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SMSF SUCCESSION PLANNING

Murray Wyatt
Morrows Pty Ltd



What we will cover

- Trustee-Member Rules
- Trustee Succession
 - Individual v Corporate Trustees
 - *Katz v Grossman* example
- Reversionary pensions
- Binding death benefit nominations
- Legislative update (TR 2013/5)
- Hardwiring deeds
- Invalidity (or incapacity)

- Definition of SMSF outlined in s17A of the SISA
 - Have less than 5 members
 - Each trustee/trustee director is a fund member, unless a single member fund
 - Each member of the fund is a trustee/director
 - No member of the fund is an employee of another member unless related
 - No trustee receives remuneration for trustee services
 - The fund is a resident regulated superannuation fund

Trustee-member rules for SMSFs



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- Children (under 18) can be members,
- and their parents can hold office as a trustee (or director of a corporate trustee) in their place
- Enduring powers of attorney can be used in case of incapacity once the fund is established
- But not to establish a SMSF

Trustee-member rules

Who are members of your SMSF?



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- Once over 18, children have the legal right to be trustees (or directors of corporate trustee)
- This gives rise to a succession planning opportunity via the trustee of the SMSF
- Assets can be allocated to member accounts via the SMSF – segregation of assets
- But....

REMEMBER FAMILY DYNAMICS



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Who are members of your SMSF?

- If employer company is also trustee of SMSF
- Consider whether it is a wise decision to have children as directors of that company?
- Consider *Triway Superannuation Fund and Commissioner of Taxation* [2011] AATA 302,
- where a drug addicted son ‘cleaned out’ the SMSF where the son and his parents were members
- Family feuds can also make SMSFs difficult to run!

- In *Basil Notaras v Brinos Notaras* [2012] NSWSC 947, two brothers refused to co-operate in relation to their joint SMSF, due to a separate family feud
 - Brinos withdrew almost \$60,000 more than his member entitlement from the fund, and also refused to sign a number of compliance documents (eg, tax returns)
 - Order granted from the NSW Supreme Court to have Brinos replaced as trustee
 - A very expensive and painful process!

- Consider Trustee Succession
 - Whoever holds office as trustee will impact on how death benefits are paid
 - As such, this is an important aspect of SMSF succession planning
 - Need to examine the differences between:
 - Corporate v Individual Trustees

Trustee Succession

Individual Trustee



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- The deed will usually outline who succeeds an individual trustee – generically expressed
- If individual trustees, usually (under the trust deed) the survivor trustee will have power to change the trustee
- This is common in a lot of deeds, ok for perhaps Mum and Dad (depends on facts), but for siblings or business partners?
- Alternatively, the legal personal representative (‘LPR’) of the deceased member will be appointed – a safer approach
- When an individual trustee dies, change of trustee documents may need to be executed to appoint the replacement

Trustee succession

Corporate trustee



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- Smoother succession occurs with a corporate trustee (simply change director)
- The company will continue on after the member's death
- This means no change of trustee upon member's death
- Change of director forms must be lodged via ASIC
- ATO will also need to be notified

Trustee succession

Corporate trustee



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- Advantages of a Corporate Trustee
 - Asset protection – the capacity argument
 - More efficient for estate planning as follows:
 - Successor directors can be nominated via the constitution to allow them to hold office after the death of the member
 - Eg, constitution may allow a director to appoint a successor director in their place after their death
 - To implement this an additional agreement/nomination of successor director may be needed

Trustee succession

Corporate trustee



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- Advantages of a corporate trustee (continued)
 - Shares in the company can be gifted via the deceased member's will
 - Less administration when a member dies – no change of trustee required
 - If no corporate trustee, it can be cumbersome from a registration viewpoint if there are numerous assets such as property or shares

Individual trustees can be dangerous?



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Example below is adapted from *Katz v Grossman* [2005] NSWSC 934, a leading case on SMSF succession:

- Mr and Mrs Katz were individual trustees and members of an SMSF
- Mrs Katz died and Mr Katz was the sole surviving trustee and member
- He appointed his daughter, Linda Grossman as a trustee in place of his wife

Individual trustees can be dangerous?



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- Mr Katz also signed a ‘non-binding’ death benefit nomination
- Non-binding nomination not discussed in detail in judgment
- Likely that nomination did not comply with relevant provisions of SISA (s 59)
- Nomination was probably similar to the standard pro forma ‘non-binding’ nomination handed out by public offer funds – needs to say it is binding and be properly witnessed!

Individual trustees can be dangerous?



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- Mr Katz intended for both his daughter (Linda) and son (Daniel) to benefit from his superannuation assets
- When Mr Katz passed away, Linda was left holding office as the sole trustee of the fund
- Linda appointed her husband, Peter, as a second individual trustee of the fund
- Linda and her husband then resolved to pay Mr Katz's death benefits entirely to her
- NSW Supreme Court held that Linda's appointment of her husband was valid

Katz v Grossman Example

Superannuation Succession



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- How could this injustice against Daniel been avoided?
 - Have a corporate trustee!
 - The trustee could have continued with Mr Katz as the sole director after Mrs Katz' s death
 - Successor directors could be nominated to specifically succeed Mrs Katz, depending on constitution eg, Mr Katz nominates Son and Daughter
 - Or complete a valid binding death benefit nomination ('BDBN')
 - If Mr Katz properly executed a BDBN, the trustee (Linda and her husband) would be bound to follow it

- Despite advantages of corporate trustee, the majority of SMSFs have individual trustees
- As at 30 June 2011, 74% of SMSFs had individual trustees
- 90% of SMSFs established in the year ended 30 June 2011 were established with individual trustees
(source: self-managed superannuation funds. A statistical overview 2009-10. ATO publication)

- **Why?**

Pensions on death

Auto-reversionary v BDBN



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- Auto-reversionary pension vs binding death benefit nomination ('BDBN')
- Which one wins?
- Example:
 - H and W are members of the HW Super Fund
 - H has a reversionary pension in place that will revert to W on his death
 - Additionally, H has a BDBN that directs the trustee to pay all his super to his estate
 - If H dies, which of the pension v BDBN will win?

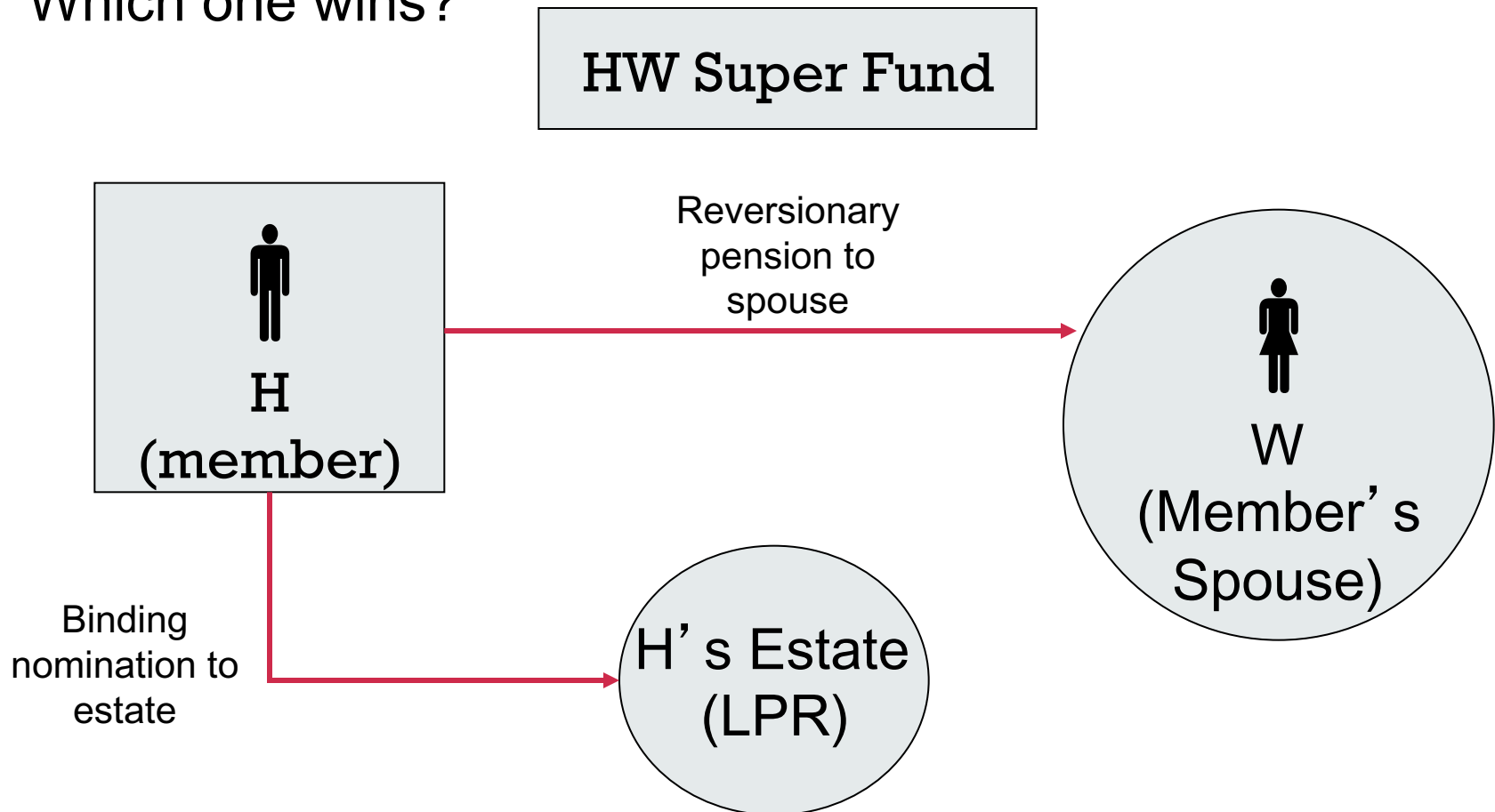
Pensions on death



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Auto-reversionary v BDBN

- Auto-reversionary pension vs binding death benefit nomination ('BDBN')
- Which one wins?



- Example: (continued)
 - It depends on the deed?
 - Established principal of law is that a trustee cannot fetter their discretion
 - ‘Fetter’ : is not a type of cheese; it refers to a restriction
 - One exception to this principal is where the deed provides a restriction (*Muir v Inland Revenue Commissioners* [1966] 1 WLR 1269, 1283)
 - SMSF deeds should provide a valid fetter of a trustee’s discretion in relation to the BDBN, which will bind the trustee to follow the BDBN

Auto-reversionary v BDBN

- Notwithstanding, honouring pension documentation, eg reversionary pensions, will still be at the discretion of the trustee
- The pension documents are a mere request of the trustee, the trustee has the option whether to honour this request
- However, BDBNs usually bind the trustee
- For example, consider the clause in Morrows' trust deed
 - *11. The Trustee exercises its powers subject to any written direction signed by a Member in respect of:*
 - *(a) a nominated Beneficiary who is to receive benefits on the death of a Member...*
- the trustee's discretion under the deed is restricted by this clause, (a valid fetter) which relates to BDBNs

Pensions on death

Auto-reversionary v BDBN



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- Documentation is the key
- Have a trust deed, BDBN and pension documents that aligns
- Ensure that the deed is updated to provide for BDBNs
- Note that ‘reversionary’ pension documentation may not be essential from a tax perspective due to recent legislation, as well as finalisation of TR 2013/5

Legislative update – reversionary pensions



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Finalisation of TR 2013/5 (Draft ruling TR 2011/D3)

- Ruling concerned with when a pension commences and ceases (including cessation on death of a member)
- Draft ruling highlighted the importance of reversionary pensions and binding death benefit nominations
- The ruling outlines that if you don't have a reversionary pension via pension documents or BDBN, the pension ceases on death of the member
- However, recent changes to legislation have changed the tax position when a member dies without pension succession

Legislative update – reversionary pensions



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- Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013
 - Amends *Income Tax Assessment Regulations 1997 (Cth)*, reg 995-1.01
 - Amendment to tax treatment of assets supporting a pension after a member dies
 - These assets can now be sold tax-free, even if the pension is not reversionary and does not continue after death
 - Proposed changes apply retrospectively from 1 July 2012

Legislative update – reversionary pensions



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- In summary:
 - TR 2013/5 is now finalised
 - Amendment to *Income Tax Assessment Regulations 1997* (Cth) will make sale of pension assets tax free on death
- So, why bother with the documentation?
 - Tax shouldn't be the only consideration, reversionary pension and binding nomination documentation provide certainty

Pensions on death

hardwiring trust deed



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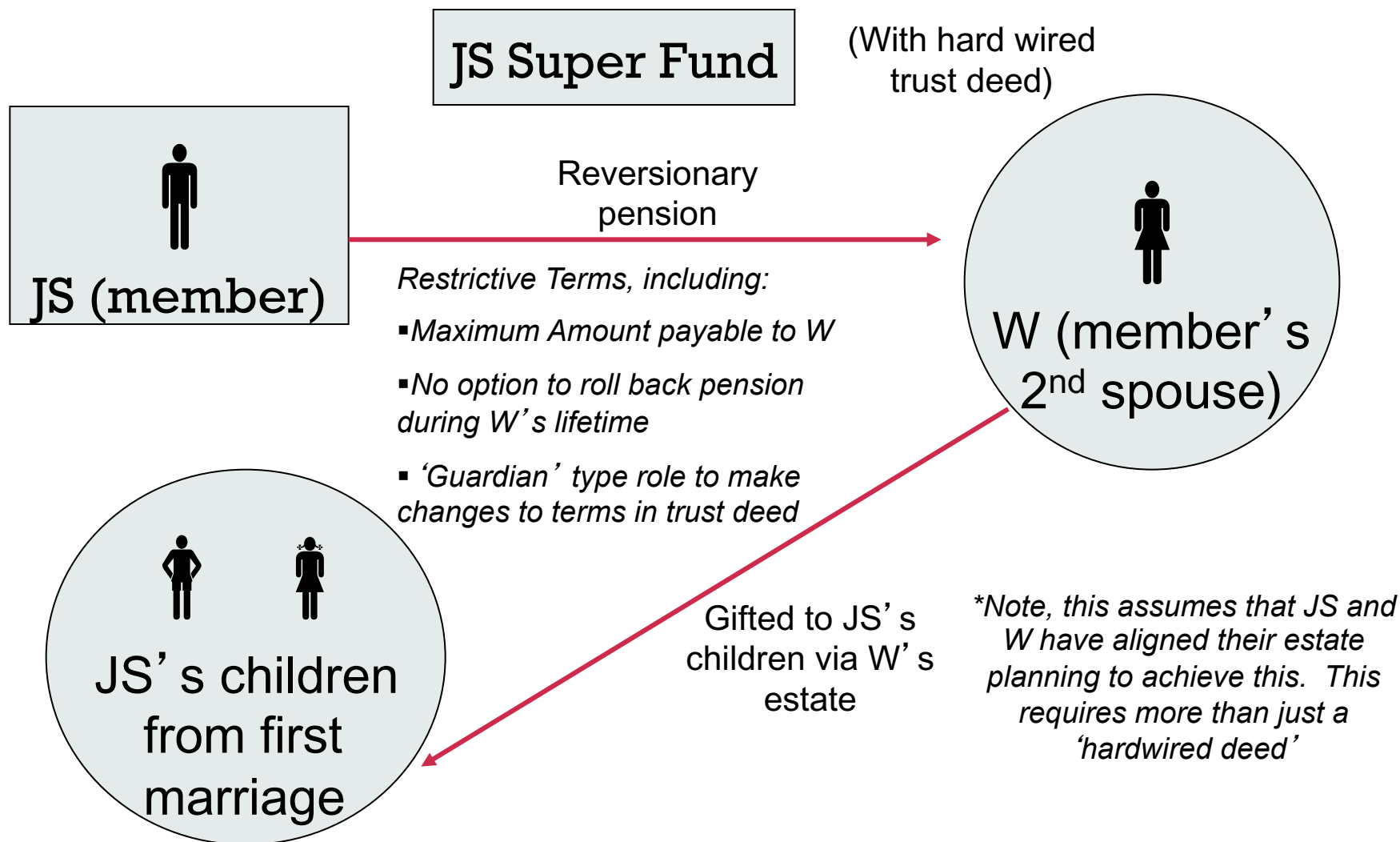
- ‘Hardwiring’ a trust deed with member’s succession is also an option
- Particularly useful for ‘blended families’
- Example:
 - John Smith (‘JS’) is currently married to a second spouse (‘W’)
 - He has children from his first marriage, and a stepson from his second
 - John has the JS Super Fund and he ‘hardwires’ the trust deed to provide an income stream for his second spouse during her lifetime (without access to capital)
 - The capital is to go to his children from his first marriage

Pensions on death hardwiring trust deed



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Blended Family Example – using hard wired trust deed



Pensions on death hardwiring trust deed



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- ‘Guardian’ will need to be a party to a variation to the deed
- Guardian could be JS’ s children from first marriage
- For this example to be effective, W and JS must agree to align their estate planning
- This requires a mutual wills agreement, as well as W including JS’ s children in her will
- Depending on family dynamic, it may not work in all circumstances.
- It requires, JS, W and JS’ s children to all work together!

Pensions on death

hardwiring trust deed



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Additional Example: Blended Family using hard wired trust deed



JS 1 Super Fund


JS 2 Super Fund

(with hard wired trust deeds)

 JS (member)

 JS (member)

 
JS' s children
from first
marriage


W (member' s
2nd spouse)

Smaller balance exposed to risk
of redirection or kiss it goodbye

Pensions on death

hardwiring trust deed



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- (From prior example)
 - W has the right notwithstanding a mutual will to change it, to say give her child the benefits
 - Changing it may assist a TFM claim in the courts, by JS' s children, but she has the right!
- Solution
 - JS can establish two super funds and quarantine his super benefits payable to each of his second spouse and bloodline children
 - Hard wired trust deeds could be used to 'lock in' his succession to the respective beneficiaries in the actual trust deed
 - This would mean that his super benefits could not be changed via his estate
 - Further, the administration of his super funds after his death would be clear, due to the directions in the deed

- Focus of presentation so far has been on succession on death
- But what if a member became incapacitated during their lifetime?
- Importance of enduring power of attorney ('EPoA')
- Person holding an EPoA in respect of a member can make decisions on behalf of the member in relation to their SMSF
- Legislative power for this to happen per SISA s 17A(3)(b)
- ATO gives further guidance per SMSFR 2010/2
- Having EPoA is not enough, the attorney must be appointed to office of trustee

▪ Example

- Andrew and Bernice are individual trustees and members of the AB Super Fund.
- Andrew works in the CBD and unfortunately gets hit by a bus on his way to work, which sends him into a coma
- What if Andrew did not grant an EPoA?
 - Bernice cannot make trustee decisions in relation to the fund by herself.
 - Both trustees are required to make decisions
 - Hope that deed provides for trustee succession if there is incapacity?
 - Apply to VCAT (or similar tribunal) for an order
 - But this can be costly, and Bernice is not guaranteed to be picked as attorney

- Example continued
 - A lot easier if Andrew had signed an EPoA
 - A corporate trustee will also greatly assist with this succession planning

- Morrows Legal Pty Ltd is an established legal practice operating within the broader Morrows Group. Our lawyers have expertise in the following areas:
 - Trust deeds (SMSFs, discretionary trusts and unit trusts)
 - Superannuation law – borrowing, compliance and structuring advice, drafting relevant source documents
 - Property law – conveyancing, subdivisions and developments
 - Commercial law – shareholders/unitholders agreements, buy-sell agreements, loan agreements, sales of business
 - Estate planning – wills, powers of attorney, succession planning, probate
 - Taxation law – income tax, capital gains, stamp duty, GST

Disclaimer and questions



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- Legal disclaimer
 - The content in this presentation is based on our understanding of relevant laws and proposals as at 16 October 2013
 - This presentation is for illustrative purposes and to provide general guidance only. It should not be relied upon as specific legal advice
 - We note that the material may be subject to change in the future due to changes in law and/or policy
- Questions?



- Murray Wyatt
- mwyatt@morrows.com.au
- (03) 9690 5700

- Nathan Papson
- npapson@morrows.com.au
- (03) 9690 5700

- Wendy Dickson
- wdickson@morrows.com.au
- (03) 9690 5700



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UPCOMING EVENTS

Event 1

Event 2

Event 3

Event 4

Event 5

Event 6

Event 7



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