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# Death and SMSFs

Clarifying all the issues

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# Your Presenter



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# Questions?



You can type them in the “Questions” box now,  
Or contact me via:

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# Today's session will cover

- Incapacity – relating to SMSFs
  - Implications
  - How to plan for it



- Death – relating to SMSFs
  - Implications
  - How to plan for it



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# Who has been involved with a Member incapacity in an SMSF?

- a) Yes
- b) No

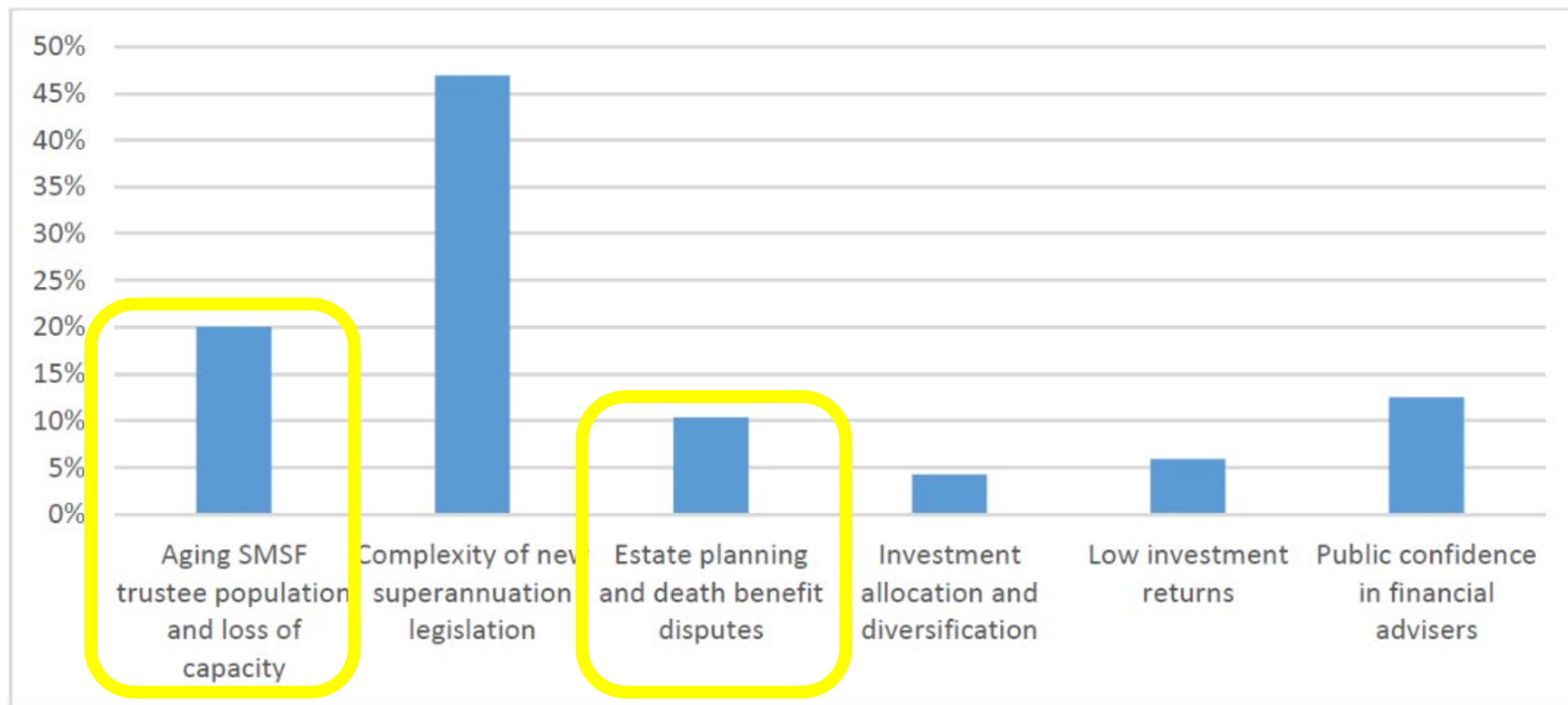
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Who has been involved with a Death of a Member in an SMSF?

- a) Yes
- b) No

# Recent SMSFA survey – it's a growing issue

What is the single biggest challenge you believe the SMSF industry is currently facing or will face in the near future?





# ATO Trustee Declaration

## Sole Purpose

I understand it is my responsibility to ensure the fund is maintained for the purpose of providing benefits to:


- the members upon their retirement (or attainment of a certain age) or
- their beneficiaries if a member dies.

***I understand that I should regularly evaluate whether the fund continues to be the appropriate vehicle to meet this purpose.***



# Incapacity – why do we need to worry?

ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/setting-up-an-smsf/appoint-your-smsf-trustees

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Setting up an SMSF

Choose your SMSF trustee structure

Appoint your SMSF trustees

Check your SMSF is an Australian super fund

Create the SMSF trust deed

Holding SMSF assets

Register your SMSF

Set up your SMSF bank account

Get an electronic service address

Create your SMSF investment strategy

Prepare an exit plan

## Eligibility of trustees and directors

All members of your self-managed super fund (SMSF) must be individual trustees or directors of the corporate trustee. When selecting fund trustees, you need to make sure they're eligible.

### Who can be a trustee

Members are eligible to be a trustee if they're:

- at least 18 years old
- not under a legal disability such as mental incapacity
- not a [disqualified person](#). A disqualified person includes a person who has been convicted of dishonest offences, is bankrupt or insolvent, or may be a future risk to retirement savings.

It is an offence to knowingly act as a trustee while being a disqualified person. A legal personal representative (LPR) cannot act as trustee on behalf of a disqualified person either.

You may have to appoint an LPR to be the trustee or director where a member:

- is over the age of 18 with a legal disability
- is under the age of 18
- requires a person to hold enduring power of attorney to act on their behalf (see [SMSF Ruling SMSFR 2010/2](#))
- is deceased, until the death benefit becomes payable.



# Incapacity – why do we need to worry?

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# Incapacity – defined

- Legal disability
- Generally refers to a member being unable to make decisions or manage their financial affairs due to mental or physical impairment
- Arrangements need to be in place before the impairment happens
- Enduring Power of Attorney (EPoA) to be validly executed / signed up before it is too late



## **SIS Act s17A(3)(b)(i) & (ii)**

(b) the legal personal representative of a member of the fund is a trustee of the fund or a director of a body corporate that is the trustee of the fund, in place of the member, during any period when:

- (i) the member of the fund is under a legal disability; or
- (ii) the legal personal representative has an enduring power of attorney in respect of the member of the fund

[https://www5.austlii.edu.au/au/legis/cth/consol\\_act/sia1993473/s17a.html](https://www5.austlii.edu.au/au/legis/cth/consol_act/sia1993473/s17a.html)

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# Steps to take with incapacity

- Need valid EPoA – can't set it up 'after the event' – too late!
- Review deed / constitution acceptance of the change in Trustee / Director
- Document decisions
- It depends on the SMSF structure:
  - Individual trustees
  - Corporate trustee
- Can have two member fund have 1 Trustee, acting as self and under EPoA
  - will not result in a breach of the SIS definition



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# Trustee structure dictates next steps

## Individual trustees

- An attorney replacing an incapacitated individual trustee is quite simple.
  - refer to the terms of the SMSF deed to ensure the appointment is valid – may include:
    - the attorney signing a resignation by the incapacitated trustee, on behalf of that person;
    - the continuing trustee, or the SMSFs members, appointing the attorney as replacement trustee
- The appointment (which does not occur 'automatically' when the relevant member loses capacity) must take place within 6 months from the date of the incapacity
- The newly appointed trustee needs to act in the best interests of all members of the fund, not just the member for whom they hold an EPoA.

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# Trustee structure dictates next steps

## Corporate trustee

- An attorney replacing a Director of an SMSF trustee company involves a few steps:
  - refer to the terms of the SMSF deed and company constitution to ensure the appointment is valid – may include:
    - the attorney signing a resignation by the incapacitated Director, on behalf of that person;
    - the corporate trustee's shareholders passing a resolution to appoint the attorney as a Director (*obtain a Director ID*)
- The appointment (which does not occur 'automatically' when the relevant member loses capacity) must take place within 6 months from the date of the incapacity
- The newly appointed trustee needs to act in the best interests of all members of the fund, not just the member for whom they hold an EPoA.

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# If no attorney has been appointed ...

- It depends on each state or territories' specific requirements
- An administrator / guardian for the individual can be appointed
  - Civil and Administrative Tribunal – e.g. SACAT / Public Trustee
- Can be quite a costly and time-consuming exercise
- Often not ideal and resulting different outcomes for the member

# Death and taxes ...

- Death is a compulsory cashing event
- Death benefit paid “as soon as practicable after the member dies”
- Lump sum (to a SIS dependant) or pension (Qualifying dependant) or combination of both
- Paid = cashed out of the super system
  - Lump sum
  - Pension, over time
- Cannot be retained in super system in accumulation



# But first, paperwork!

- Trust deed
- Company constitution for corporate trustees
- Pension commencement documents
- Member death instructions
- Member annual benefit statements
- Deceased member's Will
- Grant of Probate
- Dependant recipient information





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# Who is in control?

- Trustee - individual / Corporate
- Surviving trustees still have powers to make decisions
- No new trustee is compulsorily required to be appointed
- Timeframes exist, due to SMSF definition
  - 6 months after payment of death benefit
  - Continuing members (existing, death benefit pensioners) to be trustees
- SIS permits the LPR to be appointed – like for capacity issues

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# Deceased member instructions

- Reversionary pensions
- Non-binding death benefit nominations
  - Just a guide
- Binding death benefit nominations (specified in the deed)
  - 3 year lapsing in accordance with SIS – not automatic for SMSFs
  - Non-lapsing permitted
- Reversionary pension vs death benefit nominations

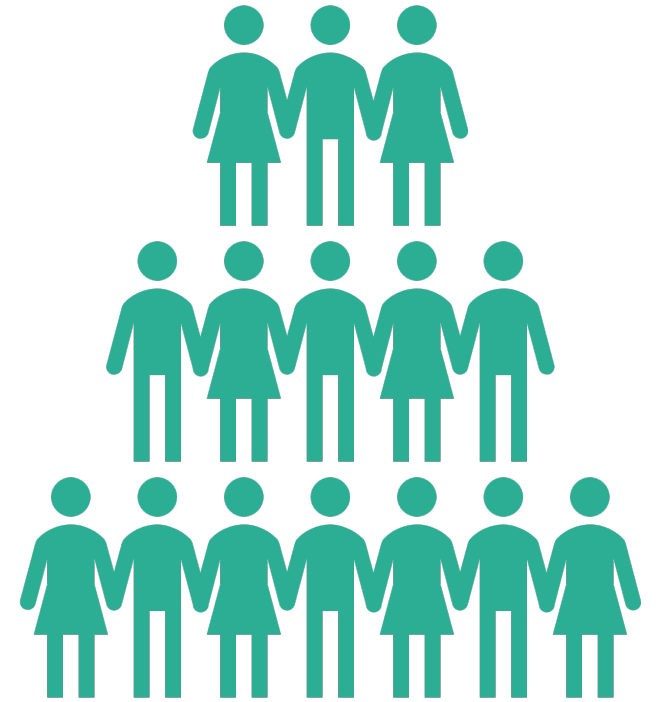
# Can I have some \$\$ ?

- Only **SIS Dependants** can be paid a benefit directly from a SMSF and be included in a death benefit nomination
- **Tax Dependant** definitions are only used to determine tax rates



# DEFINED: SIS Dependant

- Legal or De-facto spouse
- Child of any age
- Interdependency relationships
- Financial dependency
- Legal personal representative



# DEFINED: Spouse

- Another person who, although not legally married to the person, lives with the person on a genuine domestic basis in a relationship as a couple, and
- Another person (whether of the same sex or a different sex) with whom the person is in a relationship that is registered under the law of a State or Territory

*(Same for Tax)*





# Spouse – proofs

- duration of the relationship;
- nature and extent of the common residence;
- whether or not a sexual relationship existed;
- procreation of children;
- degree of financial interdependence & arrangements for support;
- ownership, acquisition and use of property;
- performance of household duties;
- degree of mutual commitment and mutual support;
- reputation and "public" aspects of the relationship.



# DEFINED: Child

- Step-child, ex-nuptial child or adopted child
- Child of the person's spouse and
- Child within the meaning of the Family Law Act 1975
- **Tax is different !!**
  - Age & financial support are key factors
- Be aware: **ATO ID 2011/77**
  - The stepchild/step-parent relationship is severed when the marriage of the parent ceases (either due to the death of the natural parent or upon the divorce of the natural parent from the step-parent)
  - Could qualify as financial dependant or interdependant
  - Estate planning implications



# DEFINED: Interdependent relationships

- Characterised by
  - A close personal relationship
  - Living together
  - Financial support
  - Domestic support and Personal care
- Still OK if not satisfied only because of physical, intellectual or psychiatric disability.



*(Same rules for Tax)*

- 2 cases
  - SIS Financial dependant: *Faull v SCT* [1999] NSWSC 1137
  - Tax Financial dependant: *Malek v FC of T* 99 ATC 2294



# Payment – lump sum



- Interim lump sum & final lump sum
- Payment can be effected in cash or by way of transfer of fund assets (in-specie)
- PAYG Withholding requirements for payments to non-tax dependants
  - Not if paid to LPR
- Cannot pay via journal entry (ATO ID 2015/23)

# Death benefit pensions – who?



- Outlined in SIS – refer previous slides
- SIS Dependant of the member: AND if a child \*\*
  - any age, but must be disabled
  - 18-25 years old - financially dependant
  - <18 years old
- Covers all death benefit pension types
- Limitations on amounts due to Transfer Balance Cap rules

*\*\* must be commuted to a lump sum on or before 18, unless financially dependant (commute at 25 years) or disabled (can continue the pension)*



# Death benefit pensions – how?



- 💧 Reversionary pensions
- 💧 Pensions to certain dependants after an existing pensioner dies (non-reversionary / discretionary pensions)
- 💧 Pensions paid to certain dependants from a deceased person's accumulation account
  - "Once a death benefit pension, always a death benefit pension"
- 💧 Can rollover to another fund, 'death benefit pension' continues

# Tax on lump sums

- Two tax components:
  - tax-free
  - taxable
- The taxable component can have two elements if the lump sum benefit includes insurance proceeds
- Components are based on a formula:
  - Taxable component – taxed element
  - Taxable component – untaxed element



# Tax on lump sums

- Tax dependants - total benefit → tax free
  - Spouse, child U18, financial dependent, interdependent
- Non-dependants (Adult Children):
  - 0% tax free component
  - 15% taxed element
  - 30% untaxed element – only applicable if insured benefits
- Medicare levy for individuals is 2% (*not paid if Estate is beneficiary*)



# Tax on pensions

- A death benefit pension retains the taxable proportion established on pension commencement
- Tax determined by age of deceased and/or recipient
  - If deceased or recipient 60 years old +
    - Pension is tax free
  - If deceased and recipient younger than 60 years old
    - Taxable component taxed at marginal rate & 15% tax offset
- Any lump sums commuted are taxed as lump sum death benefits but cannot be rolled back and retained in accumulation



# Dependant definitions - SIS & Tax

Dependant	SIS definition of dependant (regulates who can receive a death benefit)	Tax definition of dependant (determines how a death benefit is taxed)	Pension availability (can a pension be paid)
Spouse – married	Yes	Yes	Yes
Spouse – de facto/Same Sex	Yes	Yes	Yes
Spouse – former	No	Yes	No
Child – under age 18	Yes	Yes	Yes
Child – over age 18	Yes	No unless financially dependant or interdependent relationship	No unless Permanently Disabled or Under 25 and financially dependent
Financially dependent at the time of death	Yes	Yes	See Above
Interdependant	Yes	Yes	See Above

# SMSF Taxes

- Fund tax situation continues on
- Disposal of assets may trigger CGT liabilities which need to be paid before benefit payments are made
- Non dependants benefit payments may be subject to PAYG withholding tax
- Payments to the deceased estate transfers any PAYG obligation to the estate if distributed to non dependants for tax purposes
- Can be an issue if in specie benefits are paid



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## Quick quiz - 5 questions

1. An SMSF death benefit can be paid to my neighbour

- a) True
- b) False
- c) It depends (on SIS dependency)



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## Quick quiz - 5 questions

2. All SMSF death benefits are tax free if paid to a recipient over 60 years of age

- a) True
- b) False

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## Quick quiz - 5 questions

3. Death benefits paid in the form of a pension are unlimited

- a) True
- b) False

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## Quick quiz - 5 questions

4. Tax is required to be withheld from some death benefit payments

- a) True – if the recipient is a non-dependant for tax purposes
- b) False – tax is the recipient's issue, not the SMSF's

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## Quick quiz - 5 questions

5. Taxable components are taxed in the hands of a non-dependant at the following rate:

- a) 0% - all super payments are tax-free
- b) 15% - no Medicare Levy
- c) 17% - Medicare Levy applies

# Key Takeaways from today's session

- Incapacity – must plan for it and review annually
- Death – many considerations of what happens, who can receive the death benefit payments, in what form, and the tax implications for each payment type



# Questions?

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# Thank you for attending

