

# RISKS WITH SMSF DEATH BENEFITS

## - METHODS TO ENSURE BENEFITS GO WHERE THEY ARE INTENDED

Careful planning is required to ensure benefits go where they are intended on the death of an SMSF member

This article considers some of the possible risks associated with SMSF death benefits and illustrates how you, as a trusted adviser, can assist in protecting your clients from those risks.

### Superannuation Death Benefits

A member's superannuation balance at the time of their death does not automatically form part of their estate. That balance is generally controlled, following their death, either by the remaining trustees or by specific documentation.

The principal risks to the correct allocation of superannuation death benefits are:

- the risk that the benefits are not paid to the deceased member's designated/preferred beneficiaries - **payment risk**; and/or
- the risk that the amount of the benefits paid will be reduced as a result of unnecessary taxation - **taxation risk**.

This article will cover aspects associated with payment risk, and detail ways to mitigate those risks.

### Payment risk

Payment risk occurs because:

- the remaining trustees do not pay the benefits to the intended recipients, or in the correct proportions, either by:

- deliberate action – the often quoted case of Katz v Grossman, and the more recent cases of 'Conti' and 'Morris' provide examples, to varying degrees, of the remaining trustees not paying the benefits to the individuals the deceased member had intended would receive their benefits; or
- non-deliberate action, such as because of:
  - a lack of guidance or instructions provided to the remaining trustees; or
  - documentation intended to provide guidance or instructions proving to be faulty and, therefore, of no effect; or
- there are no remaining trustees, leading to the questions such as:
  - who will act as trustee? and
  - what has happened to the directions provided by the deceased member? or
- the documented beneficiaries:
  - are no longer the preferred beneficiaries, e.g. following relationship breakdown; or
  - are not eligible under superannuation law to directly receive benefits; or
  - have predeceased the member, with no guidance

provided as to the succession of those benefits.

### Mitigating risk

Methods to reduce those payment risks include:

#### Reversionary Pensions

The pension automatically becomes payable ('reverts') to another person, previously nominated by the member, on the death of that member. That removes the discretion from the surviving trustees. However:

- correct, up to date documentation is required to ensure the reversion can proceed. For example, if a nominated child has turned 18 and commenced working full time since the documentation was prepared, the pension is not permitted to revert;
- who holds the documentation confirming the reversion?
- the recipient needs to be able to become a member and trustee of the fund, if they do not already fill those roles;
- can the reversion be countermanded by any other document?; and
- what about accumulation balances held in the deceased member's name, as accumulation funds are not

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covered by a pension reversion nomination?

### Death Benefit Nominations

There are a range of Death Benefit Nominations, each with a degree of potential risk, including:

- Non-Binding Death Benefit Nominations;
- Lapsing Binding Death Benefit Nominations; and
- Non-Lapsing Binding Death Benefit Nominations

Potential risks include:

- the remaining trustee could:
  - 'lose' the Binding Death Benefit Nomination, possibly even deliberately; or
  - transfer the benefit to another fund, which has no Binding Death Benefit Nominations;
- the Binding Death Benefit Nomination may:
  - lapse, and be of no effect; or
  - be faulty - e.g. it may not have been correctly witnessed;
- the trust deed may not be sufficiently current to allow the acceptance of appropriate Death Benefit Nominations; or
- the trust deed may be unclear as to whether there is conflict between a Reversionary Pension and a Death Benefit Nomination and, if so, which takes precedence.

There is also a degree of 'adviser risk' in regards to the preparation of Death Benefit Nominations. Whilst incorrectly or inappropriately completed documents may result in litigation from disenfranchised beneficiaries, properly completed Death Benefit Nominations can reduce adviser risk, by utilising:

- the flexibility available through a properly prepared Death Benefit Nomination; and
- the introduction of multiple layers of potential beneficiaries to the Nomination.

The Topdocs trust deed provides for a range of Death Benefit Nominations, including quite complex, multi-tiered, arrangements.

### Death Benefit Rule

The Death Benefit Rule is similar to a Binding Death Benefit Nomination, the main difference being that the document is effectively 'built into' the trust deed. This removes some of the possibly detrimental actions mentioned above (such as a 'lost' BDBN), but can be relatively inflexible.

### Automatic inclusion of Legal Personal Representative as Trustee

The term 'legal personal representative', for a deceased person, refers to the executor of their Will, or administrator of their estate. The person nominated under a Will needs to apply for a Grant of Probate, meaning there would be a delay in that person or persons

being in a position to act as trustee of a SMSF.

What if there is a dispute as to whether the 'last' Will is valid? Also, what if the deceased left no Will and, as sometimes occurs, a dispute over 'control' of the deceased's assets arises between the deceased's family and for example, a person claiming to be a de facto spouse? The actual legal personal representative may not be determined for some months - even years.

Apart from that, the inclusion of the legal personal representative may not be an effective means of control, for example, if there are 2 or 3 other members/trustees of the fund, unless there are specific rules in place regarding voting powers.

### Death Benefit Guardian

A Death Benefit Guardian provides a degree of oversight of the trustee actions in regards to death benefits, and can operate in conjunction with Reversionary Pension, Death Benefit Rules and Death Benefit Nominations.

The Death Benefit Guardian could be a trusted friend/relative or a professional adviser, and could hold:

- copies of the Reversionary Pension documents; and
- copies of Death Benefit Nominations;

so as to ensure that payments made by the trustee are in accordance with the wishes of the deceased member.

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What happens if the trustee refuses to accept the power of the Death Benefit Guardian? The dispute would need to be settled in Court. In that event, properly drawn provisions in the trust deed will be crucial to the argument. However, it is likely the issue would not reach Court, as the legal personal representative will generally have been added as a trustee of the fund, in the meantime, in accordance with the trustee/member rules.

#### Conclusion

Maximum protection can be provided, in regards to Reversionary Pensions and Death Benefit Nominations, with the added oversight of a Death Benefit Guardian.

Whilst the amount of documentation ultimately required will depend, on a case by case basis, on the degree of potential risk levels perceived to exist, comfort can be taken from the availability of properly drawn documentation designed to mitigate any risks faced by members, their intended beneficiaries, their advisers and the remaining trustees, concerning the distribution of death benefits.

#### What should you do now?

We suggest you consider the position of your clients and their SMSF structures and, if necessary:

- review whether Death Benefit Nominations are current and appropriate and, if not, replace them; and
- consider recommending the appointment of a Death Benefit Guardian (a relatively simple form) to your client members.

#### Need assistance?

The Topdocs estate planning specialists can assist with your client requirements.

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*The Legal Personal Representative of a deceased person may not be known for some considerable time following the death of a member.*

*The interests of the deceased member, and their beneficiaries, need to be protected from the time of death.*

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