

Aspects of Financial Planning

Superannuation death benefits

July 2008

There are a number of important factors to consider to ensure your superannuation death benefits are distributed according to your intentions. This will include a consideration of who is deemed a dependant, the method of nomination you use, the type of benefit to be paid and the taxation implications that may arise.

Introduction

A superannuation death benefit may only be paid to certain classes of people as outlined in superannuation legislation. An essential estate planning task is the nomination of who is to receive your benefit. Unfortunately some neglect to make or update their nomination of beneficiaries and others mistakenly nominate those who cannot legally receive their superannuation benefit. There are rules to follow to ensure that your super benefits are distributed to those you intend.

Another consideration leads to a discussion of the type of death benefit to be paid; your beneficiaries may receive a lump sum or an income stream directly or alternatively, your benefit may be paid to your estate and distributed in accordance with your Will. Given that superannuation balances can be substantial, it is necessary to consider the tax implications of distributing your superannuation death benefit.

Who can receive your superannuation death benefit?

Under the *Superannuation Industry (Supervision) Act 1993* (SIS Act), a superannuation death benefit may be paid to one or more of your dependants or to your legal personal representative (LPR), (the executor of your Will or administrator of your Estate). When paid to your Estate, the benefits will be distributed according to your Will. Payment may be made to another individual only if the trustee, after making reasonable enquiries, has not found either





a dependant or your LPR. Further restrictions may also apply through the relevant superannuation trust deed or Family Law provisions.

Dependants

Under the SIS Act the following dependants are able to receive your superannuation death benefit:

- Your spouse (including a de facto spouse)
- Your children, at any age (including step, adopted, ex-nuptial)
- A person financially dependent on you at the date of your death; and
- A person with whom you have an interdependency relationship.

Interdependency

An interdependency relationship is one in which two people have a close personal relationship, live together, provide each other with financial support, domestic support and personal care. Examples include two elderly sisters living together; or an adult child who resides with and cares for an elderly parent. It is not intended for people who share accommodation for convenience (flatmates) or people who provide care as part of an employment relationship.

There is also provision for persons having a close personal relationship where they do not satisfy the other conditions because either or both of them suffer from a physical, intellectual or psychiatric disability.

It is important to note that for the purpose of eligibility to receive a death benefit, dependency must be established at the time of the member's death.

How do you nominate your beneficiaries?

There are essentially three types of beneficiary nominations available:

- Non-binding death benefit nomination
- Binding death benefit nomination
- Non-lapsing binding death benefit nomination.

Non-binding death benefit nominations

Most superannuation funds offer non-binding nominations which enable you to provide the trustees with an indication of your preferred beneficiary(s). There is no ongoing administration requirement and the trustee of the superannuation fund will usually take this nomination into





account in making its decision on the distribution of your death benefit, however because it is not binding on the trustee, there is no estate planning certainty.

Binding death benefit nominations

It is not a legal requirement, but where the superannuation trust deed provides for it, superannuation death benefits may be paid by way of a binding nomination which will lock in who is to receive your benefit. Those with self managed superannuation funds (SMSFs), again depending on the trust deed, may use binding death nominations.

There are certain procedural requirements that need to be met in order for the binding death nomination to be valid. Where it is offered and you choose to make such a nomination, the super fund will require you to complete and sign a "nomination notice" form with the following features:

- The person or persons mentioned in the notice are dependants of the member or the legal personal representative, no other person may be nominated
- The proportion of the benefit that will be paid to each of the beneficiaries is readily ascertainable
- A nomination notice must be made in writing, signed and dated by the member in the presence of two witnesses (who are at least 18 years old and are not nominated beneficiaries); and
- The notice is valid for a maximum of three years (please note that some fund trust deeds allow a non-lapsing nomination).

It is important the nomination notice form is completed correctly and that your intentions are clear. Ensure that the total proportion of benefits allocated to your dependants or LPR equals 100% in total. You can revoke or change your nomination at any time.

Trustees will generally provide an annual notice to all members who have completed a binding nomination form. The notice will include such information as: who the nominated beneficiaries are and their proportional entitlement, how one can change the notice, the date the notice will lapse and a form to complete if the member wishes to change the notice.

Non-lapsing binding death benefit nomination

A non-lapsing binding death benefit nomination binds the trustee to pay a superannuation death benefit according to the deceased's wishes however unlike a binding nomination, it does not lapse. A non-lapsing nomination remains in force until it is amended or revoked by the member. Whether a fund can offer this type of nomination depends on the specific trust deed and only a handful of retail superannuation funds currently do.





Advantages and disadvantages of nominations

A binding death benefit nomination enables you to have some degree of certainty regarding how your superannuation death benefits are distributed. This may be particularly useful if you are in a complex family relationship and wish to sustain inter-generational wealth through a specific family line.

Death benefits are likely to be distributed to nominated beneficiaries more quickly than if the trustee was required to go through the normal process of determining beneficiaries and distributing the death benefit at the trustee's discretion which is the case with non-binding nominations.

However a binding death benefit nomination, unless it is non-lapsing, requires ongoing administration – it must be renewed at least every three years otherwise it becomes invalid. Should a binding death nomination become invalid, it would depend on the rules of the fund as to how the benefits are paid – usually they would be paid at the trustee's discretion.

Having a binding nomination can be potentially detrimental where the deceased's situation or wishes have changed since the nomination was made. In such as case the trustee has no discretion and will be bound to pay the death benefit as instructed.

At death, the trustee must go through a process to validate the eligibility of any nominated dependants. This may not be a straight forward task, for example in respect of determining those who claim an interdependent relationship. Also, Family Law provisions will leave any trustee decision open to possible challenge. Complete certainty of payment of a superannuation death benefit cannot be assured in any case.

Who will actually receive my superannuation benefit?

If you have completed a valid binding nomination your death benefit will simply be paid to those nominated. If your binding nomination is invalid or you have completed a non-binding nomination, the trustees have the task of distributing your superannuation benefits at their discretion. This can be a difficult task given that a large number of people could potentially contest the proceeds. Trustees will collect relevant documentation to identify potential recipients and will take applications made by:

- Family members
- Beneficiaries nominated in your Will; and
- Any other person who considers they have a claim to your benefit.

There will potentially be competing interests among beneficiaries, each of whom will claim a degree of dependency and feel a sense of entitlement.





The difficulty is exacerbated because there are no legislative guidelines or regulations issued to indicate who among the potential beneficiaries takes priority. However practice has shown that in determining their decision, trustees may consider the following:

- The strength of the relationship between you and the potential beneficiary(s)
- The length of any marriage-like relationship, and financial contributions made during that relationship
- Who would/should have continued to benefit from your income if you had not died? Minors or children, adults undertaking further study and disabled adult children may be considered as having a high priority; and
- Intentions expressed through your Will.

There are no easy answers to such questions. Trustees must face the decision as best they can. There will be widely differing views and there is no necessarily correct answer.

Type of death benefit paid

Superannuation death benefits may be paid to the deceased's dependants as a lump sum, one or more pensions or a combination of these. Where a pension is paid to a child that is either less than 18 or, 18 and less than 25 years and financially dependant on the deceased, it must be cashed as a lump sum no later than when the child turns 25, unless the child has a permanent disability.

There are taxation consequences that must be considered when determining in what form the death benefit is to be paid.

What are the tax implications?

There are a number of factors that affect the tax on your superannuation death benefit, including who receives it, your age and their age, as well as the underlying components your superannuation benefit is comprised of. The first thing to consider is that tax legislation provides for a different definition of "dependant" to superannuation legislation. So although superannuation legislation may allow a death benefit to be paid to a particular person, tax legislation may treat the payment as if it was paid to a non-dependant.

Dependants for tax purposes

Under taxation legislation, the following are considered death benefits dependants:

- Your spouse (including de facto and former spouse)
- Your children, aged less than 18 years (including step, adopted, ex-nuptial)





- A person financially dependent on you at the date of your death; and
- A person with whom you have an interdependency relationship.

Death benefits paid as a lump sum

A superannuation death benefit is tax free when paid as a lump sum to a death benefits dependant of the deceased. This is irrespective of whether the benefit has come from a pension that was being paid to the deceased or simply represents the deceased's accumulated benefit (plus any life insurance, if applicable).

A superannuation death benefit paid as a lump sum to a non-dependant (for example an adult child) is divided into taxable and tax free components based on the proportion these make up of the total benefit. The tax free component is paid tax free and the taxable component is taxed at 15% plus Medicare levy.

If a complying superannuation fund has elected to claim tax deductions on the insurance premiums or on an amount for future liability to pay benefits, the taxable component of the superannuation lump sum will include an *element untaxed*. Untaxed amounts will be taxed in the hands of the non-dependant beneficiary at 30% plus Medicare levy.

Death benefits paid as a pension

The tax treatment of a death benefit paid as a pension will vary depending on the age of deceased and/or the recipient.

Where the deceased died aged 60 or above, the pension is paid tax free (regardless of the age of the recipient).

Where the deceased died under age 60, the age of the recipient will determine how the pension is taxed. Where the recipient is over age 60, the pension is paid tax free. Where the recipient is under age 60, the pension is proportioned into tax free and taxable components and taxed accordingly. The tax free component remains tax free while the taxable component is taxable but subject to a 15% tax offset. This is the case until the recipient turns 60 at which point the pension becomes tax free.

Death benefits paid to the estate

A superannuation death benefit may be paid to the estate of the deceased in accordance with the fund rules and also whether a non-binding or binding death benefit nomination has been completed in favour of the estate. In this instance, the fund trustee does not direct to whom the benefit will be paid rather, the benefit forms part of the estate assets and is distributed in accordance with the terms of the Will.





If a lump sum superannuation death benefit is paid to a trustee of the estate, the tax treatment is based on whether dependants or non-dependants benefit from the estate. To the extent that dependants will benefit, no tax is payable.

The following table summarises the differences in the definition of dependant between superannuation and taxation legislation.

| | Dependant under superannuation legislation | Dependant under taxation legislation |
|----------------------------|--|--------------------------------------|
| Married or de facto spouse | Yes | Yes |
| Former spouse | No | Yes |
| Child under 18 | Yes | Yes |
| Child over 18 | Yes | No |
| Financial dependant | Yes | Yes |
| Interdependent | Yes | Yes |

Strategy considerations

While superannuation assets fall outside of your estate, your nomination should be considered in the context of your Will to ensure estate planning consistency; taking into account your overall portfolio and tax situation; and should be reviewed regularly and especially after major life events (marriage, children etc).

Clearly, given the different treatments, depending on who receives the benefit and the form in which the benefit is received, there are important and valuable estate planning considerations involved in the payment of superannuation death benefits. The treatment of superannuation death benefits opens up some particularly tax-effective estate planning opportunities that should be compared in some cases with alternative strategies such as the use of testamentary trusts.

One other strategy consideration that can boost a superannuation death benefit payment is the anti-detriment payment. Please refer to our Aspect entitled "Anti-detriment payments".

Conclusion

Your superannuation benefit can help ensure that your family or beneficiaries are looked after when you die. However you will need to be mindful that there are a number of rules that treat super differently to other assets. Careful planning can ensure an effective estate planning strategy that incorporates superannuation. As part of this, your adviser can provide guidance as to which type of death benefit nomination is suited to your particular circumstances.





Centric Wealth Advisers Ltd may be able to be of assistance

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