Death of a Member in an SMSF

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Outcomes?

- Death Benefit Nominations
- Insurance Inside of Super
- Changing Trustee's etc after death
  - Definition of SMSF
  - Corporate v Individual Trustees
  - Who controls benefit payments
- Paying Benefits
  - Who to?
  - How?
  - When?
- Anti Detriment Payments
- Capital Gains Tax in the fund after death
- Death of a member where the fund has borrowings

Death Benefit Nominations

- Types of Nominations
  - Non-Binding
  - Binding in Accordance with the SIS Regulations
    - In writing
    - 2 witnesses over the age of 18
      - Must not be beneficiaries
      - Must sign a declaration that the member signed in presence
    - Lapses after 3 years or earlier if governing rules provide
  - Binding not in accordance with SIS Regs
  - Write it into the trust deed

Binding Benefit Nominations

- Section 58 & 59 SISA
  - Only applies to non SMSF funds.
- SIS Regulation 6.17A
  - Forces fund to pay in accordance with BDBN
    - 6.17A(4)
  - Only if BDBN is in accordance with the Regs
    - 6.17(4)(c)
    - Unless the Trustee is subject to a court order
  - Better protection for the member
  - Can be challenged as with wills in NSW

Binding Benefit Nominations

- SMSF's don't have to comply with regs
  - Trust law requirement to pay.
  - Ensure nomination is in form required by deed
- SMSF Will
  - Form of BDBN
  - Again only trust law requirement to pay
- Put requirements in the trust deed
  - Again only trust law requirement to pay

Insurance inside Super

- Life Insurance
  - – Allocate to member directly.
  - – Have the SMSF as beneficiary
    - Possible sole purpose test issue
- TPD
  - – Look at definition in Governing Rules
  - – Lump Sum tax if benefit paid under 55
  - – Full premium now deductible
- Income Protection

Changing Trustee's after member dies

- Definition of SMSF
  - S17A SIS
  - All members to be trustees s17A(1)
  - Can use your LPR after death until benefit paid s17A(3)(a)
    - LPR is one or more executors – not necessarily spouse
  - You have 6 months to rectify s17A breach
    - No need to appoint LPR for 6 months
  - Corporate trustee much easier
    - Changing asset ownership etc

Changing Trustee's after member dies

- Changing Trustees
  - Must be by registered deed
    - Section 6(1) Trustee Act NSW
    - Rarely actually registered
  - No need with Corporate Trustee

Paying a benefit – who to

- Regulation 6.17A SISR
  - Must be paid to dependent
  - Or Legal Personal Representative (i.e. Estate)
- Dependent SISA s10.1
  - Common law definition Plus Financial Dependent
- Dependent ATO s302.195
  - includes former spouse
- Can pay to SIS dependent but tax based ITAA definition

Who controls the payment

- Where there is a binding death benefit nomination
  - Must be paid in accordance with the nomination
  - Beneficiary could challenge
- No (or invalid) Nomination
  - Important to structure trusteeship after death
  - Katz v Grossman
- Courts can overrule
  - Be conscious of the 6 months to challenge

Paying a benefit – when/how

- Regulation 6.21 SISR
  - Must be paid “as soon as practical” after death
  - Up to 2 lump sums (can not be more than 2) or
  - 1 or more pensions
  - Pensions can only be paid to a dependant or child

Child Pension

- Regulation 6.21 SISR
  - Child must be less than 18 years of age, or
  - Less than 25 and financially dependent, or
  - Have a disability
- Must be paid out as a lump sum at age 25
  - Unless the child has a disability
- Tax free to the child s303-5 ITAA97

Anti Detriment Payments

- Prior to 1 July 1988 lump sum payments on death to a dependant not subject to any tax

- 1 July 1988 Introduction of 15% contributions tax
  - Seen as quasi death duties

- Government introduced tax concession on death benefit payments
  - Lump sum payment
  - Equivalent of Contributions Tax paid by the member
  - Restore pre-contributions tax benefit

Section 295-485 ITAA 1997

- Prior to 01/07/20007 anti detriment provisions were contained in Section 279D ITAA 1936
- New Section 295-485 ITAA 1997
- Formula Method Updated in ATO ID 2007/219 and again in 2010/5
- Fund must have been continuously complying since 1 July 1988
- ATO Satisfied full benefit passed on to death benefit recipient

- **INCOME TAX ASSESSMENT ACT 1997 - SECT 295.485**
- **Deductions for increased amount of superannuation lump sum death benefit**
- (1) An entity that is a * complying superannuation fund, or a * complying approved deposit fund, and has been since 1 July 1988 (or since it came into existence if that was later) can deduct an amount under this section if:
  - (a) it pays a * superannuation lump sum because of the death of a person to the trustee of the deceased's estate or an individual who was a * spouse, former spouse or * child of the deceased at the time of death or payment; and
  - (b) it increases the lump sum by an amount, or does not reduce the lump sum by an amount (the *tax saving amount) so that the amount of the lump sum is the amount that the fund could have paid if no tax were payable on amounts included in assessable income under Subdivision 295-C.*
- (2) The fund can deduct the amount in the income year in which the lump sum is paid.
- (3) The amount the fund can deduct is: Tax Savings Amount / Low tax component rate
  - where: *"low tax component rate" is the rate of tax imposed on the low tax component of the fund's taxable income for the income year.*
- (4) The amount the fund can deduct for a superannuation lump sum paid because of the death of a person to the trustee of the deceased's estate is so much of the subsection (3) amount as is appropriate having regard to the extent to which individuals referred to in paragraph (1)(a) can reasonably be expected to benefit from the estate

Who can Receive

- Spouse or Former Spouse of the deceased
  - New definition of spouse
  - Same Sex Couples
  - Interdependency relationship
  - ITAA Definition of Dependent different to SIS definition.
- Child (if any); or
  - Includes step child or adopted child
- The Estate (if ultimate beneficiary is as above)
- Must be paid as a lump sum and benefit paid as a lump sum.
  - Within 6 months of death or 3 months of probate (whichever is later)
- Not available on Terminal Illness payment before death

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Method of Calculation

- Calculate the amount of contributions tax paid by the member on the death benefit
  - Needs to be certified by the auditor
- Formula method acceptable to the commissioner
  - ATO ID 2010/5
- Acceptable Formula: (0.15 x P)/(R-0.15 x P) X C where:
  - P = number of days in component R that occur after 30/06/1988
  - R = Total number of days in the service period after 30/06/1983
  - C = Taxable component of lump sum excluding insurance benefits for which tax deductions have been claimed
  - Assumes no untaxed element
- Or use calculator at www.cst.com.au

Sources of Anti-Detriment Payments

- Use a reserve
  - Problems if you decide not to pay an anti detriment payment
  - S 292.25.01(4) ITAR97
- Life Insurance Policy
  - Owned by the fund and not allocated to the member
  - Payments are a general expense of the fund and not allocated to the member
  - May have a sole purpose test issue
- Take from other members balances:
  - Must ensure that the Future Income Tax benefit will be used up
- ATO March 2010 Superannuation Technical Minutes:
  - *“The true source of the anti-detriment payment is always future income tax benefit created by the anti-detriment payment. The use of ‘reserve’ is simply one of the mechanisms used”*

Other Issues

- Tax Free Pension Income offsets carried forward tax losses
  - Consider if you will be paying a pension after claiming the deduction
  - Roll out pensioner member to their own fund and leave accumulation members in the fund
- Re-Contribution Strategies reduce Anti-Detriment amount
  - You need to model these numbers
- Maybe roll out members balance to public offer fund if you can plan that.
  - Must ensure that the Fund pays Anti-Detriment Payments

Example

- Mum and Dad fund with two kids in the fund
  - Both Mum and Dad over 60
  - Kids in their 30's and making contributions
  - Assume only asset of the fund is cash
- Balances:
  - Dad: $400,000 – ESP starting 1 July 1988
  - Mum: $150,000
  - Child 1: $30,000
  - Child 2: $20,000
- Dad Dies
  - Using Calculator Anti Detriment amount is: $56,166
  - Allowable deduction is $374,443
  - Death benefit is $456,166
- Source of Funds – other members accounts (well, not really)

Example

- Cash payment to mum as beneficiary of $456,166
- Balance Sheet after payment:
  - Assets: Cash: $143,834
  - FITB: $ 56,166
  - Net Assets $200,000
- No change to remaining members balances after payment:
  - Mum: $107,876 cash plus FITB $42,124 = $150,000
  - Child 1: $21,575 cash plus FITB $8,425 = $30,000
  - Child 2: $14,383 cash plus $5,617 = $20,000
- Need to roll Mum out or pay her a lump sum

Capital Gains Tax

- TR2011/D3
  - After death members balance reverts to accumulation
  - Unless reversionary pension under provisions in deed
  - Draft ruling only
  - Capital gains can be managed here
- Pensions can ONLY be paid as Cash
  - Superannuation Technical Minutes March 2011
  - Death of pensioner with no reversionary
  - Capital gains can't be managed here
  - Use Anti Detriment payment to offset CGT

Fund has borrowings

- Example
  - Fund has property worth $500,000 and debt of $300,000
  - Two members both with balances of $100,000
  - If member dies, fund wants to keep the property
  - Need to pay lump sum benefit (and maybe Anti Detriment Payment)
- Use of Life Insurance
  - Have a policy owned by the fund (possible Sole Purpose Test issues)
  - Need to insure fro members balance PLUS other members' share
  - Example above assume insurance of $200,000
  - After death of member fund becomes worth $400,000
  - $200,000 per member
  - $200,000 cash paid to beneficiary of deceased member
  - $200,000 equity now with other member

Questions