Sladen Legal

Seamlessly Integrating Superannuation into Effective Estate Planning

Estate Planning: Maximising Asset Protection

Legalwise

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1. INTRODUCTION

As I am sure most readers of this paper will be aware (although most super fund members are not) super benefits do not automatically form part of a member's estate upon the death of the member. As such, a member's will cannot deal with their super benefits[1], unless the benefits are paid to the estate of the member. Consequently, a person's super benefits must be dealt with separately in the estate planning process. Rather than dealing with super in a person's will the tools for dealing with super death benefits are binding death benefit nominations (**BDBNs**), reversionary pensions, and the control of the decision making process through the control of the super fund trustee.

In this paper I examine how to incorporate super into the succession process. In particular, the use of BDBNs and reversionary pensions and the interaction between the two and the succession of the super fund trustee is examined.

In this paper I have concentrated on the use of BDBNs and reversionary pensions in relation to self managed superannuation funds (**SMSFs**), although I touched on other superannuation funds, such as public offer super funds.

All references in this paper are to the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) and the *Superannuation Industry (Supervision) Regulations 1994* (**SIS Regs**) unless otherwise stated.

2. WHO CAN RECEIVE DEATH BENEFITS?

It is important to note that under regulation 6.22(2) of the SIS Regs, death benefits can be paid to a 'dependant' of the member or the member's legal personal representative (**LPR**).

A dependant is defined in section 10(1) of the SIS Act to include the spouse of the person, any child of the person and any person with whom the person has an interdependency relationship (**SIS Dependant**). As an inclusive definition, a SIS Dependant will also include other persons who are financially dependent on the member at the date of the member's death.

A LPR is relevantly defined to include the executor of the will or administrator of the estate of a deceased person.

3. IN WHAT FORM CAN DEATH BENEFITS BE PAID?

Death benefits can be paid in the form of a lump sum or in the form of a pension. Lump sums can be paid to anyone who can receive death benefits. Pensions, however, cannot be paid to the estate, nor can they be paid to adult children who are not financially dependent on the deceased at the time of the deceased's death.

Children can receive a death benefit pension if they are under 18, or if they are aged between 18 and 25 and were financially dependent on the deceased at the time of the deceased's death or if they otherwise suffer from a disability. In relation to non-disabled children, the death benefit pension must be commuted on or before they turn 25, at which time the balance of the pension account must be paid as a lump sum to the child.

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[1] *McFadden v Public Trustee for Victoria* [1981] 1 NSWLR 15

4. TAXATION OF DEATH BENEFITS

The taxation of death benefits depends primarily on two things, first whether the recipient is a death benefits dependant, and second the form of the death benefit (ie a pension or lump sum).

"Death benefits dependant" is defined in the *Income Tax Assessment Act 1997* to mean:[2]

- the deceased person's spouse or former spouse; or
- the deceased person's child, aged less than 18; or
- any other person with whom the deceased person had an interdependency relationship just before he or she died; or
- any other person who was a dependant of the deceased person just before he or she died; or
- the payment to any person as a result of the member (who is a member of the defence forces or police) dying in the line of duty

The following tables show there is a strong tax incentive to pay death benefits to a death benefits dependant.

Table 1 - Taxation of lump sum death benefits

	Tax free component	Taxable component (taxed in the fund)	Taxable component (not taxed in the fund eg., life insurance proceeds)
Death Benefit Dependants	Nil	Nil	Nil
Non-Death Benefit Dependants (eg., adult children)	Nil	Up to 16.5%	Up to 31.5%

Table 2 - Taxation of pension death benefits (only payable to death benefits dependants)

	Tax free component	Taxable component (taxed in the fund)	Taxable component not taxed in the fund
Either deceased or dependant 60+	Nil	Nil	Included in assessable income with a 10% rebate
Neither deceased nor dependant 60+	Nil	Included in assessable income with a 15% rebate	Included in assessable income

[2] Section 302-195

5. DEATH BENEFITS AND FUND TAXATION

The payment itself of a death benefit by the trustee of a fund does not cause any direct tax consequences to a fund, but the form of the death benefit can have tax consequences to the fund. In particular, a pension death benefit can have two tax advantages over a lump sum benefit.

A death benefit that is paid in the form of a pension will result in the assets supporting that pension not being subject to taxation (if a segregated method is used) or that a pro-rata tax exemption will apply to the assets of the fund (if a non-segregated method is used). Whereas, once a lump sum death benefit is paid to a beneficiary, if it is invested outside of super, then those investments will be subject to tax in the ordinary way (the tax treatment will depend on whether the assets are invested in the name of the beneficiary, another person or another entity).

Until recently, where the member had a pension interest at the time of their death, there was a tax incentive that favoured reversionary pensions over other non-reversionary death benefits. This was on the basis of the ATO's view that, absent a reversionary pension, a pension will cease upon death and therefore the super fund would go from "pension phase" to "accumulation phase". The consequence of this view was that assets realised after the death of a pensioner, without a nominated reversionary pensioner, would potentially trigger capital gains tax. This issue has now been remedied by legislation (see regulation 307‑125.02 of the *Income Tax Assessment Regulations 1997* and the definition of superannuation income stream benefit), with the result that "pension phase" will continue after the death of a pensioner even if the death benefit is paid as a lump sum. This is provided that the death benefit is paid out as "soon as practicable".

The only remaining difference between the tax treatment of reversionary pensions and non-reversionary death benefits is the treatment of insurance proceeds and anti-detriment payments. For reversionary pensions, if such amounts form part of the reversionary pension, then the taxable/tax free components will match the existing ratio for the reversionary pension. Whereas, for a non-reversionary death benefit such amounts are added to the taxable component (see regulation 307‑125.02).

6. BINDING DEATH BENEFIT NOMINATIONS

BDBNs can be thought of as a will for super benefits. They are a document prepared by a member that compels the super fund trustee to pay the member's death benefits to the member's SIS Dependant and/or LPR.

What requirements must the BDBN meet?

The only legislative requirements relating to BDBNs are contained in regulation 6.17A of the SIS Regs. The purpose of regulation 6.17A is to provide an exception to the general prohibition in section 59(1) of the SIS Act that prevents persons other than a super fund trustee from exercising a discretion of the super fund trustee. Regulation 6.17A permits a super fund's trust deed to contain a provision under which the super fund trustee is compelled to pay a member's death benefits in accordance with the member's direction.

In order to qualify as a BDBN nomination under regulation 6.17A, the BDBN must meet certain criteria; including that it must:

(a) be in writing;

(b) be signed, and dated, by the member in the presence of 2 witnesses, being persons:

  (i) each of whom has turned 18; and

  (ii) neither of whom is a person mentioned in the notice;

(c) contain a declaration signed, and dated, by the witnesses stating that the notice was signed by the member in their presence.

In addition, such BDBNs expire after 3 years.

Until recently, there had been some debate as to whether the requirements in regulation 6.17A applied to BDBNs from SMSFs. This debate has now been settled, at least from the Australian Taxation Office's (**ATO**) perspective, with the release of the Commissioner of Taxation's determination, SMSFD 2008/3[3],. In this determination, the ATO has (correctly in my opinion) formed the view that the provisions in SIS Act and the SIS Regs[4] do not prescribe the form or operation of a BDBN.

Consequently, the form and operation of a BDBN relating to a member's benefits in a SMSF will be governed by the trust deed of the SMSF. Importantly a SMSF BDBN does not need to expire after 3 years, but can operate indefinitely.

What form and requirements must a SMSF BDBN satisfy?

This will depend exclusively on the terms of the trust deed of the SMSF. This will include whether the SMSF offers the ability of a member to make BDBNs (as many older SMSF trust deeds don't).

Requirements could potentially include:

- a particular form (often a schedule to the SMSF trust deed);
- particular wording in the BDBN (eg that it says its binding);
- delivery of the BDBN to the SMSF trustee; and
- witnessing requirements.

Some older SMSF trust deeds that offer BDBNs mirror or incorporate the requirements of regulation 6.17A, including the requirement that BDBNs lapse after 3 years.

7. CASE EXAMPLES OF BDBNS

The following is a summary of a number of cases that have considered BDBNs.

Donovan v Donovan – BDBN requirements

The decision of the Supreme Court of Queensland in *Donovan v Donovan*[5] is a good illustration of when a BDBN may fail. In that case the member wrote a letter to himself as director of the corporate trustee of the SMSF expressing that it was his wish that his benefits be paid to his estate. The SMSF trust deed granted the members the power to make BDBNs "in the form required to satisfy the Statutory Requirements".

Two of the questions that arose during the case were whether the deceased's "wish" was a BDBN and whether the BDBN had to satisfy the SIS Act and SIS Regs requirements. The Court decided that the member's "wish" was not expressed to be binding and therefore it was not a BDBN. The court also found that the reference in the trust deed to BDBNs satisfying the "Statutory Requirements" meant that the BDBN was required to satisfy the requirements of reg 6.17A SIS Regs. As observed in the judgment that it is:

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[3] Self Managed Superannuation Funds Determination SMSFD 2008/3 Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) legislation on a self managed superannuation fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?

[4] Specifically s59(1) and s59(1A) SISA and reg 6.17A SISR

[5] [2009] QSC 26

> "very understandable that a deed should specify a requirement in effect to comply with the form described in regulation 6.17A(6) out of an abundance of caution. The alternative would be to require the trustees or the member to take legal advice about [whether a purported BDBN is binding] and run the risk that their advice might turn out to be incorrect. Such an approach is uncommercial and unlikely."

However, if the trust deed does adopt the requirements of reg 6.17A SIS Regs it will potentially reduce the effectiveness of a BDBN as a purported BDBN will be defective if it does not comply with reg 6.17A SIS Regs and could expire after 3 years. It is therefore vital that the trust deed be reviewed before a BDBN is made.

In most cases it is preferable that the BDBN provisions of the deed be less onerous than those in reg 6.17A SIS Regs.

Wooster v Morris – BDBN was valid

In *Wooster v Morris* [2013] VSC 59 the second spouse and surviving trustee of a SMSF determined that the BDBN made by her husband in favour of the children from his first marriage was defective.

Although whether the BDBN was valid was a question to be determined in the case of Wooster v Morris, the decision itself does not go into detail as to why the BDBN in question was valid. This is because that finding was made by a special referee whose findings were not made public. Rather, Wooster v Morris is really a decision in relation to costs of the proceedings. The Court found that the failure of the trustee to seek the Court's view as to whether the BDBN was defective and not seeking the Court's permission to defend the proceedings brought by the plaintiffs meant that the costs of the proceedings must be borne by the trustee personally and that she was not entitled to be reimbursed from the assets of the SMSF.

The case is important for 2 reasons. First, it confirms that BDBNs are not infallible. That is, even though in this case the deceased had made a BDBN in favour of his daughters, the control of governing the SMSF remained with his spouse. It would have been better for the husband to have structured his SMSF to ensure his daughters controlled the SMSF after his death. For example, if he was the sole member of the SMSF and his daughters were his executors so that they could take over the role of trustee.

Second, it confirms that SMSF trustees need to consider seeking the Court's review or permission if they are to make determinations in relation to the effectiveness of BDBNs or to defend or commence proceedings. The risk of not taking such course of action is that a costs order could be made directly against the trustee/director of the corporate trustee.

Ioppolo v Conti – BDBN had lapsed

In *Ioppolo & Hesford v Conti* [2013] WASC 389 the deceased member had made 2 BDBNs in favour of her husband. Both BDBNs had lapsed. She also stated in her subsequently prepared will that her super benefits were to be paid to her children and not her husband. After the death of the deceased, the husband controlled the SMSF and in the absence of any binding directions determined to pay the deceased's benefits to himself.

Ioppolo v Conti is not strictly a BDBN case, as the BDBNs in question had lapsed after 3 years in accordance with the BDBN provisions of the particular SMSF trust deed. Like Donovan v Donovan, this case is a reminder that the particular provisions of the SMSF trust deed must be reviewed in order to ensure a BDBN is effective and in accordance with the wishes of the member.

It is also confirmed that the provisions of a will do not bind SMSF trustees and that legal personal representatives do not have an automatic right to be appointed as a trustee.

Munro v Munro – incorrect nomination of the trustee of an estate

In Munro v Munro [2015] QSC the deceased (a lawyer) made a BDBN to pay his death benefits to the “trustee of my estate”. In a classic example of a “black letter of the law” approach the Court found that the BDBN was invalid.

This was because the SIS Act and the relevant deed only permitted death benefits to be paid to “legal personal representatives” which in turn is relevantly defined to include the “executor of a will of a deceased person”. The Court found that the role of an executor of a will is distinct from the role of the trustee of the estate and that they could be different persons (although they were not here). Therefore, the Court found that the nomination of the trustee of the estate was not the nomination of a legal personal representative and on that basis not a valid nomination.

Like Donavan v Donavan this case is another reminder that members and SMSF trustees must strictly comply with the trust deed and the SIS Act when making BDBNs.

8. REVISIONARY PENSIONS

Like BDBNs there are few statutory provisions governing the operation of a reversionary pension. Although there are a number of references to reversionary beneficiaries in the SIS Regs, they are mechanical in that they substitute requirements relating to pensioners to also apply to reversionary pensioners. The provisions relating to reversionary pensions will therefore be governed by the super fund trust deed and the pension agreement (if any).

The notion of a reversionary pension encompasses a pension in which, after the death of the original member, the pension continues to be paid to a nominated reversionary beneficiary. That is, the pension does not cease upon the death of the original pensioner but rather continues to be paid to the reversionary pensioner as though that reversionary pensioner was the original pensioner.

In that way a reversionary pension is akin to a joint tenancy where the asset (or in this case the pension) automatically transfers upon death.

Limitations of reversionary pensions

Although reversionary pensions generally work well for death benefits paid to spouses and minor children, they have a major limitation when death benefits are to be paid to the LPR or adult children. This is because, as noted above, pensions cannot be paid to the LPR or adult children (whether as a reversionary or a death benefit pension).

In such circumstances, a BDBN will be required to ensure the death benefits, upon the death of a spouse, are paid to the LPR or adult children. Alternatively, the pension agreement could deal with the payment of the capital of the pension should there be no reversionary pensioners nominated.

Another limitation is that only one reversionary beneficiary can be nominated to receive the reversionary pension. Generally, this is not a problem where the reversionary pensioner is the spouse but it will be an issue if multiple beneficiaries are to receive death benefits (eg a number of minor children). In such situations either a BDBN would need to be used or multiple pensions would need to be created, each with their own reversionary pensioner nominated (eg one for each child).

A third limitation is that reversionary nominations must be made for each pension. You generally cannot do a holistic nomination to cover all pensions and reversionary nominations will not cover accumulation interests.

A forth limitation is that the nomination of the reversionary will be lost if the pension is commuted. For example, if a member made a new contribution to the SMSF and decided to commute her existing pension so she could add it to her other benefits (from the commuted pension) then the previous nomination of a reversionary will be lost and a new reversionary

nomination will be required. In addition, if a new pension is commenced, an existing reversionary nomination will not carry over to the new pension, rather a new nomination will be required.

Whereas, a BDBN can operate over all benefits, including multiple pension and accumulation interests and will generally not be affected by the commencement or commutation of pensions.

Advantages of reversionary pensions

One advantage of a reversionary pension is that you can deal with multiple pension interests separately. This is discussed further below.

Up until recently, there was a significant tax advantage in having a reversionary pension, as without one the super fund would switch from pension phase to accumulation phase upon the death of a pensioner. As noted above, this has been remedied by legislation. However, a tax advantage of a reversionary pension over non-reversionary death benefits remains, as any life insurance proceeds added to a reversionary pension will retain the tax components of the pension, rather than be simply added to the taxable component.

9. WHAT TAKES PRECEDENCE BDBNs OR REVERSIONARY PENSIONS?

Like many of the issues considered in the paper, the answer to which of BDBNs and reversionary pensions takes precedence in SMSFs, depends on the SMSF trust deed. Again there are no regulatory provisions which regulate this issue.

In my experience, SMSF trust deeds will either:

- expressly state that one takes precedence over the other;
- provide that the one signed later will take precedence over the earlier one; or
- be silent as to which takes precedence.

Although it is clear which takes precedence in the first 2 examples, what about the third? Although the question has yet to be tested, in my view, a reversionary pension will take precedence regardless of the order of signing the pension document and the BDBN. This is because the reversionary pension will automatically transfer the pension to the reversionary pensioner. That is, the reversionary pension will not form part of the member's death benefits for the BDBN to attach to.

This view has been cautiously adopted by the ATO in the following extract from the minutes of the March 2010 NTLG Superannuation Technical Sub-group:

> There are no SIS Act or SISR provisions that are relevant to determining which nomination an SMSF trustee is to give precedence where a deceased pension member had both a valid reversionary nomination and a valid BDBN in existence at the same time of the member's death.
>
> While section 59 of the SISA and Regulation 6.17A of the SISR place restrictions on superannuation entity trustees accepting BDBNs from a member, as explained in SMSF Determination SMSFD 2008/3 the Commissioner is of the view that those provisions do not have any application in regards to SMSFs.
>
> In the absence of relevant provisions in the SISA or SISR, the issue of which nomination takes precedence is one which would need to be determined by reference to the governing rules of the fund under which the nominations are made, general trust law and any other legislation which may be relevant.
>
> However, we would suggest that a pension that is a genuine reversionary pension, that is, one which under the terms and conditions established at the commencement of the pension reverts to a nominated (or determinable) beneficiary must be paid to the reversioner. It is only where a trustee has a discretion as to the beneficiary who is entitled to receive the deceased member's benefits and the form in which the benefits are payable that a death benefit nomination is relevant. It must be remembered that section 59 of the SIS Act and regulation 6.17A of the

SISR are necessary because of the general trust law principle that beneficiaries cannot direct trustees in the performance of their trust.

10. "LIFE INTEREST" PENSIONS

The use of "life interest" pensions is increasingly being considered by SMSF members, especially in the case of blended families. Under a "life interest" pension, upon the death of the initial member, a beneficiary (typically a second spouse) is provided with a death benefit pension or reversionary pension for their life. Then, upon the death of that beneficiary (ie the second spouse), the remaining capital of the pension is paid to children or the LPR of the initial member. This has the advantage that the initial member can ensure that their second spouse is looked after during his/her life and that any remaining capital stays with the initial member's family.

The "life interest" pension is to be contrasted with a "standard pension" in which the remaining capital must be paid to the beneficiary's SIS Dependants or LPR.

Does a "life interest pension" breach the SIS Regs?

The biggest question mark in relation to the "life interest" pension is whether it complies with regulation 6.22 of the SIS Regs. That regulation relatively provides:

6.22 Limitation on cashing of benefits in regulated superannuation funds in favour of persons other than members or their legal personal representatives

(1) Subject to sub regulation (6) and regulations 6.22B, 7A.13, 7A.17 and 7A.18, a member's benefits in a regulated superannuation fund must not be cashed in favour of a person other than the member or the member's legal personal representative:

(a) unless:

(i) the member has died; and

(ii) the conditions of subregulation (2) or (3) are satisfied; or

(2) The conditions of this subregulation are satisfied if the benefits are cashed in favour of either or both of the following:

(a) the member's legal personal representative;

(b) one or more of the member's dependants.

The key question is whether, upon the death of the beneficiary/reversionary pensioner, the terms "member's benefits", "member's legal personal representative" and the "member's dependants" only refer to the beneficiary or whether it can also refer to the initial member.

In my view, these references can relate back to the initial member under a "life interest" pension provided the documentation effectively compels the death benefit in 2 parts. That is, a life interest to the beneficiary and a reversion interest to the initial member's dependants or LPR, in that the initial member's death benefit is paid to the initial member's dependant and/or LPR.

The alternative view is that, upon the payment of a death benefit pension to the beneficiary/reversionary pensioner, the benefits belong to that beneficiary. Consequently, upon the death of the beneficiary the benefits can only be paid to the beneficiary's dependant or LPR.

Given the uncertainties in relation to the application of regulation 6.22, it would be prudent to advise any SMSF members entering into such a situation of the risks involved or to seek specific advice from such an arrangement from the ATO before entering into the arrangement.

What else should be considered for a "life interest" pension?

In addition to the regulatory issues, there are a number of practical issues in relation to a "life interest" pension that must be considered. These issues relate to the ability of the beneficiary to access the capital of the life interest pension. This could be done in a number of ways, including:

- by commuting the pension and taking the capital as a lump sum;
- calling for 100% of an account based pension to be paid in a particular year;
- amending the deed and pension documents to remove the requirement to pay the remaining capital to the initial member's dependant or LPR;
- rolling over the life interest pension to another fund to commence a new pension without such restrictions.

In order to protect the purpose behind the creation of a "life interest" against such actions the following could be considered:

- prohibiting the commutation of the pension;
- imposing a maximum pension draw for each year (eg it could be fixed at the minimum pension level or a specified amount about the minimum);
- preventing the amendment of the provisions relating to the pension and preventing the amendment to the pension agreement;
- prohibiting the rollover of the "life interest" pension out of the SMSF;
- the introduction of a "guardian" position.

In relation to a guardian role, the guardian's consent could be required before any of the above actions are undertaken. For example, the pension could not be commuted without the written consent of the guardian.

Unlike the persons who undertake the role of the SMSF trustee/director of the corporate trustee which are regulated by section 17A of the SIS Act, there are no regulations on who can be in a guardian role. For example, the guardian could be the initial member's LPR or dependants.

11. SUCCESSION OF THE TRUSTEE

Perhaps the most important aspect of ensuring that a member's benefits are dealt with as intended by the member is to ensure that the succession of the role of the trustee is appropriately structured. This is especially so, where the member has not made a BDBN or where the BDBN is invalid or has lapsed and in the case of blended families.

Two examples, where the succession of the trustee was not appropriately dealt with are set out below.

Examples of problems with trustee succession

The classic example of succession of a SMSF trustee going wrong is the case of *Katz v Grossman.*[6] In *Katz v Grossman* a father, who had a son and a daughter, was the sole member of his SMSF after the death of his wife. In order to ensure that his SMSF complied with s17A[7] the father appointed his daughter to be a co-trustee.[8] When the father died, the daughter was the sole surviving trustee.[9] Therefore, under the terms of the trust deed, the daughter, as sole trustee, had the sole discretion to pay the father's benefits. Although it was

[6] [2005] NSWSC 934

[7] i.e. that a sole member SMSF with individual trustees has 2 trustees, one of which is the member

[8] The daughter also became a member, although this appointment was found to be defective

[9] She later purported to appoint her husband as a co-trustee and member, although this was found to be defective

not recorded in the court's decision it is implicit that the daughter proposed to exercise her discretion to benefit herself, despite it being the wish of her father that his assets be divided equally between his children. The son (a co-executor with his sister of his father's will) brought an action against his sister on the basis that her appointment as a trustee was ineffective.

The court found that the daughter's appointment as trustee was effective under the SMSF deed. Therefore the daughter was left with the sole discretion to determine to whom her father's benefits would be paid.

Another example of SMSF trustee succession gone awry is the case of *Moss Super Pty Ltd v Hayne*[10]. In this case the deceased member provided in his will that his assets be divided equally amongst the two children of his first marriage, his second wife and her two children. The deed of the SMSF provided that the trustee had a complete discretion in determining who would be paid the deceased's benefits. At the time of trial, the second wife was the sole director of the corporate trustee[11]. The daughter of the deceased member from his first marriage brought a claim against the trustee seeking to remove the trustee or have the benefits paid in accordance with the deceased's will.

Again, the court found the appointment of the trustee was effective under the SMSF deed and that the discretion to pay the deceased's benefits was held by the trustee. In addition, the court found that the deceased's benefits must be paid in accordance with the SMSF deed and not the deceased's will.

These cases show the importance of reviewing the SMSF deed and the structure of the trustee whenever reviewing or implementing a succession plan for a client with superannuation benefits, regardless of whether the trustee of the SMSF is a company or individuals.

Controlling the succession of the trustee

In order to ensure that a deceased member's benefits are paid in accordance with their wishes or by person(s) they determine, the member should review how the control of the trustee will pass on their death. The member must look at all areas of control of the trustee, as the control of the trustee will often be determined by numerous factors.

Control of a corporate trustee

After the death of a member/director of a corporate trustee, the control of the corporate trustee will be determined by one or more of the following:

- who will be the surviving director(s);
- the shareholder(s) who (generally) have the right to appoint and remove directors;
- the constitution of the company which may dictate how decisions may be made and how directors are removed and appointed;
- the SMSF deed which will dictate how the trustee can be removed and appointed and whether the trustee is bound to pay the deceased member's benefits in a particular way or to particular person(s); and
- the *Corporations Act 2001* (Cwlth).

[10] [2008] VSC 158
[11] The deceased's lawyer was a director but had previously resigned after incorrectly interpreting the SIS Act trustee requirements in s17

Control of individual trustees

After the death of a member/trustee, the control of the trustee will be determined by one or more of the following:

- who will be the surviving trustee(s);
- the SMSF deed which will dictate how the trustee can be removed and appointed and whether the trustee is bound to pay the deceased member's benefits in a particular way or to particular person(s); and
- the relevant state Trustee Act.
- Where the trustees of a SMSF are individuals, one of the most important controls on the succession of the trustee is the SMSF trust deed. If the trust deed does not contain a mechanism to determine how the position will be succeeded after the death of a member, then generally the surviving trustee will be the trustee of the SMSF, which without planning, as seen in *Katz v Grossman*, can have disastrous results.

Which is better: corporate trustee or individual trustee?

Both a corporate trustee and individual trustees can cause succession problems and therefore succession strategies must be considered regardless of the type of trustee.

A corporate trustee has more avenues for succession through the shareholding and the appointment of alternative directors.

However, as the corporate trustee will be primarily governed by its constitution rather than the SMSF trust deed, succession provisions in the trust deed may be ineffective. For example, if the trust deed provided that a deceased member's legal personal representatives (LPR) must be appointed as a director, such a clause will be ineffective as the shareholders of the corporate trustee, who have the power to appoint directors, are not a party to the trust deed and therefore are not bound by it.

Dispute between trustees or directors of a corporate trustee

Even the best laid succession plans can be undone by a subsequent falling out of individual trustees or directors of a corporate trustee. It is therefore important that the SMSF trust deed and (if applicable) the constitution of a corporate trustee contain dispute resolution clauses to deal with disputes between parties.

12. MECHANISMS FOR DETERMINING THE CONTROL OF THE TRUSTEE OF A SMSF

Consider a BDBN

To create certainty as to who will receive benefits, a BDBN could be considered. A BDBN is an important tool where the succession of the SMSF trustee cannot be controlled after the member's death.

However, as discussed below, a BDBN can have unexpected consequences and therefore must be considered with care rather than being implemented as a matter of course.

Ensure upon the death of a member of a SMSF, that control of the trustee to passes to the appropriate persons

The most important aspect of ensuring that that a member's SMSF benefits are paid in accordance with the member's wishes is to ensure that the appropriate persons will control the trustee after the member's death.

If a member cannot be satisfied that the appropriate persons will be appointed then the member should consider ways in which the payment of the member's benefits can be "locked in" after death, for example through BDBNs or through the trust deed.

In considering who are the appropriate persons a member should consider:

- if the trustees are individuals – who will be the surviving trustee(s) and who will be the trustee after the death of all of the trustees;
- if the trustee is a company – who will be the surviving director(s), are there any alternative directors and who holds the shares in the company;
- does the SMSF trust deed provide for the succession of the trustee;
- does the deed grant the power to pay benefits to the persons who are to receive the member's benefits;
- is there a guardian position and what powers does the guardian have;
- how are the voting rights for the surviving trustees or directors determined?

If a member is satisfied that the appropriate persons will have control of the trustee after the member's death then the member may decide to leave the decisions as to the payment of their benefits to the trustees.

For example, spouse A and B may decide to leave the discretion to pay benefits after their death to the survivor of them and upon the death of the survivor that their two children will be appointed trustees or directors of the corporate trustee. Those two children would then together determine how and to whom their parents' benefits would be paid.

In the example given there may be no need to specifically deal with the successive control of the trustee if spouses A and B were satisfied that the determination would be made by their children. But in many other circumstances it would be both necessary and appropriate to deal with succession issues concerning the trustee. Examples include, members in their second marriages, where members wish to disproportionately benefit one or more of their children to the exclusion or partial exclusion of the other(s), where members have a specific wish as to who should receive their benefits, or where it is not appropriate to appoint one or more of their children as a trustee/director due to temperament, disability or personal or health issues, or where the preference is to send to the super benefits to the estate so that they can be dealt with by the wills..

Ensure control through individual trustees - surviving trustees

If control of individual trustees after a member's death is passed to persons with whom the surviving trustees are comfortable, the circumstances that occurred in *Katz v Grossman* will be unlikely to occur.

In most cases where spouses hold benefits in a SMSF they would like the survivor of them to control the payment after the death of either of them. This generally is not a problem where the SMSF has a corporate trustee as such a company can have a sole member/director. However where a SMSF has individual trustees and the surviving member wants to retain individual trustees, then another individual must be appointed as a co-trustee.[12] In that situation a surviving co-trustee may have the ultimate discretion as to who the member's benefits are to be paid and therefore it is vital that this co-trustee is an appropriate person or that a BDBN be prepared by the member.

[12] Section 17A(2)(b) SIS Act

Ensure control through individual trustees – legal personal representatives

Control of individual trustees can pass through the appointment of a LPR to be a co-trustee after the member's death. This should ensure the member's benefits are paid in accordance with their wishes.

Many individuals incorrectly believe that after their death the executor and trustee of their estate will automatically be appointed a trustee of their SMSF.

Section 17A(3) SIS Act allows a legal personal representative of a member to be appointed as a trustee (or director of a corporate trustee)[13]. A LPR (from a SIS Act perspective) includes the executor of a will or administrator of an estate of a deceased person.[14]

However, just because a LPR can be appointed to be a trustee does not necessarily mean that this will occur. *Katz v Grossman* and *Moss Super* are both examples of where a LPR sought to be appointed as a trustee/director but the courts found that there was no enforceable right to appointment under the relevant SMSF trust deed.

Therefore it is important that if a member wishes that their LPR be appointed as a trustee after their death, there must be some mechanism to achieve that. For example, a mechanism could be contained in the SMSF trust deed which effectively allows a LPR to be appointed as a co-trustee after the member's death.

Ensure control though the control of the corporate trustee

The various methods for the control of a corporate trustee are listed above. Like individual trustees, it is important to consider who the surviving directors are likely to be and whether a LPR can be appointed as a co-director after the member's death.

The constitution of the corporate trustee and also the SMSF trust deed should be reviewed to determine where control of the SMSF will lie after the death of a member/director.

It should be ascertained who are the shareholders of the corporate trustee and hence the persons who have control of the appointment of directors. Unlike the director requirements of SIS Act[15], there are no provisions in SIS Act that dictate who must or cannot hold the shares in the corporate trustee. The shares could be held by a discretionary trust, the control of which, after the death of the member will pass to a beneficiary of the member's choosing. It should be noted that if such a course of action is to be taken the beneficiary should be a person who will qualify to be appointed as a director of the corporate trustee[16], i.e. the beneficiary is a LPR.

It is also important to consider potential deadlocks. For example, the *Katz v Grossman* problem would not have been solved if the deceased father and his daughter had been directors of a corporate trustee and the shares passed upon the father's death to his executors. This is because the daughter was a co-executor and therefore could have stymied any attempt by the son to remove his sister as a director or have himself appointed to be a director.

Ensure control through the SMSF trust deed

The SMSF trust deed can be a vital tool in ensuring appropriate succession of the trustee. However, many trust deeds do not deal with the succession of the trustee and will often rely on surviving trustees/directors to implement the succession plans.

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[13] For the ATO's view on when a LPR can be appointed as a trustee/director see Self Managed Superannuation Funds Ruling SMSFR 2010/2Self Managed Superannuation Funds: the scope and operation of subparagraph 17A(3)(b)(ii) of the *Superannuation Industry (Supervision) Act 1993*

[14] s10(1) SIS Act

[15] See s17 SIS Act

[16] See s17((3) SIS Act

For example, in the circumstances of *Katz v Grossman* the trust could have included a provision allowing for the appointment of the deceased's LPR, but the provision would be ineffective if the inherent power lay with the surviving trustee (i.e. the surviving trustee could choose not to exercise the power) or the LPR (if the surviving trustee was a co-executor that person could refuse to exercise their rights as LPR to appoint the person's sibling to be a co-trustee).

Provisions in the SMSF trust deed that could aid succession include:

- the power to appoint a LPR as a trustee/director of a corporate trustee;
- the power of the LPR to force their appointment as a trustee/director of a corporate trustee if the existing trustees/directors refuse to appoint the LPR;
- the power to make BDBN or a provision that regulates the payment of benefits.

Guardian position

Another method of ensuring the payment of benefits is the use of a "guardian" position in the SMSF. The guardian can have powers (such as the power to appoint and remove trustees or to determine who will receive benefits) or rights of veto (such as a right to prevent the appointment/removal of a trustee or the right to prevent the payment of benefits to a particular person).

The position of guardian could be helpful where children have been appointed as members and trustees/directors. For example, if the surviving parent is predisposed to their children becoming members of their SMSF but that parent wishes to preserve their ultimate control of the SMSF, the parent could be appointed to be the guardian of the SMSF.

The appointment of a guardian will not always solve the succession issues for the trustee, for example if there are no provisions for the succession of the position of guardian after the guardian's death. Therefore it is important that the SMSF trust deed appropriately deals with the succession of the position of guardian after the guardian's death.

The position of guardian must also be carefully considered to ensure that it is appropriate. For example, it would be inappropriate in most instances, where spouses are the only members of a SMSF, for only one person to be appointed guardian, because if that were so the person appointed could effectively control the benefits of the other. The use of a guardian is also counter to the notion that members should generally have an equal say about how a SMSF is run.

Who can be paid benefits?

Another important factor in payment of benefits after the death of a member is to ensure that the benefits can be paid to desired people. For example, only dependants, as defined in SIS Act, can receive benefits directly from a SMSF.
If on death, a member would like their superannuation benefits to be received by other persons the benefits must be paid to the estate of the member. If this were to occur it is important that the member's will provides that those benefits be paid from the estate to the desired person.

Voting rights

Another important factor in the payment of benefits is the voting rights of the trustees/directors.

Generally, SMSF trust deeds and constitutions of corporate trustees provide that each member who is a director has one vote. This would seem to be appropriate as members should generally have an equal say about how a SMSF is run.

However, there will be some circumstances where it may be appropriate to have voting rights determined on the percentage of benefits held in the SMSF. For example, a surviving parent with 90% of the SMSF benefits may intend that their three children become members of the SMSF whilst retaining control of the decision making process. In these circumstances proportionate voting rights may be appropriate provided the children are fully informed of their voting rights.

13. EFFECTIVELY USING POWERS OF ATTORNEY IN RELATION TO SUPERANNUATION[17]

The following section looks at the use of powers of attorney in a superannuation context. It should not be read as an exhaustive review of powers of attorney including the requirements to make powers of attorney or the roles, responsibilities and liabilities of an attorney.

Powers of attorney and SMSFs

To this point I have discussed the importance of effective succession planning and providing a direction of payment of superannuation benefits upon death. However it is just as important to address the succession of a superannuation fund during a member's life.

Having a financial enduring power of attorney in place can assist in dealing with those situations where a member is unable to make decisions in relation to the SMSF themselves. As a general rule every member of an SMSF must also be a trustee, or director of the corporate trustee, of the SMSF. However, one exception to this rule is that a member's legal personal representative (which is defined to include an attorney appointed under an enduring power of attorney[18]) may act as trustee/director in place of the member.

A legal personal representative of a member of a fund can be the trustee of the fund (or a director of the corporate trustee) in the following situations:[19]

- The member of the fund is under a legal disability; or
- The legal personal representative has an enduring power of attorney in respect of the member of the fund.

The SIS Act defines a legal personal representative to include a person who holds an enduring power of attorney granted by a person.[20]

The ATO's view on when a legal personal representative may be appointed as a member/trustee is set out in SMSFR 2010/2. The ATO has expressed that only an enduring power of attorney will satisfy the requirements of section 17A(3)(b) of the SIS Act[21] and therefore a general power of attorney will not be effective in these circumstances.

It is important to note that each Australian state and territory have their own legislative requirements in relation to preparing powers of attorney and such requirements must be followed to ensure that the power of attorney is effective both at the time of making the power of attorney as well as continuing to be effective during the time the attorney has been appointed.

Appointing an attorney as a trustee of the SMSF

A common scenario where a member may appoint an attorney in their place as trustee, or director of corporate trustee, of the SMSF is when such member moves overseas for a prolonged and/or undefined period of time which would cause the fund to be non-complying.

[17] I would like to thank and acknowledge Melissa Brazzale (Associate, Sladen Legal) for assisting in the preparation of this section of the paper

[18] Section 10(1)

[19] Section 17A(3)(b)

[20] Section 10(1)

[21] SMSFR 2010/2

Where an SMSF has a member who will be based overseas, the SMSF must continue to satisfy the definition of an Australian superannuation fund[22]. Whilst it's beyond the scope of this paper to go through each of those conditions, an important consideration for the purpose of this paper is that the central management and control of the SMSF must be in Australia. Whilst the term "central management and control" is not defined in legislation, case law suggests that this relates to the location where the SMSF's operations are administered and directed[23].

On this basis, when a member of an SMSF is moving overseas for a period of time which would cause the SMSF to cease being an "Australian superannuation fund", the member must either:

- Appoint an attorney in their place as trustee of the SMSF;
- Roll out their member benefits to a public offer fund.

When appointing an attorney, and in order to comply with section 17(3)(b)(ii) of the SIS Act, it's important to note that the attorney must be appointed as an attorney/director. This means that the member must appoint the attorney as trustee in their place, and the member must cease to be a trustee/director. For this reason, an attorney will not automatically become a trustee, or a director of a corporate trustee, simply because they hold an enduring power of attorney.[24]

Member loses capacity to make decisions

Another common scenario where an enduring power of attorney is an important tool for succession of an SMSF is where a member becomes incapacitated and is no longer able to make decisions themselves.

Under section 17(3)(b)(i), a legal personal representative is able to act as an individual trustee or a director of a corporate trustee of an SMSF where a member becomes legally incapacitated. On this basis, where a member holds an enduring power of attorney, such attorney may become be the member's legal personal representative. However, it is important to note that section 17(3)(b)(i) does not automatically appoint the attorney and therefore it must be determined under the SMSF trust deed how the attorney can be appointed. This could be problematic, for example, where the incapacitated member has the power to appoint/remove trustees/directors. However, in such a situation it may be possible that the attorney could exercise such a power in their capacity as attorney for the member.

What if more than one attorney is appointed?

Where a member makes an enduring power of attorney in favour of more than one person, each of the nominated attorneys would satisfy the definition of legal personal representative under section 10(1) of the SIS Act. As such, one or more of those attorneys can be appointed as trustee, or director of the corporate trustee, in place of the member. A person may also be an attorney (and therefore a legal personal representative) for more than one person.

It is also worth mentioning that an existing member of an SMSF is able to be appointed as a trustee, or director of the corporate trustee, in place of another member of the same SMSF.

What can the attorney do?

In general, an attorney is able to exercise all or any powers that the donor themselves would otherwise exercise themselves. It is important to take note of any express conditions contained in the power of attorney as the attorney's powers may be limited on this basis.

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[22] Section 295-95(2) ITAA 1997
[23] *Koitaki Para Rubber Estates Limited v FCT* (1941) 64 CLR 241, 248 – See also TR 2008/9
[24] This was confirmed in the Western Australia Court of Appeal decision of *Ioppolo v Conti* [2013] WASC 389

Acting in a trustee capacity, an attorney can do all acts that the trustee is empowered to do under the SMSF deed. Such acts, in an SMSF context, generally include[25]:

- Signing off on financial accounts;
- Making decisions in relation to SMSF investments;
- Making a decision as to whether a member can access their benefits;
- Making a decision in relation to the payment of a deceased member's death benefits (this would include either following a BDBN made by the member, or in the absence of a BDBN, determining who the death benefits should be paid to).

As well as acting as the trustee, or a director of the corporate trustee, an attorney also acts as a representative for the member and therefore can make decisions that the member would have otherwise made themselves. This can include requesting[26]:

- Withdrawal of benefits;
- Commencement or cessation of a pension;
- changes to pension payments;
- A roll over or transfer of benefits to another superannuation fund;
- A change in investment options.

As outlined above, these powers will always be dependent upon any restrictions set out in the power of attorney and any relevant provisions contained in the superannuation fund deed.

Attorneys and BDBNs

There continues to exist considerable debate in relation to the ability of an attorney to make, revoke or amend a BDBN on behalf of the donor member. There is nothing in the SIS Act or the SIS Regs that specifically prohibits an attorney from doing so however it has been argued that the making of a BDBN is a personal power and therefore must be done by the member themselves (ie akin to the making of a will which cannot be done by an attorney of a person).

The following are examples of where an attorney may wish to action a member's BDBN:

- An attorney prepares a BDBN to refresh a lapsed BDBN in the same manner that the lapsed BDBN had directed;
- An attorney prepares a completely new BDBN inconsistent with the member's previous BDBN (which has now lapsed);
- An attorney revokes an existing BDBN and makes a new nomination inconsistent with the member's existing BDBN and such nomination is not in favour of themselves;
- An attorney revokes an existing BDBN and makes a new nomination inconsistent with the member's existing BDBN and such nomination is in favour of themselves;

A 2008 decision of the Superannuation Complaints Tribunal[27] (**SCT**) acknowledged that an attorney (under an enduring power of attorney) could make a BDBN on behalf of the member. Specifically, the SCT stated that:

> *"…the Enduring Power of Attorney would have permitted the Complainant to complete and sign the Binding Death Benefit Nomination".*

In light of the above comment, the SCT determined that the BDBN was not a valid determination as it was unclear in what capacity the complainant was nominated on the form (and therefore did not have to make a direct determination in relation to the validity of the attorney making the BDBN).

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[25] Please also see Louise Ricardo, "Superannuation fund control – planning for incapacity and death" January/February 2015, *Retirement & Estate Planning Bulletin*

[26] Please also see Heather Gray, "Enduring powers of attorney – issues for trustees" November 2012, *Australian Superannuation Law Bulletin;* Louise Ricardo, "Superannuation fund control – planning for incapacity and death" January/February 2015, *Retirement & Estate Planning Bulletin*

[27] SCT Determination No D07-08\030

Unfortunately, other than the abovementioned case, there is no other case law which further clarifies this issue. As such, trustees must consider each BDBN on its own face. Whilst the position remains unclear, it is submitted that an attorney who makes a BDBN in favour of themselves (and to the exclusion of other beneficiaries) would be acting outside their authority as an attorney[28] (unless the power of attorney express empowers the attorney to make such a BDBN). On the other hand it is possible that an attorney who prepares a new BDBN to refresh a lapsed BDBN, and such directions are consistent with the directions contained in the lapsed BDBN, would be acting within their powers.

If an attorney is to make a BDBN on behalf of a member then it would be preferable that the power of attorney specifically empowers the attorney to make, amend or revoke BDBNs and if desired by the member that the attorney be empowered to make BDBNs in favour of the attorney. In addition, it would be preferable that the trust deed specifically empower the trustee to accept BDBN's from attorneys.

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[28] Heather Gray, "Enduring powers of attorney – issues for trustees" November 2012, *Australian Superannuation Law Bulletin*