



DEEP DIVE 6

Death benefits: everything under the sun

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Cashing requirements

SIS regulation 6.21(1) states that:

“Subject to subregulation (3), a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the member dies.”

Subregulation (3) allows the benefits of a deceased member to be rollover over, as soon as practicable, for immediate cashing. This permits, for example, superannuation death benefits to be transferred to another fund to immediately commence a death benefit pension for an eligible death benefit recipient.

Death benefit must be ‘cashed’

A benefit is regarded as being ‘cashed’ when the beneficiary accepts the money that has been paid by the superannuation fund, either by via an electronic transfer or banking of a superannuation fund cheque, which is subsequently honoured. A death benefit would also be ‘cashed’ where a lump sum superannuation death benefit payment has been made via an in-specie transfer of a fund asset to the beneficiary. Generally, the benefit would be regarded as ‘cashed’ once the beneficiary obtains ownership of the asset from the fund. The beneficiary obtains ownership of an asset when beneficial ownership of the asset is acquired, which can occur earlier than obtaining legal ownership.

[TR 2010/1](#) – Income tax: superannuation contributions, outlines the ATO’s views on when a fund obtains ownership of an asset in relation to an in-specie asset contribution. These views can be applied to when a beneficiary would obtain ownership of a fund asset as part of an in-specie death benefit payment.

Further, for the deceased member’s benefits to be regarded as ‘cashed’, their benefit cannot be merely transferred to the relevant beneficiary by way of journal entries. Refer to ATO Interpretative Decision (ID) [2015/23](#). Note this ID only applies to lump sum death benefits, where the deceased member’s benefit is paid in the form of a pension, a journal entry to affect the transfer of the benefit amount from the deceased member to the death benefit pension recipient would likely be used to implement.

How long is ‘as soon as practicable’?

SIS reg 6.21 requires the deceased member’s superannuation benefits to be cashed ‘as soon as practicable’. The term ‘as soon as practicable’ is not defined either in the superannuation or income tax legislation. Industry understands that the ATO regards ‘as soon as practicable’ to be within six months, however, this has never been officially confirmed. Further, given there is a [12 month](#) deferral of when a credit arises in relation to a reversionary pension, there may be an argument that this rule of thumb should be 12 months.

What's important is to be able to demonstrate that the trustee(s) are doing everything to affect the cashing of the deceased member's benefit. It would be worthwhile noting and or recording any delay to cashing at the time the delay occurs. This will assist with any subsequent scrutiny of compliance with the 'as soon as practicable' requirement.

There have been a number of Private Binding Rulings (PBRs) around the term 'as soon as practicable' as it applied in the Income Tax Regulations. The ATO can only provide a binding ruling in relation to income tax matters. The PRBs focus on sub-regulations 995-1.01(3) and 995-1.01(4) ITAR 1997, as they were worded at the time. These sub-regulations concerned the ability of a fund to continue to claim exempt current pension income (ECPI), after the death of a member who was in receipt of a non-reversionary pension, up until the fund paid the death benefit of the deceased member, either as a lump sum (sub-reg 3) or as an income stream to an eligible recipient (sub-reg 4).

Each sub-regulation included a requirement for the death benefit to be paid 'as soon as practicable' for the fund to continue to claim ECPI post the death of the member who was in receipt of the non-reversionary pension. The PBRs addressed different scenarios where there was a delay to the payment of the death benefit and whether the ATO regarded that payment to have been made 'as soon as practicable' for the purpose of sub-regulations 995-01.(3) and (4).

Whilst the PBRs are not binding on the term 'as soon as practicable' in SIS regulation 6.21, it does provide the ATO's views on the same term as it was contained in the income tax sub-regulations. Note: these sub-regulations were amended in December 2018 to remove the term 'as soon as practicable' (applies to the 2012-13 and later income years).

Whilst there is no legislative definition of the term 'as soon as practicable', the ATO expects that a trustee will make all reasonable efforts to cash the death benefits in a prompt manner. The Oxford English Dictionary defines the term 'practicable' as being able to do or put in practice something successfully. The Cambridge English Dictionary explains the term 'practicable' as capable of being able to be done or put into action.

If there are reasonable delays that can be verified, then the ATO may accept the actions of the trustee. The ATO will take into consideration any legal issues that prevent the liquidation of fund assets for the payment of the death benefits to the beneficiary.

Explanatory Statement to amendment to Income Tax Regulations

The [Explanatory Statement \(ES\) to the Income Tax Assessment Amendment \(Superannuation Measures No.1\) Regulation 2013](#) included examples of the types of delays to the payment of the deceased member's superannuation interest that would not mean that it was paid 'as soon as practicable', for the purpose of the income tax regulations that allow the fund to continue to claim ECPI after the death of the member who was in receipt of a non-reversionary pension.

The example are as follows:

Example 3

Arthur was a member of a complying superannuation fund who was receiving a superannuation income stream immediately before his death on 1 September 2012. The income stream did not automatically revert to another person on Arthur's death and no

amounts (other than investment earnings) were added on or after his death to the superannuation interest that was supporting the income stream.

After undertaking a claims staking process, the trustee of the fund determined that the entire value of the deceased member's benefits in the fund would be paid to the deceased's widow as a lump sum. On 20 December 2012, which was in the circumstances as soon as practicable after Arthur's death, a single lump sum of \$100,000 was paid to the widow using only an amount from the relevant superannuation interest.

For the purposes of the earnings tax exemption, the \$100,000 will be taken to be the amount of a superannuation income stream benefit that was payable from 1 September 2012 until 20 December 2012.

Example 5

Bob was a member of a complying superannuation fund who was receiving a superannuation income stream immediately before his death on 1 November 2012. The income stream did not automatically revert to another person on Bob's death and no amounts (other than investment earnings) were added on or after his death to the superannuation interest that was supporting the income stream.

After undertaking a claims staking process to determine the appropriate beneficiaries, the trustee of the fund determined that the deceased member's benefits in the fund would be paid as equal single lump sums to the deceased's two adult children, David and Mary.

Using only an amount from the relevant superannuation interest, a lump sum of \$100,000 was paid to David on 10 January 2013, which was in the circumstances as soon as practicable after Bob's death. **Due to Mary living overseas, there was a delay in making contact with her. As a result, it was not until 1 February 2013, which was in the circumstances as soon as practicable after Bob's death**, that a lump sum of \$100,000 was paid to Mary using only an amount from the relevant superannuation interest.

For the purposes of the earnings tax exemption, \$100,000 will be taken to be the amount of a superannuation income stream benefit payable from 1 November 2012 until 10 January 2013 (when David was paid), and \$100,000 will be taken to be such an amount payable from 1 November 2012 until 1 February 2013 (when Mary was paid).

Example 6

Doris was a member of a complying superannuation fund who was receiving a superannuation income stream immediately before her death on 25 January 2013. The income stream did not automatically revert to another person on Doris's death and no amounts (other than investment earnings) were added on or after her death to the superannuation interest that was supporting the income stream.

After undertaking a claims staking process to determine the appropriate beneficiaries, the trustee of the fund determined that the deceased member's benefits in the fund of \$200,000 would be paid equally between the deceased's two children – Grace (age 14) and Max (age 22).

Using only an amount from the relevant superannuation interest, Max was paid a lump sum of \$100,000 on 3 April 2013, which was in the circumstances as soon as practicable after Doris's death. **As Grace was a minor, advice was sought as to whether to pay her share of**

the deceased member's benefits as an income stream or a lump sum. As a result, it was not until 6 May 2013, which was in the circumstances as soon as practicable after Doris's death, that a new superannuation income stream for Grace was commenced using \$100,000 applied from the relevant superannuation interest.

For the purposes of the earnings tax exemption, \$100,000 will be taken to be the amount of a superannuation income stream benefit payable from 25 January 2013 until 3 April 2013 (when Max was paid), and \$100,000 will be taken to be such an amount payable from 25 January 2013 until 6 May 2013 (when the new income stream for Grace was commenced).

Private binding rulings (PBRs)

A summary of the delays to paying a deceased member's superannuation interest and whether the ATO accepted that the superannuation death benefit was still paid 'as soon as practicable' as it applied in the then relevant income tax regulations is below. Reference should also be made to the PBR for the full facts and detailed reasoning.

Cause of delay to cashing death benefit	Accepted that death benefit was paid ASAP ¹	PBR authorisation number
Benefit paid on grant of probate, which was delayed due to court action	Yes	1051519629834
Holding assets in the fund to maximise profit on sale for the convenience of related entities	No	1051519629834
SMSF trustee was reluctant to pay death benefit until estate dispute with deceased's children has been resolved	Yes	1051495531393
Trustee unable to determine to whom the deceased's benefits should be paid until issues relating to the Will were resolved	Yes	1051458634353
Non-binding death benefit nomination. Estate dispute involving former spouse and child. One of the SMSF trustees being absent and unlocatable for a period of time due to depressive illness after settlement of estate legal dispute.	Yes	1051360004770

¹ 'as soon as practicable'

Cause of delay to cashing death benefit	Accepted that death benefit was paid ASAP ¹	PBR authorisation number
Legal proceedings prior to death of single member, sole director, continued post death with estate. Court proceedings for appointment of Administrator of estate + appointment of Administrator as director of SMSF trustee company. Getting back control of fund assets from State Trustee & Guardian. Delays in sale of commercial properties.	Yes	1051503773816
Single member SMSF with children from prior relationship. Not all children known. Delay due to investigations and enquiries made by the SMSF Trustee and the administrators Estate to identify and locate the Child for the purpose of determining whether or not that child had survived the Deceased.	Yes	1051372887709
Multiplicity of factors causing delay, including: complications in dealing with the deceased's Will and estate; appointment of replacement directors of SMSF trustee company; delays to marketing and sale of SMSF's principal asset; determining how super death benefits were to be paid	Yes	1051349363989
Multiplicity of factors causing delay, including: SMSF trustee believing estate lawyers were handling payment of the super death benefit; trustee suffering much stress and anxiety dealing with illness of the deceased pre death, illness of sibling and spouse; complications with deceased's estate.	Yes	1051275791573
Issued with drafting of Deceased's Will which led to delay in obtaining probate; Engaging different solicitors for advice, with one solicitor having to withdraw due to conflict of interest; seeking	Yes	1051240397687

Cause of delay to cashing death benefit	Accepted that death benefit was paid ASAP ¹	PBR authorisation number
advice re a beneficiary that was an undischarged bankrupt; lease expiry + negotiations for new lease on SMSF property leased to related party, determination of tax status of beneficiaries.		
Gathering information on fund assets and liabilities to lodge outstanding returns, second spouse in possession of fund information + SMSF accountant, both un-cooperative, change to LPR of deceased, LPR hampered by poor internet connection and phone access due to being in a rural area and family issues.	No – various delays and challenges in finalizing the administration of the SMSF were considered not outside the control of the deceased’s LPR.	1051222473595

The importance of documentation

From the PBRs on the question as to whether a deceased member’s superannuation death benefit was paid ‘as soon as practicable’, a common factor is the documentation that was provided to the ATO to allow them to ascertain whether the delay to payment was reasonable. Such documentation would also be considered by the SMSF’s auditor in considering compliance with SIS regulation 6.21. The following are extracts from the above PBRs in relation to the documentation provided by the PBR applicant:

From PBR 1051372887709:

*“In this case you have provided details and **documentation** that the delay in payment has been due to investigations and enquiries made by the Trustee of the Fund and the administrators of the Deceased Member’s estate to identify and locate the Child for the purpose of determining whether or not that child had survived the Deceased. In late 2017, you received material to verify the identity of the Child as well as material regarding their disability and the authority to act.”*

From PBR 1051240397687

“The Trustee passed a resolution in early 20CC which recorded the reasons for the delays in administering the Estate and paying the death benefit from the Fund.”

As accountants or administrators of an SMSF, where delays to the payment of the deceased member’s superannuation interest are occurring, the relevant documentation and file notes should be recorded contemporaneously so as to show that the trustees are taking all reasonable steps to ensure compliance with the compulsory cashing requirement in SIS regulation 6.21. Further, it would also be prudent to inform and continue to remind, the

SMSF trustee(s) of the requirement to pay the superannuation death benefit without delay, but to record the cause of such delays, the reasons and consider whether they would be objectively considered as reasonable.

Form of death benefit

SIS sub-regulation 6.21(2) states that the form of cashing a deceased member's benefit is any one or more of the following:

- In respect of each person to whom benefits are cashed:
 - A single lump sum; or
 - An interim lump sum and a final lump sum.
- One or more pensions or the purchase of one or more annuities, payable to an eligible recipient

In relation to death benefits being cashed in the form of lump sums, it is often forgotten that it is restricted to an interim and final lump sum payment. However, this applies to each person to whom benefits are cashed, for example, if there were three persons to whom the deceased member's benefit were to be paid, this would allow an interim and final benefit payment for each person. Where the deceased member's benefit was cashed in favour of their LPR, that is, paid to their estate, a maximum of two payments would be permitted.

In respect of cashing the death benefit in the form of a pension, SIS regulation 6.21(2A) includes restrictions, where the member died on or after 1 July 2007, and the death benefit pension recipient was a child of the deceased. A child cannot be paid a deceased member's benefit in the form of a pension unless at the time of death of the member, they were:

- Less than 18 years of age; or
- Being 18 or more years of age:
 - Is financially dependent on the member and less than 25 years of age; or
 - Has a disability of the kind described in subsection 8(1) of the Disability Services Act 1986.

Further, where the child was eligible to receive the death benefit in the form of a pension, the pension must be cashed as a lump sum on the earlier of:

- the day on which the annuity or pension is commuted, or the term of the annuity or pension expires (unless the benefit is rolled over to commence a new annuity or pension); and
- the day on which the child attains age 25.

However, this requirement does not apply where the child has a disability of the kind described in subsection 8(1) of the Disability Services Act 1986.

Cashing requirement continues to apply to a death benefit pension

Cashing the benefits in the form of a reversionary or death benefit income stream only satisfies the compulsory cashing conditions as long as the interest can continue to be cashed in that form. Law Companion Ruling (LCR) 2017/3 – Superannuation reform: Superannuation death benefits and the transfer balance cap states, at paragraphs 61 to 64:

“61. Where the superannuation provider cashes a deceased member's superannuation interest to a beneficiary as a superannuation income stream (death benefit income stream) then the compulsory cashing requirement is met as long as the superannuation income stream continues to be paid and continues to be in the retirement phase.

62. A superannuation provider will not have fully met their obligations under the compulsory cashing requirements until all of the deceased member's superannuation interest has been paid out of the superannuation system.

63. Broadly, in the case of a death benefit income stream this will be when the superannuation interest supporting the death benefit income stream is exhausted or the dependant beneficiary commutes the death benefit income stream in full and the resulting superannuation lump sum is paid out of the superannuation system to the dependant beneficiary.

64. In this context a superannuation provider will contravene the compulsory cashing requirement if it:

- (a) allows the deceased member's superannuation interest to remain in the accumulation phase after a time when it became practicable to cash the deceased member's superannuation interest, or*
- (b) pays the deceased member's superannuation interest to a dependant beneficiary as a superannuation income stream that is not in the retirement phase.”*

Consequently, the only alternative to pension payments is either a partial or full commutation of the death benefit pension as a lump sum benefit payment out of the superannuation system. That is, a partial or full commutation of a death benefit pension cannot be retained within the superannuation system in a member's accumulation interest.

Further, a failure to meet the minimum pension standards may result in a contravention of the cashing requirement in SIS regulation 6.21. This is due to a pension ceasing to be in the retirement phase where the minimum pension payments requirement is not satisfied. Where this contravention has occurred the trustee must act swiftly to prevent further contraventions by ensuring death benefits continue to be cashed 'as soon as practicable'.

The ATO have identified that, for example, as long as the trustee immediately commences to pay a new death benefit income stream as soon as they become aware of the breach, and then continues to meet the minimum standards for that income stream, the Commissioner will accept that the trustee is meeting the requirement of cashing 'as soon as practicable' and will not have further contravened the SIS Regulations. This is because the new income stream's payments will come out as soon as they practically should. Note that if the income stream which failed the pension standards was a reversionary income stream, the new

income stream would be a death benefit income stream not a continuation of the reversionary income stream.

By taking this action the trustee would rectify the issues that caused the breach and prevent future contraventions of SIS regulation 6.21, but would not remove the breach that has already occurred. The ATO note that failure to resolve the matter swiftly once the trustee is aware of the breach may have significant compliance consequences.

Who can be paid a superannuation death benefit?

Under regulation 6.22, the trustee can pay to any 'dependant' or to the legal personal representative.

If the death benefit is paid to the legal personal representative to be dealt with in accordance with the Will, there is no restriction on who can receive the death benefit. The Will can leave the death benefit to a person even if they are not a 'dependant'.

'Dependant' is defined in section 10 of the SIS Act to include:

- the deceased's spouse;
- the deceased's children; and
- any person who the deceased has an interdependency relationship with.

It is an inclusive definition, and therefore is not exhaustive of who can be a 'dependant'. A good example of this is that it is generally accepted that a person who is actually financially dependent on the deceased will also be a 'dependant' for the purposes of the SIS Act even though this is not specifically stated in the definition.

Spouse

Under section 10 of the SIS Act a spouse includes:

- another person (whether of the same sex or a different sex) with whom the person is in a relationship that is registered under a law of a State or Territory prescribed for the purposes of section 2E of the Acts Interpretation Act 1901 as a kind of relationship prescribed for the purposes of that section; and
- another person who, although not legally married to the person, lives with the person on a genuine domestic basis in a relationship as a couple.

Section 2F(2) of the Acts Interpretation Act 1901 contains a list of factors to consider whether two people are living together on a genuine domestic basis. The factors are:

- the duration of the relationship;
- the nature and extent of the couple's common residence;
- whether a sexual relationship exists;
- the degree of financial dependence or interdependence, and any arrangements for financial support between the couple;
- the ownership, use and acquisition of the couple's property;
- the degree of mutual commitment to a shared life;

- the care and support of children; and
- the reputation and public aspects of the relationship.

Child

The definition of 'child' in the SIS Act includes:

- an adopted child;
- a stepchild;
- an ex-nuptial child;
- a child of the person's spouse; and
- a child under the Family Law Act 1975.

This definition expands who can be considered a 'dependant' for superannuation. For example, if you have a 'spouse', then your 'child' includes your spouse's children, which effectively includes your spouse's stepchildren.

In relation to a member's stepchild, the Australian Taxation Office has followed the common law definition. Historically, this provided that your spouse's children will only remain your 'stepchild' while their parent remains your spouse (see [ATO ID 2011/77](#)). If that child's parent dies first, then that child will not be a 'stepchild' for the purposes of the survivor's superannuation death benefit and therefore the child will only be an eligible beneficiary if they have been formally adopted or are in a financial or interdependency relationship with the survivor.

However, the Superannuation Complaints Tribunal (SCT) in D19-20\023 followed an updated view of the common law definition of stepchild to allow the stepchild relationship to continue provided the relationship with the natural parent was not dissolved earlier other than by death.

In that decision, the SCT upheld the superannuation fund trustee's decision to pay the death benefit to a stepchild where their natural parent's relationship with the deceased had ended because of the natural parent's death.

As a result, it may be possible to determine that a stepchild remains a beneficiary of their stepparent after the death of that child's parent. This will help resolve a significant number of complex estate planning issues that arise in blended family situations. However, care needs to be taken where attempting to pay a superannuation death benefit to a stepchild after their death of their parent as this issue still has not been determined by a court in the context of the SIS Act.

Interdependency

The 'interdependency relationship' is an older addition. Two people are in an interdependency relationship if:

- they have a close personal relationship;
- they live together;
- one provides the other with financial support; and

- one provides the other with domestic support and personal care (section 10A of the SIS Act).

Section 10A(2) provides an exception to the requirement to 'live together' where one or both of the parties to the relationship suffer from a physical, intellectual or psychiatric disability which prevents them from living together.

The importance of the trust deed

While the SIS Act and the SIS Regulations outline the compliance requirements for the payment of death benefits, the trust deed for the superannuation fund is paramount when it comes to paying a superannuation death benefit.

It is critical that you carefully check the relevant trust deed as the drafting can impose additional limitations on who can actually be paid.

Binding directions v discretionary v reversionary pensions

After the death of a member, the trustee of the fund has to make a decision about the payment of the superannuation balance. Those decisions will consist of one or more of the following:

- consider whether there was a reversionary pension;
- to pay the benefit in accordance with a binding nomination; and
- if neither are present (or validly binding), a decision that they must exercise their discretion, and exercise that discretion.

Reversionary pensions

A reversionary pension is a pension that continues to another beneficiary on the death of the original pensioner.

When set up properly, the reversion is automatic and it takes no decision of the trustee for it to occur. This means it can be an effective way to remove the trustee's discretion in choosing the recipient of a death benefit payment.

After the death of the member, although a reversionary nomination means that the trustee does not have any discretion about paying the balance of the pension, or whether the pension continues, the trustee must decide that the reversionary nomination is valid. This decision of the trustee must be documented, along with the enquiries the trustee made to reach this decision.

A pension can only revert to a 'dependant'. There are further limits on a dependant who is a child receiving a death benefit as a pension (broadly the child must be under 18, or under 25 and dependent, or disabled, and except in the last case must commute to a lump sum when the child turns 25).

A death benefit pension cannot be paid, for example, to the estate of the deceased member. When choosing who is to be a reversionary beneficiary, it is important to make sure the trustee can pay a pension to the nominated recipient.

There is nothing in the SIS Act and SIS Regulations that provides legitimacy to reversionary pensions or requires a trustee to pay a reversionary pension to the nominated recipient. As a result, the effectiveness of a reversionary pension is dependent on the trust deed. There is a view amongst some practitioners that a reversionary pension provides greater certainty than a BDBN. However, as reversionary pensions are a creature of the trust deed (the same as BDBNs), they are subject to the same risk of challenge in relation to their validity as BDBNs (although they have not been as frequently litigated as yet).

In particular, it is important to check the trust deed to ensure it allows for a member to nominate a reversionary beneficiary for their pension and that the trust deed requires the trustee to follow the reversionary nomination and no longer has discretion about how and to whom the benefits supporting a pension is paid on the death of the pensioner. Not all trust deeds adequately deal with this and many leave room to argue the trustee is not bound to continue to pay the pension.

The other vital documents are the pension documents themselves. Do they require the trustee to continue the pension after the death of the member to the reversionary beneficiary? It is important this is spelt out clearly in the pension documents, and this also means the pension documents themselves can be produced at the time of death – which may be years or even decades after the pension commenced.

Another trust deed issue is what happens if there is both a reversionary pension and an inconsistent binding nomination in place when a member dies – which must the trustee follow? A good trust deed will prescribe which has precedence, but, again, many do not deal with this issue, which again could lead to arguments. There is no clear authority that determines which would have precedence.

Binding nominations

A binding nomination allows a member to pre-make the death benefit payment decision, therefore removing the ability of the trustee to determine who will receive the death benefit.

In addition to specifying who can receive the death benefit, it is possible for a binding nomination to also specify how the beneficiary is to receive the death benefit (subject to the trust deed).

Section 59 of the SIS Act and regulation 6.17A of the SIS Regulations allow the trust deed of a superannuation fund to be structured such that a member can make a nomination that is absolutely binding on the trustee in relation to how their death benefit is to be paid.

However, the provisions in the SIS Act and the SIS Regulations regarding binding nominations only apply to public offer superannuation funds and not SMSFs. Although this has been the accepted approach for some time, this was again the subject of the recent case of *Hill v Zuda* [2022] HCA 21. In this case, the High Court again confirmed that the SIS Act

and SIS Regulations provisions do not apply to SMSFs. As a result, there are slightly different considerations for each type of fund.

Binding nominations and public offer superannuation funds

The SIS Act and SIS Regulations only allow a superannuation trust deed to contain the provisions enabling binding nominations – they do not themselves give the beneficiary the power to make a nomination that is binding on the trustee. For a member to be able to make a binding nomination, the trust deed for the superannuation fund must be appropriately worded. Therefore, it is essential before making a binding nomination that the trust deed provisions are carefully considered.

Also, any process specified in the trust deed must be followed. For example, if the deed contains a form that must be used, that form must be used. If the trustee must acknowledge the nomination, then we must have evidence that the trustee has issued an acknowledgement.

For a number of years now we have seen cases where the validity of binding nominations are tested, and we see this continuing to be a battleground for disputes given the substantial wealth in superannuation.

In addition to the trust deed requirements, there are quite a number of technical requirements for a binding nomination to be effective for public offer superannuation funds set out in SIS Regulations 6.17A and 6.17B. In summary, these are:

- The trustee must give sufficient information to the member so the member understands the member's rights to make a binding nomination.
- The nominees must be dependants of the member or the member's legal personal representative.
- The proportion that is payable to each nominee is certain or readily ascertainable.
- The nomination is in writing, signed by the member in the presence of two witnesses who are over 18 and not mentioned in the nomination.
- The trustee must advise the member each year that the member has made a binding nomination, who are the nominated beneficiaries and when it lapses.

The trustee also has an obligation to clarify a nomination if the nomination is not sufficiently clear to allow the trustee to pay a benefit.

A number of public offer funds now also allow for non-lapsing nominations. These nominations fall outside the specific rules in section 59(1A) of the SIS Act and SIS Regulations 6.17A and 6.17B. These nominations are a creature of the trust deed and therefore the terms of the specific trust deed must be specifically followed for these nominations to be binding on the trustee. Also, these types of nomination must be approved by the trustee of the fund in order to comply with the requirements of section 59(1) of the SIS Act (if not approved by the trustee, the nomination would be invalid).

Binding nominations and SMSFs

As the legislative provisions have no bearing on the binding nomination process in SMSFs, the provisions of the trust deed are paramount.

As a result, it is critical that the requirements specified in the trust deed are followed precisely. For example, if the deed contains a form that must be used, that form must be

used. If the trustee must acknowledge the nomination, then we must have evidence that the trustee has issued an acknowledgement. Where the process is not followed precisely (or we cannot prove it was followed precisely), the nomination will not be binding on the trustee and it is highly likely, given the prevalence of estate litigation, to find this the subject of a challenge.

As binding nominations in SMSFs are purely a trust deed concept, they are not subject to the maximum three year validity that applies to binding nominations for retail and industry superannuation funds (see regulation 6.17A(7) of the SIS Regulations, [SMSFD 2008/3](#), [Ioppolo v Conti](#), [Munro v Munro](#), [Cantor Management Services P/L v Booth](#) and [Hill v Zuda](#)). Therefore, unless there is a restriction in the SMSF trust deed, it is possible to make a non-lapsing binding nomination in an SMSF.

The following is a summary of the common issues we see that can affect the validity of a binding nomination.

Issue	Comments
Compliance with the SIS Act and SIS Regulations	<p>By far the most common issue that arises in SMSF trust deeds, including trust deeds from extremely reputable and experienced providers, is where the binding nomination provisions require the binding nomination to comply with the requirements of the SIS Act or SIS Regulations.</p> <p>In our experience, these provisions usually present in one of two forms:</p> <ul style="list-style-type: none"> • The definition of binding nomination in the trust deed refers to a binding nomination ‘made in accordance with’ or ‘binding under’ ‘section 59(1A) of the SIS Act’. • The operative clause in the trust deed requires the binding nomination to comply with section 59(1A) or regulation 6.17A (or both) for the trustee to be bound. <p>As mentioned earlier, neither the SIS Act nor the SIS Regulations provisions relating to binding nominations apply to SMSFs. Despite being the subject of a number of previous cases, this issue has been finally resolved by the High Court in the recent case of Hill v Zuda.</p> <p>Therefore, the trustee of the SMSF will not be bound by the binding nomination where the trust deed requires the binding nomination to comply with or be binding under the SIS Act or SIS Regulations.</p> <p>This is contrasted to a provision that does not require compliance with section 59(1A) or regulation 6.17A but merely imports the technical requirements set out in those provisions into the trust deed. This issue was the subject of the dispute in the case of Donovan v Donovan.</p> <p>In this case, the deceased (Mr Donovan) was a member of the SMSF and a director of the trustee company. The operative provision that allowed the member to make a binding nomination was clause 11.4(b) of the trust deed, which provided as follows:</p>

Issue	Comments
	<p>A member may make a binding death benefit nomination in the form required to satisfy the Statutory Requirements;</p> <p>The trust deed provided as follows:</p> <ul style="list-style-type: none"> • ‘Statutory Requirements’ was defined widely to include ‘any law...which must be satisfied by a superannuation fund in order to qualify for income tax concessions...’. • Where a member had made a valid binding nomination, the trustee must pay the death benefit to the nominated legal personal representative or dependant of the member. <p>The deceased purported to make a nomination by letter to the trustee which specified that he wanted his benefits paid to his legal personal representative for inclusion in his estate assets.</p> <p>The deceased’s second wife and a child of the deceased’s first marriage, who were the deceased’s executors, were disputing whether this was a valid binding nomination that had to be followed by the trustee. The second wife argued that the nomination was binding on the trustee.</p> <p>However, the deceased’s children argued that the nomination was not binding for two reasons:</p> <ul style="list-style-type: none"> • First, the language used was not sufficient to convey a binding intention. The nomination merely indicated that the deceased ‘wished’ for his death benefit to be paid in a particular way, not required or directed. • Second, the nomination was not sufficient to comply with the requirements of the ‘Statutory Requirements’. <p>In addition to these issues, Fryberg J raised the issue of the ‘approved form’, but neither party pursued this issue and, in any event, it was irrelevant to the end result.</p> <p>Fryberg J dealt with the second issue first and held that the reference to ‘Statutory Requirements’ for the purposes of the binding nomination provision was a reference to the formalities in regulation 6.17A(6) of the SIS Regulations as to read the clause in the trust deed in any other way would render the provision meaningless.</p> <p>The formalities in the SIS Regulations required the nomination to be in writing, witnessed by two persons and contain a signing declaration from the witnesses in relation to the signing of the nomination.</p> <p>The letter written by the deceased to the trustee clearly did not comply with the requirement of regulation 6.17A. As a result, the nomination was not binding on the trustee.</p> <p>Further, the judge ordered that the costs of the dispute be paid from the estate on an indemnity basis.</p>

Issue	Comments
	<p>This position was affirmed by:</p> <ul style="list-style-type: none"> the Queensland Supreme Court in Munro v Munro where they held that a binding nomination in relation to benefits in an SMSF does not have to comply with the requirements in the SIS Act and SIS Regulations (unless the trust deed requires that); and the Full Court of the Supreme Court of South Australia in Cantor Management Services P/L v Booth where they held that the trustee of an SMSF is not bound by a binding nomination made in accordance with the SIS Act and SIS Regulations; it is the trust deed that governs the requirements for a binding nomination in an SMSF; and the High Court in Hill v Zuda where they held that section 59(1A) and SIS Regulations 6.17A and 6.17B do not apply to SMSFs.
Fund rules	<p>The most critical step when making a binding nomination is determining what are the current rules of the Fund.</p> <p>Unfortunately, this step is often overlooked with most people just assuming that the latest deed update sets out the current rules of the Fund without undertaking a detail review of the trustee and trust deed history of the Fund.</p> <p>To ensure a binding nomination will be valid, it is critical that a detailed review of both the trustee and trust deed history is carried out. If there is an error or gap in the history (which we often see), this could impact on the validity of the binding nomination.</p> <p>In the case of Perry v Nicholson the deceased's adult child, Ms Perry, was challenging her father's binding nomination, which provided that all of his death benefit would be paid to his de facto spouse, Ms Nicholson. Ms Perry argued that the binding nomination was invalid because of some technical imperfections in a change of trustee almost two years before the binding nomination was signed.</p> <p>Fortunately for Ms Nicholson (and the deceased's accountant), the court upheld the effectiveness of the change of trustee even though the documents prepared by the accountant to change the trustee did not strictly comply with the requirements in the trust deed.</p> <p>The lack of care in the earlier change of trustee resulted in the court case which would have involved substantial costs.</p> <p>Had the Court applied the stricter approach from previous cases, the change of trustee may well have been invalid, which could have then resulted in the binding nomination being ineffective. This was the outcome in Moss Super Pty Ltd v Hayne, where the Court found that an earlier resignation signed by the trustee rendered a later change of trustee ineffective, unravelling the deceased's expressed estate planning intentions.</p> <p>This was also an issue in Re Narumon, where the validity of the BDBN turned on the which trust deed was valid at the time the nomination was made.</p>

Issue	Comments
Approved form	<p>There are a number of common trust deeds in circulation that require the binding nomination to be made in the ‘approved form’.</p> <p>Usually, this requires the member to use the specific form set out in the schedule to the particular trust deed. In the grand scheme of things, this is a fairly basic condition to satisfy, but it is surprising how many times it is not.</p> <p>In most of these situations, we cannot be sure of the reasons why this requirement has been overlooked. However, the most compelling reason seems to be that the specified form did not have sufficient flexibility to cater for the practitioner’s drafting style (for example, it was not possible to make cascading nominations).</p> <p>Unfortunately, where the ‘approved form’ is not used, it is irrelevant how well the alternative form is drafted, as it will not be binding on the trustee.</p> <p>As mentioned many times in this paper, the provisions of the trust deed are of paramount importance. Where they are not complied with, there is no room for movement. Unlike in the world of drafting a Will, there is no such thing as substantial compliance or testamentary intention.</p> <p>Therefore, if the trust deed requires a certain form to be used, that is the only form in which a binding nomination can be made and be binding on the trustee.</p> <p>An even bigger problem is caused by trust deeds that require the binding nomination to be made in the form ‘approved’ by the trustee.</p> <p>These trust deeds do not usually include a default or pre-approved form and it is therefore up to the trustee to decide at the time what is the ‘approved form’. As a result, the trustee must have taken an active step to ‘approve’ a form before a nomination can be binding on the trustee.</p> <p>Even where this step is taken by the trustee, such provisions are at high risk of a challenge. This is because, if put to proof, the parties will need to produce evidence that the trustee ‘approved’ a form and that the form of the binding nomination used was in fact the ‘approved form’.</p>
Eligible beneficiaries	<p>Another common mistake is that the binding nomination nominates a beneficiary that is either:</p> <ul style="list-style-type: none"> • not an eligible recipient for the purposes of the SIS Regulations; or • they are an eligible recipient for the purposes of the SIS Regulations but the trust deed provisions (in particular the definitions) are inexplicably narrow. <p>A common example that arises is where a person makes a binding nomination in favour of their de facto spouse but the trust deed defines a ‘spouse’, for the purposes of the ‘dependant’ definition and the binding nomination clause, to only include a married spouse. In this case, the binding nomination to the de facto would not be valid as they are not a permitted beneficiary under the trust deed.</p>

Issue	Comments
	<p>In one prominent superannuation trust deed, a binding nomination can only be made to a dependant and not to the estate.</p> <p>Therefore, it is critical that the terms of the trust deed, including every relevant definition, are carefully considered when making a binding nomination to ensure that it is valid.</p> <p>Also, it is critical that the binding nomination itself correctly refer to the intended beneficiary. As the power to make binding nominations for SMSFs is solely based on the provisions of the trust deed, the courts have insisted on strict compliance with the requirements of the trust deed when determining the validity of binding nominations.</p> <p>In the Queensland Supreme Court case of Munro v Munro the binding nomination was found to be invalid, allowing the trustees of the SMSF to distribute the deceased's death benefit other than as set out in the nomination. The Court held the binding nomination was not valid as it did not comply with the requirements in the trust deed. The Court emphasised that the binding nomination would only be binding if it strictly complied with all the requirements of the trust deed. In this case, the nomination was to the 'Trustee of Deceased Estate' rather than the deceased's 'legal personal representative' as required by the trust deed and the SIS Act. The Court determined that this was not a nomination of the deceased's 'legal personal representative' (as required by the trust deed and the SIS Act) as the roles were different.</p>
Eligibility to make a binding nomination	<p>This issue is a twist on the situation in the section above.</p> <p>It is dangerous to assume that every member of a superannuation fund is able to make a binding nomination.</p> <p>There are SMSF trust deeds that allow a 'member' to make a binding nomination, although, the definition of 'member' did not include a person whose only interest in the SMSF was their pension account. As a result of this drafting oversight, only a person with an accumulation balance in the superannuation fund could make a binding nomination and a pension account could not be subject to any effective binding nomination.</p>
Trustee acknowledgement/receipt	<p>Another common binding nomination provision requires the binding nomination to be given to the trustee or the trustee to 'acknowledge' or 'accept' the binding nomination for it to be valid and binding on the trustee.</p> <p>Although this is not a difficult provision to comply with, such provisions are high risk. If there is a dispute, the parties will need to produce evidence that the binding nomination was given or the trustee 'acknowledged' or 'accepted' the binding nomination. In our experience this step is not often completed satisfactorily, or where it has been attended to, the client does not keep adequate records to establish this at the time of payment of the death benefit.</p>

Issue	Comments
	<p>This issue was examined in the case of <i>Cantor Management Services P/L v Booth</i>. In this case, the trust deed required the binding nomination to be ‘given’ to the trustee to be binding on the trustee. The Court found that the binding nomination was given to the trustee in this case as it was being held at the registered office of the corporate trustee, even though the sole director of the corporate trustee was not aware of its existence.</p> <p>This was a fortunate result for the nominated beneficiaries given the parties gave no thought to the technical requirement for the binding nomination to be ‘given’ to the trustee.</p> <p>Also, clauses requiring the trustee to accept or acknowledge a binding nomination presents a problem where the trustees/members have separated and one of the members wishes to make a new binding nomination. As the nomination has to be accepted or acknowledged by the trustee, you have to get the ex-spouse to consent to the new binding nomination for it to be valid. As you can imagine, this can be rather difficult.</p>
Information to members	<p>A similar issue arises where the trust deed requires the trustee to provide information to the member before they can make, or before the trustee can accept, a binding nomination. The following is an example of such a clause:</p> <p>Information to Member: Before the Trustee accepts a Binding Death Nomination, the Trustee must give the Member a statement that...</p>
Required compliance	<p>Another critical mistake is that the binding nomination clause and the death benefit provisions in the trust deed do not work together.</p> <p>Usually, the problem arises because the death benefit provisions do not ‘require’ the trustee to pay the death benefit in accordance with the binding nomination made by the member. The following is an example from a well-known trust deed:</p> <p>Where this Deed provides for the payment of a Benefit on the death of a Member, the Trustee may pay or apply the Benefit to or for the benefit of the Nominated Dependants...</p> <p>As you can see, this clause provides the trustee with a choice to follow the binding nomination or pay the death benefit in accordance with the trustee’s discretionary power. As a result, for the binding nomination to be ‘binding’ this clause needs to be amended.</p> <p>Also, do not be surprised to see trust deeds where the death benefit provisions do not even refer to the binding nomination at all. In this case, depending on the exact wording of the binding nomination clause, it is likely that the binding nomination will not remove the trustee’s discretion in relation to the payment of the death benefit.</p>

Exercise of discretion

If the trustee has determined that it must pay the death benefit by exercising its discretion, it is important that the trustee does so properly and carries out (and documents) a process for informing themselves of the decision to be made. Otherwise the trustee risks their actions being criticised, and their decision being reviewed by the court.

We know that, generally, a trustee does not need to give reasons for their decision.

Where the trustee declines to provide reasons for the decision, provided the decision has not been made in bad faith or with ulterior purpose, the court is not able to review the trustee's decision.

This however does not mean that the trustee can simply make the decision about the payment of a death benefit without properly informing themselves of certain things.

The court will review a trustee's decision if:

- there was a failure of the trustee to act honestly and in good faith;
- the trustee failed to give genuine consideration to the decision;
- the discretion was not exercised with due consideration for its proper purpose; and
- the trustee's reasons (if given) were not sound.

When exercising the discretion to pay a death benefit, the trustee must consider:

- The intention of the deceased (looking at any previous binding and non-binding death benefit nominations, or other documentation or circumstances);
- the relationship between the deceased and each of the eligible beneficiaries;
- the financial circumstances and needs of each of the eligible beneficiaries;
- the tax implications of the payment;
- the purpose of superannuation; and
- if the legal personal representative is an eligible beneficiary:
 - who will receive the superannuation under the Will;
 - what are the debts of the estate; and
 - is there a risk of dispute.

If a trustee's decision is disputed, the trustee must be able to provide evidence that the trustee made proper enquiries to obtain the relevant information.

The duty of the trustee to properly inform themselves is higher for a trustee of a superannuation fund. The exclusion of relevant information and the failure to seek relevant information will likely amount to a breach of trust.

The actions of the trustee in *Re Marsella* are clear examples of the trustee of a self-managed superannuation fund breaching their duty when exercising the discretion to pay a death benefit. In that case the Court found the trustee:

- did not understand her duties to consider the other eligible beneficiaries of the death benefit (including the husband and the executor of the estate);
- was either ignorant of or had deliberately mischaracterised the true circumstances;
- had denied her conflict of interest in being a trustee and eligible beneficiary (despite the conflict being clear);

- wrongly concluded the discretionary decision allowed the trustees to pay the death benefit without a genuine consideration of the trustee's duty to exercise the power in good faith; and
- had not tried to resolve these issues by seeking proper advice.

When a dispute arises about the payment of a death benefit, the court's role is to look at the:

- inquiries made by the trustee;
- information the trustee had available;
- trustee's reasons for exercising discretion; and
- manner in which the discretion was exercised.

It is not the Court's role to assess the fairness or reasonableness of the trustee's decision. However, the trustee's decision itself may form part of the evidence to prove the discretion was not properly exercised.

The decision to pay a death benefit is not as simple as preparing a resolution of trustee.

Notional estates

The concept of the 'notional estate' is unique to New South Wales and operates where there are not enough assets remaining in the estate to satisfy a family provision claim against the deceased's estate.

Although these rules are unique to NSW, it is critical to have a basic understanding of these rules as they can have broad application and impact on a client's estate plan in situations where it is not immediately obvious.

Firstly, the concept of the notional estate will only be relevant if an eligible beneficiary has a right to bring a family provision claim in NSW.

- To be eligible to make a claim in NSW, the deceased must have lived in NSW or had assets in New South Wales (personally or in entities that they control). This potentially poses a risk for a significant number of clients as they would hold shares in listed companies that were either incorporated in NSW or have their registered office located in NSW either personally or in entities controlled by them (such as their SMSF).
- The people who can make a claim against the estate of a deceased person are that deceased person's spouse (including former spouses), children, dependent grandchildren and anyone with whom the deceased was living in a close personal relationship. There are other rules that apply in different states.

The rules for relating to family provision claims and the approach adopted by the courts in determining whether to award further provision from an estate are very complex and are beyond the scope of this paper. However, I have outlined below some further detail regarding the operation of the notional estate rules in the event that there are not sufficient assets in the estate to satisfy a claim for

What is included in the notional estate?

Where a successful family provision claim is made, and there are insufficient assets in the estate to satisfy the claim, the NSW courts can apply the 'notional estate' rules. These provisions allow the courts to treat assets that do not usually form part of an estate as available for a family provision claim. This can include:

- assets transferred or given away by the deceased before their death;
- jointly held assets such as bank accounts or properties held by the deceased as joint tenants;
- assets held in trusts; and
- property that has already been transferred in the administration of the estate.

However, there are some limits on when a court can include these assets to satisfy a family provision claim. An asset will only be included in the following situations:

- Where a transaction was entered into within 3 years before the deceased's death with the intention to defeat an estate challenge.
- Any transaction within 12 months of the deceased's death.

These rules are broadened by the legislation which specifically includes a failure to do something as a transaction. Therefore, a failure to take specific action to benefit the estate is captured by the notional estate rules. This means that any action not taken within 12 months prior to death to increase the value of the estate (or within 3 years before death if the deceased did not do the action for the purpose of defeating an estate claim) can be reviewed and result in an asset being included in the notional estate. Some examples of where the courts have applied this include:

- A failure to sever joint tenancy which resulted in a property transferring to the surviving joint tenant under the rules of survivorship.
- A failure to exercise power of appointment for trusts in certain way.

How is this relevant for superannuation death benefits?

The notional estate rules apply to superannuation death benefits where a member has the power to direct where they are paid to. Where a family provision claim is made and the superannuation death benefit is not paid to the estate, the notional estate rules may potentially apply to claw back the superannuation death benefit to satisfy the family provision claim.

This was exactly what happened in the recent case of *Benz v Armstrong* [2022] NSWSC 534.

This case concerned claims relating to the estate of Dr William Benz brought by three of his six children, Anna, Catherine, and Matthew. The executor of the Will was his second wife, Erlita.

Dr Benz updated his Will in 2012 and then later prepared a binding death benefit nomination in May 2016. The effect of his estate planning was as follows:

- Erlita received \$3 million of non-estate assets that passed either directly to Erlita or to Erlita's control outside of the estate.

- Erlita received approximately \$2 million from the estate
- Dr Benz's six children received \$200,000 between them from the estate
- Erlita received \$12 million directly from the SMSF

Following Dr Benz's death in April 2016, three of his six children, Anna, Catherine, and Matthew, challenged the estate for a greater share.

The children were successful in their application. In order to satisfy the successful claim made by the children, the court sought to apply the notional estate rules to the superannuation death benefit to ensure there were sufficient assets in the estate to provide further provision to the successful children.

In applying the notional estate rules, the court examined the making of the binding death benefit nomination in May 2016 in favour of Erlita as this was within the 3 year clawback period. Ultimately, the court determined that the BDBN in favour of Erlita was not made for the purposes of defeating a claim on the estate. Therefore, the May 2016 BDBN was not overturned under the 3 year clawback rule.

However, the court then considered whether its powers under the 12 month claw back period should be applied. The court determined that the failure of Dr Benz to take action in the 12 months before his death to have the superannuation death benefit paid to his estate (i.e. by revoking the May 2016 BDBN and making a new nomination in favour of his estate), was a transaction to which the notional estate rules applied. As a result, the superannuation death benefit was clawed back from Erlita to the estate for the purposes of satisfying the successful claim by Dr Benz's three children.

Member benefit v superannuation death benefit

It has been a longstanding strategy to have a member withdraw their superannuation entitlements shortly before that member's death where the superannuation death benefits would be paid to beneficiaries who are not tax dependants and those entitlements have a high taxable component. This strategy can afford significant tax savings to the non-tax law dependent beneficiaries (i.e. adult children).

Whether a benefit payment is treated as a member benefit or a death benefit will determine the tax outcome and whether it is subject to member benefit death benefit directions, e.g., binding death benefit nomination, or trustee discretion.

The tax legislation defines the difference as being:

- on the one hand, a payment to you because you are a member of the fund; or
- on the other hand, a payment to you, after another person's death, because that other person is a member of the fund.

There can be a fine line between a (potentially tax free) member benefit and a (often taxable) death benefit. This is most often triggered by the competing desire to keep a member's superannuation entitlements in the superannuation environment for as long as possible to maximise the tax concessions provided to superannuation funds and removing

them before the member's death (rather than clearly withdrawing the member benefits well before death).

What is the issue?

The tax treatment of a benefit payment which is a member benefit, is different from a superannuation death benefit payment. For example, where the member is aged 60 or more at the time of receiving a superannuation benefit payment from an SMSF, the payment is received by the member tax-free. However, the tax implications for a superannuation death benefit will primarily depend on whether the death benefit recipient is a 'death benefits dependant' under the Tax Act. For example, generally an adult child is not a 'death benefits dependant' and consequently the taxable component of a superannuation death benefit lump sum will be subject to tax.

Turning to the estate planning issue, this concerns who will ultimately receive the benefit payment. Where the benefit payment is a member benefit, it will form part of the estate of the deceased and the payment will generally be subject to the deceased member's Will. However, where the benefit payment is a death benefit payment, it will be the trustee(s) of the SMSF that will determine the recipient of the death benefit payment, subject to the trust deed, any valid binding member directions and superannuation and trust law.

Example

Mike is the member of the Big Bunch Super Fund, an SMSF, together with his spouse, Carol. This is the second marriage for each of them and they have adult children from their prior relationship, but no children from their current marriage.

Each of their respective estate plans is for their superannuation benefits to be paid to each other upon their death, but for personal assets to be distributed between their respective children. As part of their estate plan documents, they have each put in place a binding death benefit nomination to pay their respective superannuation entitlements to each other in respect of their death.

Mike, 66, requests a lump sum benefit on 16 May 2022 for \$100,000, comprised \$80,000 taxable component and \$20,000 tax-free component. Tragically Mike dies in accident on May 18. At that time, the SMSF has not yet paid Mike's requested \$100,000 lump sum benefit. The trustee(s), whilst agreeing to make the payment and confirming that it can make the payment under the trust deed and the relevant superannuation law, had yet to arrange for the sale of some fund investments to provide the cash.

The question is, will the \$100,000 benefit payment in respect of Mike, now deceased, be treated as a member benefit or a death benefit? Let's consider the potential outcomes:

	Tax treatment	Estate planning treatment
\$100k treated as a member benefit	As Mike is at least age 60 (age 66 at the time of his death), it would be expected that the \$100,000 amount would be a tax-free benefit payment.	The \$100,000 amount will be regarded as a personal asset and form part of Mike's estate. The distribution of the amount will be subject to the terms of his Will and, based on the information we know, will be distributed amongst his adult children. They will receive their respective share of the \$100,000 without the amount being subject to tax.
\$100k treated as a superannuation death benefit:	<p>This will depend upon whether the recipient of the death benefit, either directly from the SMSF or via Mike's estate, will be a 'death benefits dependant' under the Tax Act. Based on the example, a payment to his spouse Carol would be a payment to a death benefits dependant and consequently would be received by Carol free of any tax.</p> <p>However, if the payment was made to Mike's adult children, subject to further details, neither of them would be regarded as a death benefits dependant and consequently the taxable component of the benefit paid to them would be subject to tax.</p>	<p>The trustee(s) of the SMSF will determine to whom the benefit will be paid, subject to satisfying the limitations in SIS regulation 6.22 to only cash a deceased member's benefits in favour of their legal personal representative or one or more if their dependants.</p> <p>Assuming Mike's binding death benefit nomination (BDBN) is valid (which is an important document to validate), the payment would be made to his spouse, Carol.</p> <p>Where Mike's BDBN is not valid, payment would be determined by the SMSF trustee(s).</p>

How will a death bed withdrawal be treated?

The treatment of a death bed payment will depend on how the arrangements are implemented.

The best course of action is to have the proper paperwork completed and signed and the payment made by the Fund prior to the member's death. In this scenario, there is limited

scope for the ATO to argue that this should be treated as a death benefit (rather than a member benefit).

However, we often see that the process is not fully completed prior to the member dying. Often this is caused by the desire to continue to maximise the member's benefits in the superannuation system, rather than completing these withdrawals ahead of time.

Where the process is not fully completed before the member's death, it raises the question whether the payment should be treated as a member benefit or a death benefit. There have been a number of Private Binding Rulings on this issue which have produced different outcomes as noted in the summary table below:

Date of PBR	PBR number	Paid from APRA fund or SMSF	Summary of facts	Member benefit or death benefit
2011, August	1011912974150	APRA fund	<ul style="list-style-type: none"> Member over age 60 with allocated pension. Member wrote to fund to request withdrawal. Fund confirmed request received prior to member's death. Fund processed withdrawal application and remitted funds after death. 	Superannuation death benefit.
2018, Oct 5	1051437446368	Assumed APRA fund, but not stated.	<ul style="list-style-type: none"> Member being paid account-based pension in aged care + incapable of managing affairs. Granted Enduring Power of Attorney and attorney managed affairs. Attorney provided instructions to Adviser to withdraw. Adviser provided instructions to fund to withdraw all benefits. Member died before fund had paid benefits. Fund paid benefits to (now deceased) member's nominated bank account. 	Member benefit
2019, Nov 5	1051598540809	APRA fund	<ul style="list-style-type: none"> Member had attained preservation age, but under 64 and met retirement condition of release. Completed application posted to fund for withdrawal of benefits. Member died a few days later. Fund processed application as member benefit payment and paid into (now deceased) member's nominated personal bank account. 	Member benefit

Date of PBR	PBR number	Paid from APRA fund or SMSF	Summary of facts	Member benefit or death benefit
2020, Nov 2	1051754180223	Not stated, but appears to be an SMSF.	<ul style="list-style-type: none"> Member had terminal medical condition and requested lump sum withdrawal of cash and in-specie transfer of securities. Trustee agreed to withdrawal and form of withdrawal. Next day, trustee placed sell orders for securities. Following day, member died. Next day, majority of sale proceeds deposited to fund's bank account. Trustee transferred an amount to deceased member's personal bank account. 	Member benefit
2021, Nov 2	1051914995135	Not stated but appears to be an APRA fund	<ul style="list-style-type: none"> Member in receipt of a pension. Member completed and signed application to close two superannuation accounts. Lodged with the fund on the same day and processed by the fund. The member passed away in the same month (whilst not confirmed, appears the member passed away prior to the fund paying the benefit). Fund paid benefit to the member's personal bank account. 	Member benefit
2021, Nov, 25	1051918745226	Not stated.	<ul style="list-style-type: none"> Member was suffering from a terminal illness. The member lodged a super withdrawal application with the fund. Prior to payment of the benefit the member passed away in hospital. The fund paid a lump sum benefit to the deceased's nominated bank account. 	Superannuation death benefit

Some of the comments in the PBRs are interesting and in some respect, contradictory. For example, in the 2011 PBR it states:

“As a result of the operation of section 307-5 of the ITAA 1997, the payment cannot be considered to have been paid to the deceased. Consequently, it is not wholly tax-free as if it were a superannuation benefit paid to a person over age 60.”

Section 307-5 ITAA 1997 provides that for a benefit payment to be a member benefit it must have been a payment to “you”, because “you” are a fund member. The above statement from the PBR seems to imply that once a person has died they are no longer a “you” – the

benefit could not have been paid to them. There is also the issue of whether they would still be a fund member at the time of payment.

This also appears to be the approach in the 25 November 2021 PBR as it states:

“In this case, the member died in the 20XX-XX financial year, prior to the payment being made by the Trustee of the Fund. The payment was made after the member died so cannot be considered a member benefit as it will now be distributed to the beneficiaries of his estate.”

However, in the other PBRs the determining factor appears to be whether the benefit was paid to the (deceased) member’s personal bank account, rather than the bank account of the estate. If paid to the (deceased) member’s bank account, a member benefit, if paid to the estate’s bank account, a superannuation death benefit.

Attendees of the SMSF Association National Conference were made aware of the ATO’s latest view via a presentation from Peter Burgess, the association’s Deputy CEO/Director of Policy and Education. He conveyed to attendees that in discussions between the Association and the ATO, that they had advised their settled position to be that a benefit payment should be treated as a member benefit where the member has requested the benefit payment prior to their death, despite the benefit being paid after their death.

Whilst we have a number of PBRs that provide for different outcome and the latest from the ATO on the issue, we must remember that PBRs are only binding on the applicant and comments from the ATO do not have the force of law (it would be very beneficial for the ATO to provide their comments on their website for all to read and refer to). Further, PBRs only focus on the tax issues, as the ATO can only issue a PBR on tax matters. They have not addressed the estate planning consequences of whether a benefit payment is a member benefit or a superannuation death benefit. Whilst there may be a better tax outcome for treating a benefit payment one way or the other, it may not result in all (potential) beneficiaries seeing it that way.

Certainty will only come from the courts determining whether the estate has an entitlement to enforce the payment of the requested ‘member benefit’ to it, as against the ‘dependants’ right to receive a superannuation death benefit payment.

Implementation considerations

For anyone considering the implementation of a death bed member withdrawal, below is a list of some issues to consider:

- Who will be making the request? Will it be the member themselves or their attorney?
- Who will be considering the request and how must they do it? Are there one or more trustees or directors of the corporate trustee? Will they do what we want them to do?
- What are the assets we are intending to transfer to make the benefit payment? Will these be paid out in cash or will assets be transferred in specie?

- Can the member withdraw their benefit while they are alive? Which condition of release do they satisfy?
- What will the impact be on the member's estate planning? Does the member's Will direct their superannuation differently to their superannuation documents?
- Does the payment before death expose the superannuation to the risk of an estate challenge, while leaving it in superannuation may keep it away from one?
- Will the member lose insurance entitlements?
- Does the member have an accumulation account or pension account? How will the member payment be treated in respect of these accounts?
- What are the tax and duty consequences for the fund and the member in making the proposed benefit payment?
- What does the trust deed say? Will it allow us to do what we want to do?
- What can we do now to make the work we need to do later easier?

Successfully implementing this strategy given the range of issues outlined above is a difficult exercise. It is critical that you ensure that you get proper advice to ensure you navigate the range of complex legal issues that arise when implementing this strategy to ensure that intended outcome is achieved.

Despite the issues with implementing this strategy, one thing is clear: producing pre-prepared paperwork that purports to be effective immediately before a member's death to request a payment of a 'member benefit' is unlikely to be sufficient to effectively implement this strategy.

Effect of SMSF member's death on trusteeship

Generally, a member of an SMSF is also a trustee of the SMSF or director of the corporate trustee of the SMSF. Consequently, the death of a member will commonly affect the trusteeship of the fund and require the SMSF to comply with the relevant SIS rules within the prescribed period.

Who can be trustee where member dies?

The Legal Personal Representative (LPR) of a deceased member **can** be **appointed** as either trustee or director of the corporate trustee, as the case may be. Sub-section 17A(3)(a) states that a superannuation fund does not fail to satisfy the SMSF definition by reason only that:

- (a) A member of the fund has died and the legal personal representative of the member is a trustee of the fund or a director of a body corporate that is the trustee of the fund, in place of the member, during the period:
 - (i) beginning when the member of the fund died; and
 - (ii) ending when death benefits commence to be payable in respect of the member of the fund.

Please note that I have deliberately highlighted the words "can" and "appointed" as there is still a misconception that the LPR of a deceased member automatically becomes the trustee/director upon the member's death. This is not the case, unless the trust deed

provides – a reason why it's important to review the fund's trust deed. The law merely allows the LPR to be appointed, however, you need to follow the appointment rules as set down in the fund's trust deed and where the trustee is a company, refer to the company's Constitution for the rules governing appointment of a director.

Refer to the case of *Ioppolo v Conti* [2015] WASCA 45 where one of the issues considered was whether the Executors of the deceased member's estate, being the children of the deceased, were entitled to be appointed as trustees of the SMSF. The SMSF had the deceased and her spouse, who was not the natural parent of the deceased's children, as the only individual trustee and members of the SMSF. The deceased's Will, a non-binding death benefit nomination, stated that she wanted all of her superannuation benefits distributed to her children and none of it was to be paid to her spouse. After the death of the member, the SMSF only had one remaining trustee, being the surviving spouse, to make the decision pertaining to the decision of payment of the deceased's superannuation death benefit. We can see why the children wanted the court to side with their argument that as the deceased's LPR, they should be appointed trustee and be part of the superannuation death benefit decision.

However, the Court found that whilst the SIS Act, being sub-section 17A(3) allows an LPR, which included an Executor, to be appointed as a trustee of an SMSF, it does not require that such an appointment be made.

When the LPR rule ceases

It's important to note that the LPR rule ceases once the death benefit commences to be paid. This means that once the first death benefit payment has been made, for example an interim lump sum death benefit (the rules allow for an interim and a final death benefit payment) or a death benefit pension has commenced, the trusteeship of the SMSF must be changed, within the permitted time period, to comply with the basic rules.

Once the LPR rule for the SMSF definition ceases, the fund will have six months to take the necessary action to comply with the SMSF definition rules in section 17A SIS Act.

Trustee appointment is a personal in nature

It is also important to note that once appointed, either as an individual trustee or director of the corporate trustee, the LPR is appointed in their own right and not as a representative of the deceased member. However, once the death benefit becomes payable and the LPR rule no longer applies, there is no automatic removal of the LPR as trustee or director, unless the trust deed or company constitution prescribes. Consequently, the LPR must be removed as trustee or director in accordance with the fund's trust deed and/or company constitution and the trusteeship of the fund structured to comply, both within the six month period of grace provided in sub-section 17A(4) SIS Act.

Similarly, where a person, who is an attorney under an Enduring Power of Attorney (EPOA) for a member, is appointed a trustee or director of the corporate trustee in the place of the member, that person is appointed in their own right. Such an arrangement does not cause

the SMSF to fail the section 17A SIS Act requires due to subsection 17A(3)(b)(ii) SIS Act (you can also refer to [SMSFR 2010/2](#) which explains the scope and application of this subsection).

Also, in the event of the member's death, whilst the attorney relationship ceases, they are not automatically removed from their position as trustee or director of the corporate trustee. This was at issue in the case [Dawson v Dawson \[2019\] NSW 826](#). The case involved an SMSF with two members, who were both individual trustees, Peter and Estelle. The members had separated and Peter had lost capacity. His son, Tony was his attorney under an EPOA and been appointed a trustee of the SMSF and Peter had been removed. The SMSF complied with the SIS SMSF definition as:

- Estelle, a member of the SMSF, was one individual trustee; and
- Tony, who was the attorney, under an EPOA, for Peter, a member of the SMSF, was the other individual trustee.

Unfortunately, Peter died and whilst Tony was his Attorney, this ceased upon his death. The Executor of Peter's estate and consequently LPR, was George, Estelle's son, but not George's son.

The question at issue was who was the trustee of the SMSF together with Estelle – Tony as Peter's former attorney, no longer LPR and current trustee or George, Peter's Executor and LPR?

What the court found:

- The trustees of the SMSF were Estelle and Tony;
- Tony was not automatically removed as trustee as a consequence of Peter's death;
- The death of Peter did mean that Tony was no longer Peter's attorney and consequently no longer Peter's LPR, but that did not result in Tony automatically being removed as a trustee;
- Whilst George was Executor of Peter's estate and became his LPR upon his death, he was not automatically appointed as a trustee of the SMSF;
- The appointment of a trustee is personal in nature. That is, whilst Tony was Peter's attorney at the time of his appointment as trustee, his appointment was in his own right and not as Peter's representative. However, his appointment did not cause the SMSF to fail the SMSF definition in s.17A SIS Act as it is permitted per sub-section 17A(3)(b)(ii) SIS Act;
- Peter remained a member of the fund until his death benefit was paid. That is, his membership of the SMSF did not cease at the time of his death [Comment: reference should be made to the trust deed to ascertain whether there are any provisions that define when a person ceases to be a member];
- The provisions in section 17A SIS Act do not automatically appoint a member's LPR upon the member's death. The provisions simply allow for the appointment;
- Any removal or appointment of a trustee must be in accordance with the trust deed.

It was worthwhile noting that the trust deed of the SMSF provided a mechanism for the members to remove and appoint trustees. This allowed the members, Estelle and George (as

Peter's LPR) to remove Tony and appoint George. However, these trust deed provisions were not followed – a draft deed of confirmation was prepared that purported Tony to have been removed and George appointed, due to the death of Peter and change of his LPR. This reinforces the importance of reviewing an SMSF's trust deed as in this case there was a solution, but it simply was not followed.

LPR who is an existing trustee/director

Where a member's LPR is already a trustee of the SMSF or director of the corporate trustee, they are not required to be appointed again. For example, Homer and Marge are both members and individual trustees of the Springfield SMSF. They are also named Executors under each other's respective Will. Upon Homer's death, Marge as Homer's LPR is permitted to be a trustee of the SMSF, however, as she is an existing trustee, she is not required to be appointed again.

This then leads to an interesting scenario – a two member SMSF with only one individual trustee. Whilst at first glance this may not appear to comply with the SMSF definition in section 17A SIS Act, it actually does as:

- Marge is a member of the SMSF and a trustee; and
- Homer is a member of the SMSF and his LPR, Marge, is a trustee.

However, once Homer's death benefit commences to be paid the LPR rule no longer applies and the SMSF will have six months to restructure the trusteeship to comply with section 17A SIS Act. This could be achieved by either:

1. Appointing another individual as trustee – the fund would be a single member SMSF (Marge the sole member) with two individual trustees, complying with sub-section 17A(2)(b) SIS Act; or
2. Changing the trusteeship of the fund to a company with either Marge as the sole director or Marge as one of two directors, the second director being a non-member director, complying with sub-section 17A(2)(a) SIS Act.

Determining member balance for cashing

The death of a member is the only compulsory cashing requirement and to effect requires the deceased member's entitlements needs to be determined. This will generally require the SMSF's financial statements to be brought up to date to determine the member's entitlements at the relevant time. Part of this will be to determine the market value of fund assets, which may present a challenger where there is no ready market to provide a market value for an asset, for example, non-listed shares and real property.

The timing of determining the deceased member's balance will also depend upon the type of interest, as follows:

- Reversionary pension – date the pension reverts, being the date of death of the member;
- Accumulation interest – the date the death benefit is paid;
- Non-reversionary pension – the date the death benefit is paid.

Where an SMSF member was being paid a defined benefit pension whether there is an entitlement on death to the deceased member's dependant(s) will be dependant upon the type of defined benefit pension and whether or not it was reversionary.

Of course, reference should always be made to the fund's trust deed for any provisions that apply to dealing with cashing a deceased member's interests in the fund.

Tax components of a superannuation death benefit

The tax-free and taxable components of each superannuation interest of a deceased member must be calculated. A member of an SMSF will have only one accumulation interest², but may have more than one pension interest³. The tax components of a superannuation death benefit will determine the amount of tax that a beneficiary may be required to pay. The amount of tax will depend upon whether the superannuation death benefit was paid as a lump sum or pension and whether the recipient was a 'death benefits dependant'⁴.

Death benefit paid from member's accumulation interest

The proportioning rule⁵ is applied just before the superannuation death benefit payment, either as a lump sum or commencement of a death benefit pension to an eligible recipient⁶. Effectively, the proportioning rule is applied similarly to where a member benefit is paid.

Death benefit paid from member's pension interest

The proportion of tax components applied to a superannuation death benefit paid from a deceased member's pension is based on the original split of those components at the time the pension commenced⁷. For example, a member commenced a non-reversionary account based pension on 1 July 2018 for \$800,000. The proportioning rule is applied immediately prior to commencement of the pension and the tax components are calculated as \$480,000 taxable component and \$320,000 tax-free component. This proportion, 60% taxable component and 40% tax-free component, is applied to all payments from this pension interest. When the member dies and the capital supporting the pension is paid as a superannuation death benefit, either as a lump sum or pension, the tax components will remain as 60% taxable and 40% tax-free.

However, where there is an amount of proceeds from an insurance policy added to a non-reversionary pension interest, there is a modification to this rule. Insurance proceeds are

² Reg 307.200.02 ITAR 2021

³ Reg 307.200.05 ITAR 2021

⁴ As defined in sectn 302-195 ITAA 1997

⁵ Sectn 307-125 ITAA 1997

⁶ Sub-reg 6.21(2A) SISR

⁷ Reg 307.125.02 ITAR 2021

removed from the total death benefit amount when applying the original split of tax components and the insurance proceeds will be added to the taxable component⁸.

This modification however is not applied where the pension interest was established as reversionary. Any insurance proceeds added will be split between taxable and tax-free component in the same proportion as the original split of the pension at the time it commenced.

PAYG withholding obligations

An SMSF trustee may have PAYG withholding obligations when it pays a superannuation death benefit. These obligations will include requirements to :

- Register as a PAYG withholder;
- Withhold and remit the relevant amount to the ATO;
- Provide relevant reports to the superannuation death benefit recipient and the ATO.

Whilst an SMSF may have an obligation to register and report, they may not have a requirement to withhold and remit. This is discussed below.

Registration requirement

An SMSF is required to register as a PAYG Withholder where in the following superannuation death benefit payment scenarios:

- Lump sum death benefit
 - Paid directly to an individual who is **not** considered a 'death benefits dependant', as defined in section 302-195 ITAA 1997, that is, a tax dependant, for example an adult child of the deceased who was not in an interdependent relationship with the deceased or was considered 'financially dependent' upon the deceased at the time of the member's death;
 - Paid directly to the LPR of the deceased, that is, to the estate of the deceased SMSF member.
- Superannuation death benefit pension
 - Where neither the deceased member nor the superannuation death benefit pension recipient was at least age 60 at the time of death of the member.

Notes:

1. The SMSF trustee must also obtain a Tax File Number (TFN) declaration (NAT 3092) from the death benefit payment recipient, except where the payment is made to the deceased's LP (estate);

⁸ Sub-reg 307.125.02(3) ITAR 2021

2. If the deceased member was in receipt of a capped defined benefit income stream (CDBIS) at the time of death, the SMSF should have been registered for PAYG withholding. However, a TFN declaration would still be required to be obtained from the death benefit recipient where they fall into one of the above categories.

The SMSF can register for PAYG Withholding using one of the following options:

- online through the ATO's [Online services for business](#);
- through the SMSF's registered tax agent or BAS agent
- using the SMSF's Standard Business Reporting (SBR) compatible software (if such software has this functionality);
- by [phoning the ATO's business line](#) provided the persona phoning the ATO is an authorised business contact.

A further option is to order and complete the:

- Add a new business account (NAT 2954) form
- Application to cancel registration (NAT 2955) form.

Withholding and remitting

The SMSF will have an obligation to withhold from the superannuation death benefit payment the relevant amount and remit to the ATO as follows:

- Lump sum death benefit
 - Paid directly to an individual who is **not** considered a 'death benefits dependant', as defined in section 302-195 ITAA 1997 – withhold the relevant amount per [Schedule 12 – Tax table for superannuation lump sums](#).
- Superannuation death benefit pension
 - Where neither the deceased member or the superannuation death benefit pension recipient was at least age 60 at the time of death of the member – withhold the relevant amount per [Schedule 13 – Tax table for superannuation income streams](#).

Notes:

1. Whilst there is a requirement for the SMSF to register as a PAYG Withholder in respect of a lump sum superannuation death benefit payment made to the deceased member's LPR (estate), there withholding amount is Nil.
2. Where the superannuation death benefit is paid as a lump sum to the deceased member's LPR (estate) and ultimately paid to a non-dependant for income tax purposes, the responsibility for withholding the applicable amount of tax lies with the Executor of the deceased member's estate.

Reporting

The SMSF will have an obligation to provide relevant reports to both the death benefit recipient and the ATO, as follows:

- Lump sum death benefit paid either directly to an individual who is **not** considered a 'death benefits dependant', as defined in section 302-195 ITAA 1997 or paid to the deceased member's LPR (estate):
 - Provide the recipient with a copy of the PAYG payment summary – superannuation lump sum form (NAT 70947) within 14 days of making the lump sum payment.
 - Provide the ATO with the original of each PAYG payment summary together with a PAYG withholding payment summary statement (NAT 3447) by no later than 14 August following the end of income year in which the payments were made.
- Superannuation death benefit pension
 - Provide the recipient with a copy of the PAYG payment summary – superannuation income stream (NAT 70987) in respect of all income stream payments made in respect of the income year by not later than 14 July following the end of the income year.
 - Provide the ATO with the original of each PAYG payment summary together with a PAYG withholding payment summary statement (NAT 3447) by no later than 14 August following the end of income year in which the payments were made.

PAYGW obligations – summary

The following table is a summary of the PAYG Withholding requirements and obligations for an SMSF when making a superannuation death benefit payment.

Row	SIS Act s.10 dependant type	Is the SIS dependant a Tax dependant per s.302-195?	Form of death benefit options	PAYGW registration required?	PAYGW obligations >\$0?	PAYGW Reporting obligations?
1	Spouse	Yes	Lump sum	No	No	No
			Pension	Conditional ¹	Conditional ¹	Conditional ¹
2	Child < age 18	Yes	Lump sum	No	No	No

Row	SIS Act s.10 dependant type	Is the SIS dependant a Tax dependant per s.302-195?	Form of death benefit options	PAYGW registration required?	PAYGW obligations >\$0?	PAYGW Reporting obligations?
			Pension	Conditional ²	Conditional ²	Conditional ²
3	Financially dependent child < age 25	No	Lump sum	Yes	Yes	Yes
			Pension	Conditional ²	Conditional ²	Conditional ²
4	Child who has a disability irrespective of age	Yes ³	Lump sum	Conditional ⁴	Conditional ⁴	Conditional ⁴
			Pension	Conditional ¹	Conditional ¹	Conditional ¹
5	Child 18+ (does not qualify for rows 2-3)	No	Lump sum	Yes	Yes	Yes
6	A person who was in an interdependency relationship with the deceased	Yes	Lump sum	No	No	No
			Pension	Conditional ¹	Conditional ¹	Conditional ¹
7	A person who was financially dependent on the deceased	Yes ⁴	Lump sum	No	No	No
			Pension	Conditional ¹	Conditional ¹	Conditional ¹
8	Legal Personal Representative (LPR) – Estate	N/A	Lump sum	Yes	No	Yes

Notes:

1. PAYG Withholding obligations will be dependent upon whether the member or death benefit pension recipient was aged at least 60 at the time of death of the member. If either were aged at least 60, there is no PAYG Withholding obligations;
2. PAYG Withholding obligations will be dependent upon whether the member was at least age 60 at the time of their death. If the member was aged at least 60 at the time of their death, there is no PAYG Withholding obligations. A child death benefit pension must be fully commuted prior to their 25th birthday unless they have a disability of the kind described in subsection 8(1) of the Disability Services Act 1986;

3. It is assumed that a child who has a disability of the kind described in subsection 8(1) of the Disability Services Act 1986, regardless of age. They would generally satisfy the definition of being a 'death benefits dependant' in section 302-195 ITAA 1997, either due to having had an interdependency relationship with the deceased or being financially dependent upon the member's at the time of their member's death. However, if they do not qualify as a 'death benefits dependant', you can apply row 5 applicable for a child aged at least but does not qualify for any of the previous three rows (2-4);
4. For the purposes of this summary table, it is assumed that the death benefit recipient satisfies the ATO's view and consequently satisfies the definition of 'death benefits dependant' per section 302-195 ITAA 1997.

PAYG Withholding obligations – superannuation death benefit paid to estate

Where the superannuation death benefit is paid to the deceased member's LPR, their estate, whilst there is a requirement for the SMSF to register as a PAYG Withholding and to provide a copy of the PAYG payment summary – superannuation lump sum form (NAT 70947) within 14 days of making the lump sum payment to the LPR, plus the original to the ATO by 14 August after the end of the income year, the withholding amount is nil.

The ATO has issued PBR [1051240397687](#) which address a number of questions in relation to payments from an SMSF to the deceased member's estate. From this PBR it is noted that:

- As the superannuation lump sum death benefits from the Fund were made to the trustee of the Estate section 302-10 of the ITAA 1997 will apply.
- In accordance with subsection 302-10(2) of the ITAA 1997, the taxation arrangements for superannuation death benefits paid to a trustee of a deceased estate are determined in accordance with the taxation arrangements that would otherwise apply to the person or persons otherwise intended to benefit from the deceased estate.
- This means that, where a dependant of the deceased receives or will receive part or all of a superannuation death benefit, the lump sum will be subject to tax as if it were paid to a dependant of the deceased, and the death benefit is taken to be income to which no beneficiary is presently entitled (subsection 302-10 (2) of the ITAA 1997).
- Similarly, where a person who is not a dependant receives or will receive part or all of a superannuation death benefit, the benefit will be subject to tax as if it were paid to a non-dependant of the deceased to that extent, and the benefit is taken to be income to which no beneficiary is presently entitled (subsection 302-10 (3) of the ITAA 1997). The taxable components of the payments must be disclosed in the income tax return of the Estate.
- Superannuation death benefits will be treated concessional if dependants of the deceased will benefit from the estate. Where a person receives a superannuation lump sum death benefit and that person was a dependant of

the deceased, the benefit is not assessable income and is not exempt income, that is, it is tax-free.

- Once the payment is made from the Estate to the Applicants it will not need to be included as assessable income in that Applicant's tax return as the payment represents a distribution of the Estate.

Transfer balance account

An SMSF must use the transfer balance account report (TBAR) to report transfer balance cap events to the ATO. The TBAR enables the ATO to record relevant transactions in an individual's transfer balance account (TBA) so that they can track an individual's balance for both their personal transfer balance cap (TBC) and total superannuation balance (TSB).

In respect of the death of an SMSF member, the events that would require reporting for TBA purposes would be:

1. Deceased SMSF member's benefit paid as a new death benefit account-based pension (ABP) to their surviving spouse or other eligible death benefit pension recipient. This is reported as the commencement of a new retirement phase income stream;
2. Deceased SMSF member's pension reverts to their surviving spouse or other eligible death benefit pension recipient. This is also reported as the commencement of a new retirement income stream. However, the respective TBA credit will not arise in the death benefit pension recipient's TBA until the 12 month [anniversary of the date of reversion](#).

Insurance proceeds

If a member holds a life insurance policy in their SMSF then upon their death the SMSF will receive the proceeds of that policy. The payout will be treated differently under the TBC depending on whether the member's income stream was reversionary or not.

Law Companion Ruling (LCR) 2017/3 deals with life insurance and non-reversionary income streams. The commencement value of a death benefit income stream includes any investment earnings accrued to that point. This includes any proceeds from a life insurance policy if it is decided that this will be paid as a death benefit income stream — regardless of whether the policy was held in respect of an accumulation or retirement phase interest of the deceased member.⁹

This means that where a pensioner passes away with no reversionary income stream, the value of any life insurance payout would be included in the commencement value of a resulting death benefit income stream. The death benefit recipient would have a credit

⁹ Para 44 LCR 2017/3

applied against their TBC equal to the balance of the death benefit pension at date it commenced inclusive of the insurance proceeds.

However, with an automatically reversionary income stream, the transfer balance account (TBA) credit value is the account balance on the 'starting day', meaning the date the pensioner passes away. Given that any life insurance proceeds will generally not be received until after this date, they would not form part of the account balance, and therefore the credit value for TBC purposes. This means that for an automatically reversionary income stream that included a life insurance policy (and where proceeds would be paid into this interest after death) then the value of the payout would not raise a TBA credit. A credit equal to the balance of the automatically reversionary income stream at date of death would apply to their TBA twelve months later. The life insurance proceeds, not matter how large, would not impact the TBC and could remain in the tax free retirement phase.

This will also apply to a Transition to retirement income stream (TRIS), even though it is not a retirement phase pension and consequently no TBC issues for the member. Where there is life insurance cover and the premiums are deducted from the reversionary TRIS, upon the death of the member and reversion to the reversionary beneficiary, the TRIS moves into retirement phase on date of death, when it reverts. The value of the TBA credit will generally not include any life insurance proceeds added to the TRIS as they generally are received and allocated to the reversionary TRIS after the date of reversion.

Income tax

There are a number of tax issues to consider in respect of the death of a member, both at the fund and the member or beneficiary level. Here we cover a few of them.

Taxation of death benefits

How a deceased member's superannuation benefit is taxed will depend upon:

- Whether the recipient of the superannuation death benefit is a 'death benefits dependant'¹⁰;
- The tax components of the superannuation death benefit;
- Whether the superannuation death benefit is paid as a lump sum or income stream.

A summary is included in the table below:

¹⁰ As defined in section 302-195 ITAA 1997.

Lump sum super death benefit	Death benefit pension ¹¹
'Death benefits dependant' → non-assessable non-exempt income → 100% tax-free ¹²	Tax-free component of pension payment → non-assessable non-exempt income → 100% tax free ¹³
Not a 'death benefits dependant': <ul style="list-style-type: none"> • tax-free component → non-assessable non-exempt income → 100% tax free¹⁴. • taxable component: <ul style="list-style-type: none"> • taxed element → 15%¹⁵. • untaxed element → 30%¹⁶. 	Taxable component of pension payment: <ul style="list-style-type: none"> • Either deceased or pension recipient was aged 60+ at time of member's death → non-assessable non-exempt income → 100% tax free¹⁷; • Neither deceased nor pension recipient was aged 60+ at time of death → taxed at pension recipient's marginal tax rate (MTR) with a 15% tax offset¹⁸.

When a superannuation death benefit will include an untaxed element

The taxable component of a superannuation benefit payment will include an untaxed element, which is taxed at the higher rate of 30%, where all of the following applies:

1. the benefit was a 'superannuation death benefit'¹⁹; and
2. the 'superannuation death benefit' is a 'superannuation lump sum'²⁰; and
3. the trustee claimed or will claim a deduction in relation to the benefit payment either:
 - a. insurance premiums under s.295-465 ITAA 1997; or
 - b. future liability to pay benefits under s.295-470 ITAA 1997.

¹¹ Excluding where the death benefit pension is a capped defined benefit income stream, refer Subdivision 303-A ITAA 1997 + recipient is an eligible death benefit pension recipient per SIS reg 6.21(2A).

¹² Sectn 302-60 ITAA 1997

¹³ Sectn 302-70 ITAA 1997

¹⁴ Sectn 302-140 ITAA 1997

¹⁵ Sub-sectn 302-145(2) ITAA 1997

¹⁶ Sub-sectn 302-145(3) ITAA 1997

¹⁷ Sectn 302-65 ITAA 1997

¹⁸ Sectn 302-75 ITAA 1997

¹⁹ Refer column 3 of table in sectn 307-5 ITAA 1997

²⁰ Refer sectn 307-65 ITAA 1997

The calculation of an untaxed element of the taxable component is only relevant where the recipient of the superannuation death benefit is **not** a 'death benefits dependant', as a payment to a 'death benefits dependant', e.g., a spouse, is non-assessable, non-exempt income. Generally, a superannuation death benefit made to an adult child of the deceased will include an untaxed element where the payment included insurance proceeds and the fund claimed either insurance premiums or applied the future service liability deduction option.

The untaxed element of the taxable component of a superannuation death benefit payment is calculated as follows²¹:

Step 1 – calculate the taxed element of the taxable component, using the formulae:

Superannuation lump sum x [(service days/(service days + Days to retirement)) – tax-free amount]

Step 2 -calculate the untaxed element:

Taxable component (calculated per the proportioning rule²²) – taxed element (calculated at step 1).

There will not be an untaxed element of a superannuation death benefit lump sum where the member was at least age 65 at the time of their death. This is due to the formulae's 'Days to retirement'²³ being based on the days from date of death to what would have been the member's 65th birthday.

Taxation of fund income

The ATO's ruling TR 2013/5 states, at paragraph 14:

"A superannuation income stream ceases when there is no longer a member who is entitled, or a dependant beneficiary of a member who is automatically entitled, to be paid a superannuation income stream benefit from a superannuation interest that supports a superannuation income stream."

Further, in relation to death of a member who was in receipt of a pension at the time of their death, paragraph 29 of the ruling states:

"A superannuation income stream ceases as soon as a member in receipt of the superannuation income stream dies, unless a dependant beneficiary of the deceased member is automatically entitled, under the governing rules of the superannuation fund or the rules of the superannuation income stream, to receive an income stream on the death of the member. If a dependant beneficiary of the deceased member is automatically entitled to

²¹ Sub-sectn 307-290(2) ITAA 1997

²² Sectn 307-125 ITAA 1997

²³ Sectn 307-290 ITAA 1997 states that this term means the number of days on which the deceased died to the deceased's 'last retirement day'. The term 'last retirement day' is defined in Sub-sectn 995.1(1) ITAA 1997 to be age 65, unless another age if the individual's employment or office would have terminated when they reached a particular age or completed a particular period of serve.

receive the income stream upon the member's death, the superannuation income stream continues."

Based on this ruling, it would be reasonable to conclude the following in relation to an SMSF claiming ECPI in the event of a pension member's death:

1. Non reversionary pension – pension ceases on death and ECPI cannot be claimed from date of death as there no longer exists a retirement phase pension; and
2. Reversionary pension – pension continues on the death of the member to the reversionary beneficiary; fund can continue to claim ECPI.

However, under the relevant Tax Act provisions for the two ECPI methods, reference is made to "RP superannuation income stream benefits". Amendments were made, as part of the 2012 MYEFO, to the definition of 'superannuation income stream benefit' in Tax Regulation 995-1.01(3) such that it would enable the fund to continue to claim ECPI in relation to the capital that was supporting the pension immediately prior to the pension recipient's death, provided the death benefit was paid "as soon as practicable". The death benefit can be paid either by way of lump sum or pension or a combination of both.

Interestingly, amendments made to Tax Reg 995-1.01(3) in late 2018, which were referred to as "*miscellaneous amendments*" to "*correct technical and drafting defects*", effectively removed the requirement to pay the death benefit "as soon as practicable" to allow the fund to continue to claim ECPI on the capital that was backing the non-reversionary pension. Whilst the tax regulation appears to no longer require the death benefit to be paid "as soon as practicable", for the fund to continue to claim ECPI, the SMSF trustees would still be required to comply with SIS regulation 6.21, which requires a member's benefit to be cashed, after their death, "as soon as practicable".

From a practical perspective, given the effect of the relevant Tax Regulations, claiming ECPI after the death of the member who was in receipt of a retirement phase pension appears to be the same, regardless of whether it was reversionary or non-reversionary. However, there is a difference, ECPI can only be claimed in relation to "investment earnings" (as defined per regulation 995-1.01(5)) that has been added to the deceased member's pension account. Consequently, ECPI cannot be claimed in relation to income generated from the following capital amounts that are added to the former member's pension account after their death, where the member was in receipt of a non-reversionary pension:

- Insurance proceeds from a policy held by the fund;
- An amount as a result of the fund self insuring.

Where the pension is reversionary, the fund can continue to claim ECPI in relation to the capital supporting the pension, including any insurance proceeds that may have been added to the deceased member's retirement phase (reversionary) pension account.

Insurance

As an alternative to claiming insurance premiums as an income tax deduction under s.295-465 ITAA 1997, a superannuation fund trustee can claim an income tax deduction for the future liability to pay benefits based on the actual cost of providing death or disability benefits that arise. This is an alternate deduction to claiming the actual insurance premiums.

This alternate option is unique to SMSFs as trustees who elect to claim under this option can no longer claim future insurance premiums as an income tax deduction. Large superannuation funds are unlikely to utilise this alternate option as it would deny the superannuation fund from claiming future insurance premiums in respect of all fund members.

To be eligible to claim under the alternate deduction option, the following must apply:

1. The SMSF trustee must make a choice to not claim insurance premiums and claim under the alternate option²⁴. Once the choice is made, the SMSF can no longer claim an income tax deduction for future insurance premiums under section 295-465 ITAA 1997²⁵.
2. The benefit paid by the SMSF trustee can be a death benefit payment, a terminal medical condition benefit payment, a permanent incapacity benefit payment or a temporary incapacity benefit payment. Further, the benefit can be paid as a lump sum or as an income stream (pension) [Note: for a temporary incapacity benefit, the SIS condition of release requires the form of the benefit to be a non-commutable income stream].
3. The member to whom the benefit relates must be under age 65 at the time of the relevant insured event occurring, for example the death of the member. This is due to the relevant formula used to calculate the deduction referencing 'future service days' which is regarded as a period up to normal retirement age, being age 65.
4. There must be an insurance premium paid in the year of death of the member. With this in mind, SMSF trustees should consider whether it would be better to pay monthly premiums rather than annual premiums.
5. For a benefit in relation to death, terminal medical condition or permanent incapacity, the benefit payment must be "in consequence of termination of the member's employment". This generally requires the member to be employed up until the date of the relevant insured event.

Generally, the size of the deduction means that the SMSF will have a carry forward tax loss and consequently, the following should be considered:

- The effect of net exempt current pension income (ECPI) on a brought forward tax loss. Net ECPI will reduce a brought forward tax loss prior to applying against current year assessable income²⁶.
- Whether SMSF members with retirement phase pensions should be transferred to another superannuation fund so that the SMSF does not have any net ECPI that can reduce the amount of a brought forward tax loss.
- Whether new members should be introduced to the SMSF and that they direct their assessable contributions to the SMSF so that they can benefit from the brought forward tax loss.

²⁴ Sub-sectn 295-465(4) ITAA 1997

²⁵ Sub-sectn 295-465(5) ITAA 1997

²⁶ Sub-sectn 36-10(3) ITAA 1997

- Whether members' insurance cover should be held in another superannuation fund. As the SMSF has made a choice to claim under the alternate deduction option, the SMSF is no longer permitted to claim an income tax deduction for future insurance premiums.