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YourGuardian

10 things you need to know about Death and your SMSF

Death and its impact on an SMSF is a grey area for many trustees, accountants and advisers.

We highlight some of the important facts you need to consider in this newsletter.

Your member balance reverts to accumulation mode upon your death

Many people assume that capital gains and losses are no longer a consideration when a fund is in full pension mode. Whilst this is true, if the pension member has not elected an eligible reversionary, the fund will revert to accumulation mode on death. At this point income and capital gains are again taxable within the fund.

There are several strategies around this, including:

- Establish a reversionary pension;
- Reducing the taxable component of a member balance;
- Refresh the cost base of assets in your portfolio* or

*Whilst 'washing' shares to reset cost base can be seen as tax avoidance, legitimate trading of securities and turnover in a portfolio is acceptable to the ATO. We recommend you seek advice prior to implementing this strategy.

Your super isn't automatically dealt with as part of your estate

Your super is not automatically dealt with as part of your will. It is the governing rules of the SMSF that determine what happens to your balance when you die.

The Trustees of your SMSF may have the discretion to distribute your superannuation to any 'dependent' upon your death unless a valid binding beneficiary nomination is in place.

For this reason, your death benefit nomination is a vital document and should be considered as part of your estate planning.

A death benefit nomination is a form that can be updated at any time, and should be reviewed regularly (especially in the event of the death of a nominated beneficiary or divorce).

Your Nomination of Beneficiary Form may not be legally binding

Prior to May 2009, in order for a nomination to remain valid, there was a legal requirement to renew and sign a binding nomination form every three years.

For a nomination form to be legally valid it must be witnessed and signed by 2 independent parties not nominated on the form and who are at least 18 years of age.

This posed a great risk to SMSF members, as anybody forgetting to renew their form every 3 years no longer had a binding nomination in place. It is likely that most SMSF members who do not work with a financial adviser or SMSF administrator do not hold a binding nomination on file.

This may not be a great risk in the scenario where the only members are spouses. However, consider a single member fund, where alternate directors are appointed on death, or a 4 member fund where the members are related parties. If one of the members dies and does not hold a legally binding nomination form, it is at the other trustees' discretion as to where and how the death benefit payment is made.

You can elect to have a perpetually binding nomination

In May 2009 a 'perpetually binding' nomination was introduced. This means once completed and witnessed it would continue to have validity unless updated or replaced.

As this only recently came into effect, we recommend trustees review their deed and consider upgrading if necessary prior to putting a perpetual binding nomination in place.



You can't pay your super to just anybody

There are restrictions on who can receive your super death benefit.

Your death benefit nomination is restricted to either:

- A dependent including: spouse (de-facto); children (including those over 18 years but with possible tax consequences); tax dependent or any person with an interdependency relationship
- Legal Personal Representative which includes: the executor of the will or the administrator of the estate.
- Friends, siblings, parents and other relatives are not normally 'dependents' and should only be nominated if there is an interdependent relationship.

You can claim an interdependent relationship if applicable

An **interdependent relationship** is a close personal relationship between two people who live together where one or both provides for the financial and domestic support and care of the other. This definition may include parent-child relationships that don't fall within the definition of death benefits dependent, and sibling relationships.

For example:

- Two sisters, divorced and now living together with no children. If they are seen to have an 'interdependent relationship' valid death benefit nominations can be made by each of them naming the other as their respective beneficiary of their superannuation death benefits.

It is strongly advised that specialised legal advice be sought if you wish to make a nomination based on the existence of an interdependent relationship as described above.

A portion of a death benefit paid to an adult dependent can be taxable

The 'taxable component' of your member balance will be taxable in the hands of the recipient of your superannuation death benefit if they are not your dependent.

Many SMSF members don't fully understand the 'taxable' and 'tax free' components that are listed on their member statements.

On 1 July 2007, the proportioning rule came into effect, introducing a 'tax free' and 'taxable' portion of a member balance.

The 'tax free' component will generally comprise:

- Non-concessional contributions
- Spouse contributions
- Government co-contributions
- The old pre-July 83 component before crystallisation

The 'taxable' component will generally comprise:

- Member concessional contributions
- Employer contributions
- Share of income/loss

Example

John Smith has nominated his 26 year old 'non tax' dependent adult daughter, Claire Smith as his beneficiary.

Member Balance	\$500,000
Taxable Component	\$220,000
Tax Free Component	\$280,000

Should the entire amount be paid as a death benefit payment, the tax would be calculated as follows:

Taxable Component:
 $\$220,000 \times 16.5\%$ (SMSF tax rate + medicare)
= \$36,300

As indicated above, the tax on the taxable component of your super can significantly reduce the final amount distributed as a superannuation death benefit to your nominated beneficiary.

There are a number of strategies available to alter the taxable/tax free proportion in your SMSF, including:

- Maximising non-concessional contributions to your fund up to the applicable cap. These contributions are applied to the 'tax free' component of your member balance.
- Withdrawal and re-contribution strategy* – If you meet a condition of release, funds are withdrawn from the super fund by way of pension or lump sum withdrawal (tax free to those over the age of 60), and then re contributed as a non concessional contribution up to the applicable cap. Funds withdrawn are done so on a proportionate basis (consisting of both tax free and taxable components, depending on the member balance). They are then re contributed as 100% tax free.

*We encourage SMSF members to seek appropriate financial advice before considering such strategies.

You can continue your pension after you die

SMSFs have the ability to pay a reversionary pension if their trust deed allows it.

When commencing a pension, members can nominate an 'eligible reversionary beneficiary'. With this nomination in place, upon death, the pension will continue to be paid to the reversionary beneficiary and there is no need for the account to return to accumulation phase.



The member benefits will then remain in the tax free environment and the death benefit will not be reduced by the additional SMSF Income.

Case Study

Barry Jones establishes his \$500,000 pension with a reversionary beneficiary, his wife Penny Jones.

When Barry passes away, the pension status of Barry's account remains and Penny is now in receipt of the pension. Penny can then decide to either draw down all or part of the balance as she requires and any disposal of assets is tax exempt.

In the event that Penny does not need to access the capital, she can leave the assets within the reversionary pension – and any income earned or capital gains on those assets is tax free. She will still be required to draw a minimum pension annually.

By simply establishing a reversionary pension, Barry has avoided the fund having to revert back to accumulation mode and commence a new pension for Penny.

Replacing your role as Trustee when you die

As an SMSF Trustee, you should consider who will replace you when you die, and even further, who will step in to handle your affairs should you lose capacity to run your fund.

When an SMSF member dies, the fund has 6 months from the date of death to arrange a suitable replacement for you as fund Trustee.

A number of funds are comprised of husband/wife. In the event of death, you could convert your fund to a corporate trustee structure, with the remaining member in the SMSF acting as sole trustee/member.

Alternatively, you could consider appointing a second individual to act as Trustee. Such a decision should not be made without professional legal advice.

Don't forget divorce

As many people sign their death benefit nominations without really understanding what they are, there is a risk you may forget about them and miss an important event.

For example, it is common where you have a husband/wife fund for 100% of the death benefit to be paid to the spouse.

In the event of divorce, it is vital that the death benefit nomination be updated as well as the individual's will. An incorrect assumption that your superannuation is dealt with as part of your will could result in your ex spouse receiving your super death benefit which would not have been your intention.

Summary

We hope this newsletter has highlighted the importance of planning, being prepared for the inevitable and understanding the importance of the beneficiary nomination process.

SuperGuardian clients can view their current nomination form at any point in time by logging into their account online, and selecting the 'permanent documents' folder.

This area can be highly complex and the consequences of action or inaction can be significant. As always, we strongly advise you seek specialised legal advice when dealing with estate planning and super matters.

To discuss any aspect of this newsletter in more detail please contact [Olivia Long](#) or your [Client Manager](#) on 1300 787 576.



Superannuation administration made simple!



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