Succession planning & SMSFs

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What you need to know

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Session overview

- Succession Planning - what is it?
- Control after death
- The importance of the Trust Deed
- Shares in the Corporate Trustee
- Binding Death Benefit Nomination
- Reversionary Pensions
- Bringing it all together
- Questions.

Abbreviations

- ATE – Assets Test Exempt
- ABP – Account Based Pension
- BDBN – Binding Death Benefit Nomination
- CC – Concessional Contribution
- ECPI – Exempt Current Pension Income
- EPOA – Enduring Power of Attorney
- LPR – Legal Personal Representative
- MLP – Market Linked Pension
- NCC – Non Concessional Contribution
- NOI – Notice of Intent
- OMT – Off Market Transfer
- TBA – Transfer Balance Account
- TBAR – Transfer Balance Account Reporting
- TBC – Transfer Balance Cap
- TSB – Total Super Balance.

What's the difference?

Succession Planning

- Who ***controls*** your fund:
  - In the event you lose mental capacity
  - You pass away.

Estate Planning

- How the fund assets are ***distributed:***
  - Who gets the assets
  - Reversionary pension, lump sum, or both.

Effective Succession Planning

- Smooth transition of control with minimal hassle and costs
    - Administrative ease
    - Certainty
    - Compliant
    - Tax effective
    - ***<u>The right assets, to the right person, at the right time.</u>***

Control after death

- A member ceases to be an individual trustee or director of a corporate trustee upon their death
- The fund may also cease to be an SMSF according to superannuation law
- ***BUT….***
- The SIS Act gives us 6 months to restructure the trusteeship
- A Legal Personal Representative (Executor) ***may*** be appointed as individual trustee or director of a corporate trustee
- This will again allow the fund to satisfy the definition of an SMSF
- But only for 6 months from the date the deceased's benefit commences to be paid (pension, lump sum, or both).

Control after death

- This is not an automatic appointment
- ***<u>Superannuation is not an estate asset</u>***
- Your SMSF is separate to your estate and exists in a world of its own
- Your LPR – your Executor if you have a Will – ***<u>has no control over your SMSF</u>***
- Only your SMSF Trustee does
- And it is the trust deed that determines who the Trustee is – not the Will
- ***Ioppolo & Hesford v Conti & Anor*** **[2013] WASC 389**
- ***<u>Lesson #1 – if you want to appoint your Executor as Trustee, check the Trust Deed.</u>***

The importance of the Trust Deed

- The SMSF’s deed also governs when a member ceases to be a fund member
- A common time for this is upon the death of a member
- The deed will also contain provisions which govern who (if anyone) will have the power to appoint a new trustee upon the member’s death
- This is a particularly important mechanism if there is a single member fund with two individual trustees.

The importance of the Trust Deed

- An SMSF deed will be ***more*** important for succession planning where there are individual trustees
- This should provide clarity on whether a majority or other voting threshold is required for member decisions:
    - Based on member balance?
    - LPR has the casting vote?
- If there is a corporate trustee, these steps would usually be set out in the company's constitution
- ***Lesson #2 – consider a corporate trustee.***

The importance of the Trust Deed

- Examples of appointment and removal of Trustee clauses in SMSF deeds:

  The appointment, removal or replacement of a Trustee shall be by written agreement of at least two thirds of the Members except where there are only two Members in which case unanimous agreement is required. Where there is a deadlock each individual Member's vote shall be weighted in relation to the value of the Member's interest or entitlement in the Fund.

- In a single member fund with individual Trustees:
  - Can appoint another individual Trustee
  - Or a Company with the surviving member as Director.

Shares in the Corporate Trustee

- ***<u>BUT….</u>***
- One also needs to be careful with shares in the Corporate Trustee
- On the death of a Director/Shareholder, who inherits the shares?
- Shareholders can remove Directors
- The Will could say the LPR inherits the deceased member's shareholding in the Corporate Trustee
- But one needs to be careful as to how this is structured.

Shares in the Corporate Trustee

Example 1 – LPR becomes Director

- Karen and Keith are Directors, with 3 shares each
- They have 2 children, Ray and Fran, who are their LPR
- The Trust Deed appoints the LPR as Director of the Corporate Trustee
- The Company Constitution appoints the LPR as Director in place of the deceased
- But Keith's Will says all his shares in the company are to go to Karen
- Karen is the sole shareholder, with Ray and Fran co-Directors
- ***<u>Who controls the Fund?</u>***

Binding Death Benefit Nomination

- A Binding Death Nomination (BDBN) is a direction from Member to Trustee to pay their benefit a certain way on death
- *It is absolute – the Trustee must follow the member's direction*
- However, it must be valid – otherwise it's invalid
- Most super funds can only provide 3-year lapsing BDBNs
- However an SMSF can have a non-lapsing BDBN
- BDBNs can have a cascading BDBN, which directs the Trustee to pay the benefit to a subsequent beneficiary
- But the governing rules must allow for this
- <u>***Who controls the Fund?***</u>

Binding Death Benefit Nomination

- BDBNs are a partial solution
- Subject to who is the Trustee of the Fund
- It should form part of an overall Succession Planning strategy
- *But who controls the Fund is of critical importance!*
- ***Lesson #3 – consider having a non-lapsing BDBN.***

Binding Death Benefit Nomination

- ***Wooster v Morris [2013] VSC 594***
- BDBN in favour of 2 daughters from first marriage
- Surviving Trustee (second Wife) disregarded BDBN
- Court found BDBN valid
- But plaintiffs had to wait 3 ½ years to get their money!

Reversionary Pensions

- Pension documentation or other governing rules stipulate the income stream is to continue to a beneficiary
- The pension does not cease on the death of the primary pensioner
- It can be paid to multiple beneficiaries, such as minor children
- Can be 'hard-wired' into the Trust Deed
- Reversionary pensions provide greater certainty as to who gets your death benefit
- Combined with a BDBN, can stream various benefits to different beneficiaries to maximise the outcome.

Reversionary Pension vs BDBN

- A BDBN is a direction from the Member to the Trustee instructing how the Trustee should pay the Member's benefit if they die
- A BDBN is binding on the Trustee of the Fund
- However a reversionary pension does not cease on death – it seamlessly continues to the reversionary pension recipient
- A reversionary pension is akin to a contractual obligation
- Therefore the reversionary pension trumps a BDBN
- *But it often depends on the Fund's Trust Deed and other documentation*
- ***<u>Lesson #4 – consider reversionary income streams.</u>***

Bringing it all together

Case Study

- Richard, 68, has $1m in his fund
- He is the only member
- His benefit is in accumulation mode
- He is married to Sandy
- They are both individual trustees of the SMSF
- Richard has a child from a previous marriage, Grant
- Grant is an independent adult working in IT.

Bringing it all together

Case Study

- Grant is Richard's Executor
- Upon his demise Richard would like an income stream to be payable to Sandy
- He would also like his adult son, Grant to receive a lump sum from the fund
- *How could he structure his benefit so this is achieved?*

Bringing it all together

Case Study

- Subject to the fund's governing rules, Richard could commence 2 pensions worth $500,000 each
- Sandy could be named as the reversionary recipient of one of the pensions
- The other pension could be non-reversionary
- Richard could also have a BDBN that nominates his son Grant
- This could encompass the non-reversionary pension
- This pension would cease on his death and then form his accumulation benefit
- *Therefore the BDBN would encompass the accumulation benefit, not the pension interest.*

Bringing it all together

Case Study

- A Corporate Trustee could also be established
- The fund's Trust Deed could allow the LPR to become Trustee in Richard's place
- Therefore Grant could become Director/shareholder
- Sandy would not 'control' the fund
- The non-reversionary pension would cease, and be paid as a death benefit lump sum to Grant
- *However, the reversionary pension would continue to Sandy*
- Once the death benefit is lump sum is paid out, Grant could resign as Director
- Sandy could then be the sole Director of the Corporate Trustee.

Bringing it all together

Case Study

- But he needs to ensure the pension is reversionary
- *The fund's governing rules – including any pension documentation – is key*
- If the pension ceases on death, it forms part of the accumulation interest
- All the benefit may go to Grant via the BDBN
- Richard also needs to ensure the control of the fund is in the right hands
- *Possession is nine-tenths of the law!*

Introducing your tech and education team

A team with nationwide presence, allows us to be where you are.

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Questions

Questions

- Could you please address the topic of pros and cons of death benefit nominations vs reversionary pensions for parties in their post retirement period

- To give you some context, currently my wife and I are in our mid 70s and both healthy. We have two adult children, married with young families who do not have any immediate financial needs. I imagine our circumstance may be similar to many others

- We presently have mutual wills in favour of each other which provide for the establishment of two testamentary trusts on our deaths, one in favour of each of our children's' families.

Questions

- Myself and my wife (E&N) are both aged 70, still in accumulation mode

Children R&A (aged 37 and 35) who have 3 children each themselves (aged 1, 3, 5 yrs)

All have maxed out the superannuation balance limit

    - R&A have non-lapsing BDBN that the benefits must go to their 3 minor children equally (and not their spouse). Is it valid if R&A die (the Will does not contradict this)? That is, would the benefits go to their children, not their spouse?
    - If R/A die, how is it paid to the minor children? Who decides how it is paid and into what account etc, considering the beneficiaries are minors? The Will makes mention of this.
    - What happens if E&N both die at the same time, say in an accident? How to avoid extra taxes?

Questions

- Background, we have an Estate Plan in place, which includes
  - Wills
  - BDBN
  - EPoAs
  - EGs, and
  - Testamentary trusts for both members of a two member SMSF

Questions

- When a member dies,
  - Can the SMSF account be maintained as part of the testamentary trust? Or
  - Do the normal rules apply, such as:
    - Existing pension reverts to surviving member
    - Surviving member commutes their pension to the accumulation account
    - Accumulation account for member who has died must be withdrawn (within a certain period, and hopefully before an imminent death as a lump sum)?
- With regards lump sum withdrawals (pending imminent death), we have instructions in place to cover and expedite that withdrawal, per one of your previous seminars.