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Technical Bulletin: SMSF and Estate Planning Considerations

Much planning and effort is put into the establishment and growth stage of self managed super funds (SMSFs), the same effort and planning should be placed on the end of the SMSF membership/trusteeship lifecycle.

Whilst superannuation does not automatically form part of an individual's estate it should always be an estate planning consideration. Ultimately, having a robust plan in place can help alleviate stress on the family and loved ones of the deceased during what is generally a difficult time.

Estate planning considerations

When a member dies there are three critical considerations for the SMSF:

- How much is required to be distributed
- Who will the benefits be distributed to and how
- Who is in control of the decisions being made

It is that third point that is the subject of this bulletin, understanding that it is not only about the SMSF complying with its obligations to pay a death benefit but also its obligation to comply with the definition on an SMSF.

Resolving disputes

Unlike APRA-regulated funds, parties to an SMSF death benefit do not have access to the Australian Financial Complaints Authority (AFCA) to resolve disputes, as was the case with the Superannuation Complaints Tribunal for all disputes prior to 1 November 2018. As such, any disputes that cannot be resolved between the SMSF trustees and the deceased's beneficiaries/legal personal representatives (LPRs) are likely to wind up in the court system. This is often a very timely, costly and unpleasant experience especially for the losers. To avoid this, or at least to limit the likelihood of this occurring, it is important to ensure that appropriate plans are put in place to limit any such disputes.

Who is left holding the purse strings cannot be overstated as being one of, if not, the most important elements of SMSF estate planning.

Have you ever wondered who would control your SMSF if you couldn't?

When setting up an SMSF, members often don't take the time to think about some of the issues that they might face in the future, whether it be an unexpected loss of capacity, through illness or accident, or their untimely death. Some important questions to consider are:

- If you are unable to make decisions who would have control over your SMSF interests?
- Who would safeguard your best interests in the event that you lose capacity or die?

Where blended families are involved the above questions become even more important especially as death often triggers previously dormant animosities. Therefore, SMSF estate plans should be reviewed on a regular basis to ensure that any changes in a person's circumstances are incorporated.

Control is often stated as the primary reason for having an SMSF. Yet at the time when an individual needs it the most, they often haven't implemented appropriate contingencies to execute it. As there is now a need to rely on other parties to exercise control given the individual has either lost capacity or died, more than ever appropriate and consistent documentation is a must.

Documentation considerations

It's inappropriate to make a generalised statement about what SMSF trust deeds cater for. It's not inappropriate to suggest that all (or many) deeds are different, and to rely on generalised statements about how to handle SMSF estate planning is a dereliction of duty to clients. Therefore, it's important to know your Deeds. Arguably, there is a minimum requirement to ensure SMSF clients have the following in place as part of the establishment process:

- Written for purpose Trust Deed
- Last Will and Testament
- Enduring Power of Attorney
- Nomination of beneficiaries (binding or otherwise)

By extension, all superannuation members regardless of whether they are in an SMSF should have the final three documents.

Each document in isolation may only provide part of the solution but what is certain is that at the core of all estate planning disputes is the documentation. Below are references to significant cases, not all SMSFs but all relevant to SMSFs. In each case that relates to an SMSF the judgement has hinged largely on the wording of the trust deed and accompanying nominations. They are all costly exercises for the parties involved but valuable lessons for those of us who learn from others. The biggest mistake is assuming that everyone will do the right thing.

Appointing legal personal representatives

There is a fallacy that a member's legal personal representative (LPR) will step in and take care of things when the member dies, or loses capacity. It can happen and some deeds will mandate it but up until now it has been the exception rather than the rule. As it stands, the law provides the ability to appoint the LPR in place of the member but it doesn't require it. Further, an LPR appointment requires that person/s consent to act and acknowledgement that they understand their obligations as trustee. The following cases summarise a few examples whereby the existing trustees acted without appointing the LPR, not all ended well for the trustee.

Katz v Grossman [2005] NSWSC 934

- *Son and daughter joint executors of fathers estate*
- *Father makes non-binding nomination to split benefit 50/50*
- *Daughter existing trustee of SMSF*
- *Post father's death, daughter appoints her husband as second trustee*
- *Trustees determine to pay benefit entirely to daughter*
- *Son challenges trustee appointment but fails*

Ioppolo & Hesford v Conti [2013] WASC 389 & Ioppolo v Conti [2015] WASCA 45

- *Wife and second husband are individual trustees of SMSF*
- *Wife appoints two of her children from first marriage as her executors*
- *Wife dies, husband seeks advice not to appoint children as trustees*
- *Husband pays pension to himself then replaces himself as individual trustee with a sole director corporate trustee*
- *Children argue that mum's wishes were to have super benefit paid to estate*
- *Courts agree with husband*

Dawson v Dawson [2019] NSWSC 826

- *Father appoints his son from first marriage as enduring power of attorney*
- *Father appoints son of his second wife as executor of his estate*
- *Father loses capacity and first son is duly appointed as trustee, everyone agrees with this action*
- *Father dies and wife and her son prepare minutes that first son is automatically removed and they agree to appoint executor as LPR*
- *First son disputes actions and courts agree that even though the appointment was because the son held an EPOA, he was still a trustee in his own right and was not required to be removed.*
- *This at least provides both families a say in how benefits are distributed*

Re Marsella: Marsella v Wareham (No 2) [2019] VSC 65

- *Opposite outcome to Katz v Grossman*
- *Second marriage - mum single member SMSF, mum and daughter individual trustees*
- *On mum's death daughter appointed her own husband as second trustee*
- *Determined to pay benefit 100% to herself and not to consider step-father*
- *Court determined that decision not made in good faith and animosity between step-father and daughter was factor in decision. Animosity was not apparent whilst mum was alive*
- *Court determined to remove the trustees and require benefit payment to be repaid*

The above cases highlight, amongst other things, that not all existing trustee appointments will result in the deceased having their death benefit wishes granted.

Choosing a suitable Trustee for your SMSF

In all of these cases the outcome could have been avoided with proper planning and documentation.

There is no doubt that the issues raised in these cases could also have been avoided by having a legally binding nomination in place which will be discussed in further detail below.

The other way these matters could have been avoided, or handled better, was by ensuring the trustee structure of the fund had mechanisms put in place, via the trust deed, that deal with the appointment of the LPR on the death of a member, if appropriate.

Whilst the majority of cases that go before the courts deal with blended families, it is good practice to ensure the appropriate structures are put in place in situations of single member funds and single spouse scenarios.

One of the commonly asked questions is what is the appropriate trustee structure.

Corporate vs Individual Trustee

A quick recap of the definition of an SMSF identifies that there are 2 alternatives trustee structures available:

1. The individual members of the fund are also individual trustees. In the case of single member funds there must be 2 individual trustees.
2. The fund has a corporate entity to act as trustee in which case all members are directors of the company. Single member funds can have a company with a sole director or can have a second director appointed.

It is widely accepted by the ATO, and professionals in the SMSF industry, that a special purpose corporate entity is the preferred option to act in the role of trustee. It is not without its issues but a corporate trustee can make for an easier transition when a member dies.

Sole Director Companies

Single member sole director SMSFs need to be aware that a company is subject to ASIC penalties if it doesn't have at least 1 director. Therefore, it is important that provisions are put in place, and certainty exists, as to who will replace the member as director of a corporate trustee in the event that the member dies and this occurs as soon as possible.

When an SMSF has two or more members and all are directors, the ability to appoint a new director will fall to either the surviving director or the company shareholders so it is important to know what the constitution says and document any decisions appropriately. Most special purpose SMSF trustee companies have shareholding structures that reflect the directorship but it is always important be be sure.

Extended definition of an SMSF

In addition to the standard definition of an SMSF, the law provides that a fund does not fail the definition if the members Legal Personal Representative is trustee in the place of the member. For the purposes of death it defines the LPR as the executor of the will or the administrator of the estate of the deceased. It also includes a person who holds an enduring power of attorney over the member.

This extended definition does not mandate the appointment of the LPR, it just offers it as an alternative, and in the event of death it identifies that the appointment is only until the death benefit commences to be paid.

As a result it is often the case that SMSFs do not appoint the LPR. In these instances the remaining trustee is reliant on the 6 month rule.

Six month rule

An SMSF will still satisfy the definition of an SMSF and be a complying superannuation fund for 6 months following an event that would otherwise see it failing to meet the definition. So long as the trusteeship is rectified by the 6 month anniversary then there is no issue. As stated above, this requirement is another indicator that the LPR is not required to be appointed as trustee of the fund upon death.

In the event that one member dies, then the surviving trustee can undertake all of their normal duties and come 6 months either appoint a second individual trustee or create a sole director corporate trustee. Of course if they are adding more members then they need to add that person as trustee or director immediately, as the 6 month rule doesn't apply to new members.

Ultimate control over decision making

As the legal cases referred to above, in the case of individual trustees, the surviving trustee often has the ability to appoint whoever they see fit as a Trustee and thus has ultimate control over the running of the fund and payment of any benefits subject to the deed and the existence of binding nominations. With a corporate trustee there is still the opportunity for surviving directors to appoint other parties to the directorship of the company but all actions must be taken in accordance with not only the deed but also the company constitution.

Power of Attorney and wills - nominating LPRs

Ideally an individual will nominate the same person to hold an enduring power of attorney and act as executor of their estate, if for no other reason it will avoid conflict such as those experienced in Dawson vs Dawson.

Superannuation law does not prohibit the appointment of multiple LPRs as trustee in place of a member. It is not mandatory if someone has multiple LPRs that they all be appointed but it also does not breach the definition of an SMSF to have more than one person replace the existing member.

Likewise, a surviving member can act in dual capacity and as such when the deceased's capacity to act as trustee ceases (on death), then the surviving member is already satisfying all of the requirements to meet the definition of an SMSF for the death benefit payment period, and in the instance of corporate trustees, also for the period beyond 6 months.

The importance of a Will

Whilst it is yet to be publicly tested in the SMSF space, we are starting to see a number of instances where individuals die intestate and a family member applies for letters of administration. This in itself is not problematic but what has also been occurring is that these same family members are also applying to superannuation funds as beneficiaries, often under the guise of interdependency.

In the cases listed below it is clear that once you have applied to administer the estate then making a claim personally for the super, rather than via the estate, is a breach of fiduciary duties.

Obviously this again references us back to the importance of documentation. If a member has a will and nominates their LPR and that same LPR is the other trustee of the fund and a person subject to payment of benefits under a binding nomination, then clearly document this and don't let it be up to the interpretation of others.

Recent cases that outline these issues include:

- McIntosh v McIntosh [2014] QSC 99
- Burgess v Burgess [2018] WASC 279
- Brine v Carter [2015] SASC 205

Paying out benefits from your Fund

As is known, superannuation benefits do not automatically form part of a deceased person's estate. Due to this fact it is important to have plans/instructions in place to deal with your super benefits on your death. The purpose of this bulletin is to highlight the control issues and so whilst we won't go through the death benefit payment process and options, it is important to understand that one of the key element of control is member nominations, and specifically binding nomination.

Binding death benefit nomination

A binding death benefit nomination is the document that binds the trustee on who is to receive an individual's superannuation benefits and as such is one safeguard against unscrupulous surviving trustees or vested interests. If prepared correctly, the document is legally binding on the trustee and must be followed, this doesn't always mean it will be, see 'Wooster v Morris' below. An invalid nomination, however, can be ignored by the trustee and the decision as to where your benefits are paid left to their discretion, but only to the extent of its invalidity, see 'Re Narumon'.

As per the Katz v Grossman and Ioppolo & Hesford v Conti cases above, the events could have been avoided had the nominations been made and executed in the correct manner. Other cases, such as Donovan v Donovan (2009) and Munro v Munro (2015),are further evidence of the importance of getting your documentation correct. In all instances mentioned, the wishes of the deceased were overturned in court and the decisions of the surviving trustee upheld. While it can sometimes be a costly exercise initially it is far cheaper than the alternative legal costs in going to court to deal with a dispute.

The following two examples highlight some key issues:

Wooster v Morris [2013] VSC 594

- *Mr Morris had two daughters from previous marriage*
- *Mr & Mrs Morris had an SMSF and were individual trustees*
- *Mr Morris made a binding death benefit nomination in favour of his daughters*
- *After Mr Morris died, Mrs Morris sought advice (incorrectly) that the binding nomination was no longer valid*
- *Mrs Morris firstly appointed her son as second trustee of the fund and then they resigned and she appointed a corporate trustee*
- *Trustees determined to pay the benefit to Mrs Morris*
- *The daughters applied and were successful in determining that the nomination was binding*
- *All court fees had been paid out of the benefit of Mr Morris significantly depleting the value, the court held that the benefits could be paid out of Mrs Morris' benefit*

Re Narumon Pty Ltd [2018] QSC 185

- ***Mr Giles appointed his wife Narumon Giles and his sister as his enduring power of attorney***
- ***Mr Giles regularly made binding nominations nominating majority of his benefits paid to his wife and son and a small portion to his sister***
- ***Final binding nomination Mr Giles made before he lost capacity was 47.5% to each his wife and son and 5% to his sister***
- ***When he lost capacity his EPOAs determined to extend the existing binding nomination for a further 3 years (as a separate issue this case and others have questioned the validity of SMSF using 3 year rules)***
- ***At the same time the EPOAs determined to change the nomination to represent 50% to each of the wife and son and nothing to the sister as she was not a superannuation dependent and as such her nomination was invalid***
- ***Mr Giles died and the trustees determined to seek guidance on the validity of the EPOA amending the binding nomination, amongst other issues***
- ***The courts held that there was no issue in the EPOA extending the original nomination as it was clear that this was in alignment with the members wishes***
- ***The courts held that the EPOA could not amend the nomination as this was a conflict with the previous nomination and under Queensland Powers of Attorney law the EPOA could not create a conflict***
- ***The courts held that the invalidity of the nomination did not invalidate the entire nomination, just the 5% to the sister***

Nomination lessons

What we can take from the courts is that a nomination is valid to the extent that it is not and so one bad call on a nomination may not create an issue for any other nominees, although trustee discretion will subsequently apply to the invalid portion.

We also know how important wording is. In Munro v Munro the member nominated the 'trustee of the estate' to receive the benefits and made no mention of the legal personal representative. The instructions on the form provided for nomination of the executor of the will as long as it also stipulated in the capacity as LPR. It's important to clearly articulate what is required.

Other matters that have not been fully explored here but have certainly been referenced through the courts are the need for a binding nomination to be served to the trustees of a fund. Different deeds will say different things. If the deed requires the nomination to be provided to the trustee then this needs to be appropriately documented. Not all deeds require this.

As in Cantor Management Services P/L V Booth [2017] 122 the fact that the binding nomination was held at the offices of the registered address for the corporate trustee was enough to satisfy this requirement. At the end of the day, read the deed.

Making nominations

Any superannuation death benefit nomination should be made in contemplation of other estate planning matters, including any existing pension arrangements i.e. does an existing pension have a reversionary beneficiary and if so does this tie up with the instructions in the beneficiary nomination form? Which takes precedence? If both the pension documentation and nomination form do not align, it is recommended that both should be reviewed and updated as necessary. Contradictions with other plans may increase the likelihood of legal challenges.

It is also essential to know who can be nominated to receive your benefits, this includes your spouse (including de-factor and same sex partner), child of any age and someone who you had an interdependent relationship. Nominating someone who does not fall into one of those categories will make the nomination invalid. We've discussed this in further detail in our fact sheet **Death benefits – who can be a beneficiary under superannuation law.**

Conclusion

There is a great deal to consider when it comes to estate planning and there are so many more cases that can be referenced. Ultimately the best course of action is to seek appropriately qualified legal advice and to ensure all documentation achieves the outcomes that the members desire.

As a follow on from this bulletin our next topic will be dealing with death benefits in a transfer balance cap environment including the pros and cons of reversionary v non-reversionary vs lump sums.

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