

Death and Incapacity - Who is in control of your SMSF?

With many trustees citing 'control' as one of the primary reasons for establishing an SMSF, there are many SMSF trustees that have failed to address the 'what if' scenario. It is important that you plan what would happen to your SMSF assets, and who would have control if you and/or your spouse were both incapacitated, or no longer alive. There are many disputes and legal battles around money and SMSFs (particularly amongst siblings when their parents have passed), that could be avoided with better planning.

Let's look at a common SMSF arrangement and the issues that arise:

A husband and wife as individual trustees. When one member dies, the fund needs to update its' trusteeship within the appropriate timeframe. If the remaining trustee decides to appoint another individual to replace the deceased all fund assets need to be amended to reflect the new trustee name which is the last thing most people want to be dealing with at that point in time.

Consider carefully when appointing a second person as trustee as the role entails the same legal rights and responsibilities as the trustee who is also a member in the fund.

Given this responsibility:

- Will appointing one family member over another create a point of conflict among siblings?
- What happens in this circumstance in blended families, or where parents and children do not actually get along?
- Who has ultimate say over who is appointed in this role if it's something that hasn't been discussed or addressed?
- Is appointing a corporate trustee structure which allows for a single member and one director a better option to avoid future conflict?

There is a lot to consider in deciding who will have control; to get the best outcome and minimise conflict and disputes. Control of the SMSF ultimately can impact where death benefits end up so trustees need to ensure that all of their documentation is aligned so that their wishes are adhered to in the event of their death.

Trustee and member requirements

We will now consider what actually needs to take place in the SMSF following the death of a member. With individual trustees, under Section 17A of the Superannuation Industry (Supervision) Act 1993, each individual trustee must be a member of the fund. Or for a single member fund there can be two individual trustees and one member. With a corporate trustee, under s17A SISA, each director of the corporate trustee must be a member of the fund. Or for a single member fund there can be a sole director; or the single member is one of two directors of the corporate trustee. The requirements of s17A must be met to ensure the fund satisfies the definition of a self managed superannuation fund to be a complying fund with concessional tax treatment. The fund's trust deed will specify the terms on which membership or trusteeship cease and death is generally listed as a relevant event. Some deeds will say membership ceases following the payment of death benefits.

There is an exception at 17A(3)(a) of SISA that a fund does not fail to satisfy the definition of a self managed superannuation fund if a member of the fund has died and the legal personal representative of the member is a trustee of the fund or director of the corporate trustee in the place of the member during the following period:

- Beginning when the member of the fund died; and
- Ending when death benefits commence to be payable in respect of the member.

S17A (4) of SISA provides that an SMSF has 6 months after it would cease to meet the definition before it actually ceases to be an SMSF.



Summary of timeframe:

Member dies



Death benefits commence to be paid



Ceases to be SMSF after 6 months if the trusteeship not restructured



So where the LPR is appointed as a trustee or director of the corporate trustee in place of the member from the date of death until the death benefits commence to be paid out; then there is effectively 6 months from the date of commencing to pay death benefits to restructure the trusteeship and comply with the definition of a self managed superannuation fund. The considerations previously noted and taken into account in making the important decision of who will have ultimate control; must be implemented in this timeframe.

Legal Personal Representatives

Under the definitions of s10 of SISA, an LPR can be one of the following:

- Executor of the will or the administrator of the estate of a deceased person.
- Person who holds an enduring power of attorney to act on behalf of another person.
- Trustee of the estate of a person under a legal disability/minor.

As previously noted, it is this person who will be appointed in place of the deceased member from the date of death until the death benefits commence to be paid out.

The concept of the LPR acting as an alternate trustee has been discussed in our fact sheet on 'Alternate Trustees for SMSFs'. As noted in the fact sheet, the appointment of the LPR is not automatic upon the death of a member. The trust deed rules must be checked around appointment of a trustee to make sure it allows for the LPR to act as trustee until the death benefits have begun to be paid out of the fund. If the fund has a corporate trustee, the constitution also needs to be checked to see how directors can be appointed.

Once a death benefit has been commenced to be paid, then the LPR must formally resign as trustee, unless they are to remain as a member. This is important to understand as a death benefit that is paid as a lump sum can be paid in two stages, as an interim and final payment. The LPR must be removed when the interim payment is made to the beneficiary. A death benefit is also paid when a death benefit income stream is commenced. As stated above, the SMSF then needs to meet the self managed superannuation fund definition in s17A of SISA but has a 6-month period to restructure the trustee.

Another important consideration in choosing an LPR is that whilst the legislation refers to LPR as a singular term, a member is not actually restricted in the number of LPRs they appoint to act on their behalf as trustee or director of the corporate trustee. Paragraphs 17A(3)(a) to (c) of SISA should not be read as being restricted to one for one substitution of the LPR for the member as trustee or director of the corporate trustee. Therefore, an SMSF member can have several executors named in their will and they are not restricted from having them all appointed to act for the SMSF until the point at which the death benefits begin to be paid. The LPRs can make the decision whether to appoint one and/or all to the fund.

Nomination of Beneficiary Forms

So far, we have looked at what needs to be considered in choosing who will have control, the timeframe to restructure the SMSF trustee after the death of a member and having an LPR act as temporary trustee; we will now look at the means of directing where the death benefit payments end up.

A nomination of beneficiary form is a vital instruction as to a member's wishes for their superannuation interest upon death. Superannuation does not automatically become part of the assets of a member's estate upon death. With a binding nomination of beneficiary in place the trustees **MUST** pay the death benefit as nominated (as long as the nomination is valid).

A non-binding nomination only indicates the member's wishes to the trustee of the fund, it does not compel them to pay the benefit accordingly and they retain ultimate control as to the decision. They will have the discretion to follow the stated wishes of the member or direct the entitlement to another person or persons (as long as they are dependents) or pay the entitlement directly to the estate.

Reversionary Pensions

Another way the death benefit of a member can be directed to a beneficiary is through a reversionary pension nomination. If a member has a pension account with a reversionary beneficiary nomination, the pension can continue to be paid to the reversionary beneficiary when the member passes away. Refer to our fact sheet 'Reversionary Pensions' for more information about how these work. Its important to check the terms of the pension and the trust deed of the fund to see if there is any rules regarding whether a binding nomination or reversionary pension nomination take precedence.

Overall a member's interest may be paid directly to a dependent from the super fund in the form of lump sums (interim and final) or a pension; it may be paid via a reversionary pension; or it may go straight to their estate and be dealt with in accordance with their Will.



Case study - a costly lesson

There is a widely talked about case called Katz v Grossman (2005) NSWSC 934.

Facts of the case:

- The deceased left behind a son and a daughter, both were the executors of his estate.
- His Will provided that his estate assets would pass equally to the two children.
- The deceased had \$1 million in an SMSF.
- Following his death, the SMSF was controlled by his daughter who had previously been appointed trustee. She subsequently appointed her husband as second trustee.
- The trustee decided to pay the \$1 million to the daughter, and not to the estate which was the father's intention.

The deceased's son (the brother) took the trustees to the Supreme Court to challenge the appointment of his sister and her husband as trustee of the fund, and as such the payment of the death benefit. The Court determined that despite the appointment of the husband being questionable, the appointment of the deceased's daughter was ok and as such her capacity to determine how the benefit was paid was within the scope of her trustee responsibilities.

This case highlights the importance of considering both who control passes to in the event of death and the importance of considering how a binding death benefit nomination works in with a deceased's Will.

How this could
have been
avoided?

The deceased could have prevented the ensuing legal battle and subsequent relationship breakdown between his children by taking care of 3 simple things:

1. Making sure that he considered control of his SMSF in the event of him not being around, to prevent the angst and issues that faced his grieving family.
2. Amending the Fund's Trust Deed, so that his Legal Personal Representative could be appointed as the replacement Trustee of the SMSF upon his death;
3. Preparing a binding death benefit nomination that either nominated his children to receive equal share of his superannuation OR that his benefit be paid to his Legal Personal Representative which would direct the benefit to his estate to be dealt with under the terms of his Will.



Death is not the only time disputes can arise

As SMSF members age, there are occasions where due to ill health, a member can no longer fulfil their duties as an SMSF Trustee. In this case, an 'Enduring Power of Attorney' would need to be appointed to fulfil the trustee role.

Please refer to our fact sheet *Why is an Enduring Power of Attorney essential?* for more information about what can be done to deal with the control of your SMSF whilst you are still alive but may lack legal capacity.

Trustee Tip

The ATO has found that a significant proportion of SMSF Trustees have yet to prepare for situations such as control of fund, death and incapacity. Take control of your fund affairs and be prepared for the inevitable. All of these issues can be avoided by undertaking proper estate planning.

As part of this process you would look at the following:

- Discuss your SMSF structure and future intentions
- Review the SMSF Trust Deed
- Review the Company Constitution (where relevant)
- Selecting Legal Personal Representatives and preparing Wills Preparing Nomination of Beneficiary documentation
- Preparing Enduring Power of Attorney documentation

The investment spent up front to ensure your structure is set up properly may result in savings in the future; and overall less stress for your family.



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