CHILDREN OF THE SMSF

Supposedly using defined benefit (DB) pensions for estate planning purposes rather than for the sole purpose of providing retirement benefits is one of the main reasons for the recent restrictions on the payment of DB pensions from self-managed superannuation funds (SMSF).

One suggestion is that members of an SMSF have been using lifetime pensions that have a reasonable benefit limit (RBL) value much lower than the actual value of the assets supporting the pension. The difference between the RBL value and the actual value of the assets is channelled to the fund's reserve account, and this reserve account is eventually distributed to other members of the fund. This practice can avoid excessive RBL issues by filtering the reserve to the children or spouse of the pension recipient.

If the pension recipient were to instead commence an allocated pension with the portion in excess of their RBL, upon death the beneficiaries would receive a death benefit after excess benefits tax (a maximum of 48.5 per cent) had been deducted.

When paying a death benefit, there is also the issue of the transfer of ownership of assets out of the superannuation fund, which could be time consuming and have brokerage fees as well as capital gains tax (CGT) implications for accumulation members. If the children or the spouse are members of the fund, there is no need to redeem or transfer the assets out of the fund if the allocation is direct from the reserve account to their member balance.

Any distribution made from the reserve will be subject to preservation, may be surchargeable, and will count towards the recipient's RBL when taken as a lump sum or pension. This may be unattractive if the recipient of a reserve distribution is not at preservation age and needs access to capital, or if the recipient already has RBL issues.

In order to make the most of these estate planning opportunities involving a reserve, mums and dads, as trustees of a fund, needed to consider the option to appoint their children as members of the fund (and hence also as trustees). However, the pros and cons of introducing children into a typical mum and dad fund go beyond any reserving strategy.

An important issue is that an SMSF must have less than five members. If a couple has more than two children, they will have to select only two to join the fund with them. The decision of which children to choose will inevitably cause friction within the family.

When the trustees decide to introduce their children as trustees of the fund, this will water down the parents' decision-making power on their own assets as all trustees will need to be included in all decisions made with the fund. This could lead to chaos when a child trustee with a minimal balance in the fund decides to object to mum and dad making a certain investment decision. Taking a rather bleak view, child members may also occasionally look at parents' super benefits after mum and dad pass away, ignoring what is best for mum and dad right now.

In addition to being responsible for all decisions within the fund, all trustees are equally liable for any SIS breach the fund makes. Regardless of whose fault, each member could potentially lose 48.5 per cent of their super assets to the Australian Taxation Office if the fund is considered non-complying.

In some circumstances, however, the introduction of children can be beneficial. A two-child, two-parent family will fit nicely in the four-person SMSF environment. This will give adult children a chance to accumulate their superannuation benefits with maximum investment control. All expenses, levies and fees associated with having the advantage of an SMSF can be diluted between the four members.

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When the parents pass away, the existing assets do not necessarily need to be transferred out of the fund in order to go to the beneficiaries. A fresh pension can commence to the children or other arrangements may be made.

Upon death of the parents, the remaining children may decide to introduce their spouses into the fund (keeping to the four-member rule), saving on fund establishment and administration costs. For the purposes of decision making, it may be preferable for one of the children at this stage to roll out of the fund, and establish a new SMSF for their prospective family's benefit (trustees should be diligent, as any transfer of asset ownership can have CGT implications, which can potentially be minimised).

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