiaries?

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For example:

Person	Circumstances	Eligible for Payment Direct from Super?
Husband		Yes
65 year old child	Not financially dependent	Yes
35 year old grandchild	Not financially dependent	No
	Financially dependent	Yes
16 year old grandchild	Not financially dependent	No
	Financially dependent	Yes
Defacto		Yes
Same sex partner		Yes
Sister	Not financially dependent	No
	Financially dependent	Yes
	Interdependent	Yes

Financially Dependent – **<u>does not</u>** mean private school fees for grandchildren

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What if?

- Member is in pension phase?
- Member is in accumulation phase?
- Member is in pension and accumulation phase?

- **Unless** the beneficiary is a spouse or a child under age 25, or a child with a disability, the <u>only option</u> with respect to any of the above is for the benefits to be paid out of superannuation as a <u>lump-sum</u>
- Therefore, this is the case generally upon the passing of the surviving spouse and benefits are for adult, financially independent children – money can't be retained in superannuation

What if?

What if the beneficiary is the spouse (regardless of the spouse's age)?

- Member is in pension phase?
  - The ability to retain their pension in superannuation for the spouse depends on the spouse's Transfer Balance Cap (TBC) position
- Member is in accumulation phase
  - Spouse could commence a new pension from the deceased's account, depending on their Transfer Balance Cap position
- Member is in pension and accumulation phase
  - Spouse could retain some of the benefits, depending on their Transfer Balance Cap position

Example #1

- Ned (65) and Maude (67) had $1.6M each in account based pensions as at 30 June 2017, and $400,000 each in accumulation:

	Ned Pension $	Ned Accum'n $	Maude Pension $	Maude Accum'n $
Tax Free Component	900,000	225,000	500,000	125,000
Taxable Component	700,000	175,000	1,100,000	275,000
Total	**1,600,000**	**400,000**	**1,600,000**	**400,000**

Example #1

- Maude passes away in the 2021/2022 financial year;
- Ned is the reversionary beneficiary of her pension, and sole beneficiary of her accumulation account;
- At the time of her passing, their benefits are the same value as above;
- What are Ned’s options with respect to Maude’s pension and her accumulation?

- **Prime objective** – to keep as much money in super as possible;
- **Secondary objective** – no excess transfer balance.

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Option	Pros	Cons
1. Take Maude's benefits as a lump-sum – paid outside superannuation.	- No excess TBC; - Retain higher tax-free component within the fund for estate planning purposes.	- $2M outside super and subject to tax at Ned's marginal rate on earnings and realised capital gains.
2. Commute / Rollback his own pension account to the accumulation phase and retain Maude's pension benefit of $1.6M. Take Maude's $400K accumulation as a lump-sum.	- No excess TBC; - Maximised amount to remain in super ($3.6M of $4M), of which $1.6M is in pension phase; - Amount in accum'n phase still tax effective	• Lower tax-free component within the pension phase that retains its %. • Growth in the accumulation account would add to the Taxable component. • However, only an issue for estate planning purposes and impact Rod and Todd.

Example #2

- Ned (65) and Maude (67) had $650,000 and $800,000 respectively in account based pensions as at 30 June 2017 and no accumulation accounts:

	Ned Pension $	**Maude Pension $**
Tax Free Component	150,000	150,000
Taxable Component	500,000	650,000
Total	**650,000**	**800,000**

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Example #2 continued

- Maude passes away in the 2021/2022 financial year
- There is no reversionary pension, but Ned is the sole beneficiary of Maude’s superannuation
- At the time of her passing, Maude’s super is worth $1 million, and Ned’s is worth $800,000
- What are Ned’s options with respect to Maude’s pension?

- **Prime objective** – to keep as much money in super as possible;
- **Secondary objective** – no excess transfer balance.

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Example #2 continued

- If Ned commenced a new pension with Maude's benefits, then he would have a total of $1,650,000 assessed towards his TBC:
  - 1 July 2017 $650,000
  - 1 July 2022 $1,000,000
- With the indexation of the TBC from 1 July 2021 to $1.6M, Ned has available an additional $60,000 of his TBC
- Ned can therefore retain 100% of the benefits in pension phase, despite his own pension account now being worth $800,000
- **Prime objective** – SATISFIED
- **Secondary objective** – SATISFIED

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What Happens to the Assets?

- When dealing with a death benefit in SMSF, what happens with the assets depends on the scenario
- Of money can remain in pension phase, then assets don’t need to be paid as lump-sum
- If lump-sums need to be paid:
  - Assets can be transferred to satisfy the payments
  - Assets can be sold, and the cash used to satisfy the payments
- It is NOT REQUIRED to sell assets – they can be transferred in-specie to beneficiaries or the estate
- The Trustee can decide which assets remain and which assets are paid – provided the required amount is paid

What Are the Tax Implications?

Lump-Sum Payments

- Depends whether the recipient is a tax dependent or not

<table>
<tr><th></th><th>Tax Dependent $ [1]</th><th>Non-Dependent $ [2]</th><th>Estate $ [3]</th></tr>
<tr><td>Tax Free Component</td><td>Tax-free</td><td>Tax-free</td><td>Tax-free</td></tr>
<tr><td>Taxed Taxable Component</td><td>Tax-free</td><td>15%</td><td rowspan="2">Taxed to the extent beneficiary is a dependent or not</td></tr>
<tr><td>Untaxed Taxable Component</td><td>Tax-free</td><td>30%</td></tr>
</table>

1. Tax Dependent means spouse, child under 18, financially dependent child over 18
2. Plus Medicare levy when paid directly to the non-dependent
3. No Medicare levy payable in the Estate
4. Untaxed Taxable Component isn't common – mainly arises when insurance benefits are paid out, the deceased is a fair way off age 65, and beneficiaries are not tax dependents

What Are the Tax Implications?

Pension Payments

- Depends on the age of the deceased and / or beneficiary

Tax Treatment of Pension Payments for Beneficiary	
Deceased or beneficiary over age 60?	Tax-free
Deceased over age 60 on death, beneficiary under 60	Tax-free
Deceased under age 60 on death, beneficiary over 60	Tax-free
Deceased AND beneficiary under 60 [1]	Taxable component taxed at marginal rate, less 15% tax offset

1. Upon beneficiary attaining age 60, pension payments would then become tax-free.

When Do you Have to Act?

Fund Trusteeship

- With SMSF, biggest consideration is Trusteeship
- Six months from date of death, if no change to Trustee or Directors (ie. Removal of the deceased), then can have issues with SMSF classification
- Doesn't require the benefits to be dealt with by then, for trusteeship rules only
- ATO takes a practical approach
- Easier to have a Corporate Trustee in place, as only have to change the Directorship
  - Don't have to update the asset registrations as they remain in the name of the company
  - Directors and shareholders change only

When Do you Have to Act?

Dealing with the Benefits

- As soon as practicably…..
- If reversionary pension – 12 months from the date of death for any restructure
- If not reversionary, usually the next 30 June / 1 July is an appropriate date, where the relevant paperwork is prepared, albeit the final amounts may not be known
- Consideration for tax implications within the Fund
  - Pension phase – pension exemption
  - Excess Transfer Balance Cap is not preferred
  - If not dealt with ASAPracticably, could be issues with the payment standards

What will determine the above?

Superannuation Documentation

- In terms of Who is getting the money, and then the flow on effect of What and When is determined by the documentation within the Fund
- This includes:
  - Reversionary pension documents
  - Binding death benefit nomination (BDBN)
  - Non-binding death benefit nomination
  - Super Fund Trust Deed
  - Will

Common Misconceptions

Wills and Superannuation:

1. The Will having jurisdiction over superannuation?
   - The treatment has always been (although confirmed by the recent cases):
     - Will doesn't have any jurisdiction re super
     - Unless:
       - Single member, sole director fund
       - Benefits are paid to the LPR / Executor
     - Fund succession therefore incredibly important

- Will then needs to prescribe (unless happy with residual estate):
  - Superannuation proceeds trust
  - Testamentary trusts
  - Particular assets to particular beneficiaries
  - Should consider tax if death benefits dependants.

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Common Misconceptions

Wills and Superannuation

2. That the Executors must become trustees or directors in the place of the deceased?
   – Where benefits can be dealt with within six months from the date of death, no requirement for the Executor to be appointed to the Fund
   – If benefits take longer to deal with, requirement that the Executor takes on Trusteeship role until benefits are dealt with to satisfy the SMSF definition

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Common Misconceptions

Total Wealth / Equalisation

3. If a payment is made out of superannuation directly to a beneficiary, it would be taken into consideration with respect to the distribution of the estate.
   - Only if equalisation clause in the Will
   - Only effective if there are sufficient assets external to superannuation that can be used to equalise
     - Issue with recent case – *Munro*
   - Super assets paid directly not caught in a Family Provision claim – except in NSW (recent case confirmed this also)
   - If no equalisation clause – very inequitable outcome could occur;

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Common Misconceptions

BDBNs

4. The BDBN deals with the benefits, and therefore any other mechanisms within the fund are irrelevant;

5. If there is a BDBN, a lump-sum benefit must be paid out;

6. BDBNs are foolproof

BDBNs – are not Foolproof

BDBNs can be busted for numerous reasons:

- They lapse
- They are executed incorrectly per the deed
- They don’t nominate eligible beneficiaries
- Nominate a lump sum be received – may not be ideal
  - Commencement / continuation of a pension might be more appropriate
  - Could have Centrelink implications
- Contradict pension documents;
  - Pension is reversionary to spouse, BDBN to children
  - Pension rev. to spouse, BDBN LS to spouse or LPR;
  - Centrelink implications.

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BDBNs – Remedies

Read The Deed

- Can the nomination be non-lapsing or is there a term?
  - Currently awaiting High Court decision on this point for SMSF
- Form and execution for it to be binding?
- Acceptance by the Trustee?
- Recipient as well as form?

Read All Documents

- Does the BDBN nominate a dependant or LPR?
- Are there pension documents that show reversionary?
- Which takes precedence – BDBN or reversion?

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BDBNs – Remedies

What are the intentions?

- Ensure BDBN and pension documents aren’t contradictory;
- May have done reversionary pension for Centrelink, however intention is for children to receive
- Follow deed re form, process, execution and any Trustee acceptance
- Ensure terminology is correct.
- *Munro* case highlighted all the areas to look out for

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What If the Deed is Silent…..

As to Process and Procedure?

My View

- SISA 59(1), 59(1A) and SISR 6.17A don’t apply to SMSFs (High Court Case is pending this decision)
- However, consider process in SISR 6.17A(6):
- In writing;
  - Signed and dated in front of two witnesses
  - Witnesses must be over 18 and neither be beneficiaries
  - Declaration by witnesses that signed in their presence
  - Also:
    - Acceptance by the Trustee – resolution / minute
    - Witnesses to not be immediate family.

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Strategies

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Intentions

- The NUMBER ONE consideration with respect to EP is to ensure that you are clear on your intentions:
  - Spouse receives, or children?
  - Spouse gets an amount, balance to children
  - Children get it all
  - Spouse receives, but that's paid then to the children (given the tax implications)
- Tax is secondary – although not unimportant, a beneficiary would be happier to get 85% of something than 100% of nothing
- Asset protection is also a key consideration – no point in building up wealth which then ends up in the hands of creditors or caught up in Family Law scenario.

Preventing Disputes

- Robust documentation – better to have it and not need it, than need it and not have it
- All original documentation should be located and reviewed:
  - often the intention and what the documents convey don't align
  - documents may not be effective / binding
  - restructuring to accord with intentions could have wider implications from a tax and / centrelink perspective
- Factor all family members into the process – nothing can stop an aggrieved beneficiary from making a claim, or at least delaying matters or causing a substantial turmoil and emotional strain for the family, so best to try and mitigate by ensuring there is no room for doubt.

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Blended Families

Reality / Risks

- One in 2.5 marriages ending in divorce;
- Wealth accumulated prior to 2nd (or 3rd / 4th) relationship;
- Intentions:
  - Spouse receives life interest in home
  - Spouse retains own wealth, or receives an income stream for life
  - Children receive capital either at death of their parent, or death of the new spouse
  - Assets to estate for Testamentary Trusts for children for tax and asset protection
  - That everyone gets along……….

Blended Families

What we've learned

- People don't get along;
- Even if they did, money changes all that;
- Control is everything;
- Intentions, if executed incorrectly, mean nothing;
- Intentions can be difficult to implement without the potential for someone doing the wrong thing later.

Strategic Considerations

Considerations	Yes or No (general rule of thumb)?
Deed review	Yes – what are the BDBN requirements, are there additional decision makers in the fund, who actually has control over the fund when a member dies, what happens on incapacity etc?
BDBN	Yes – in light of *Marsella* case, preferred to have the certainty
Reversionary	Not the preferred outcome – given the administrative/ practical issues.
	Yes if beneficiary certainty is important
	DON'T update existing pensions – too many other implications re tax components, loss of CSHCC or Age Pension etc…

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Strategic Considerations

Considerations	Yes or No (general rule of thumb)?
Accumulation to spouse or estate (if spouse is still alive)?	If non-property assets – spouse. Spouse can then transfer assets to inter-vivos trust post receipt for longer term benefits (not as good as testamentary trust)
	If property – estate into Superannuation Proceeds Trust for the spouse.
Succession	Should align with who will be receiving the benefits to mitigate conflict.
	If conflict will be present as everyone is getting a cut, consider an independent LPR
Blended families	Look at having two separate funds – one for the benefit of the spouse, one that the children inherit
	Will will need an equalisation clause

Action Items

- How old is your SMSF Trust Deed?
  - If earlier than 2017, is worth a review / potential update
- Do you have a copy of the original pension commencement documents for your SMSF?
  - If not, documentation from pension restructure in 2017?
- When was the last time you had your BDBN reviewed?
  - If greater than three to five years ago, is worth a review
- When was the last time you had your Will and Enduring Power of Attorney reviewed?
  - If greater than three to five years ago, is worth a review.

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Questions

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