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BENEATH THE SURFACE

Superannuation Alert - Taxed Funds

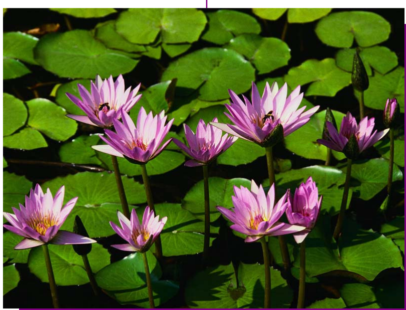
WHAT HAPPENS TO SUPERANNUATION BENEFITS ON DEATH UNDER THE NEW RULES?

Not a cheery topic to speak to you about but we have seen many superannuation death benefits get paid out differently to what the deceased's intentions were. Will you be one of them?

PAYMENT OF SUPERANNUATION BENEFITS UPON DEATH

Superannuation benefits are generally now tax free for people aged 60 years and over **but** how will they be taxed on death? Upon the death of a member, their superannuation must be paid 'as soon as practicable' as either a lump sum or a pension and can generally only be paid to:

- the deceased's legal personal representative (LPR) ie the executor which means that the superannuation forms part of the deceased's estate and must be dealt with in accordance with the terms of their Will, **or**
- the deceased's *superannuation* **dependants:**
  - the deceased member's spouse (can include de facto, excludes same sex partner)
  - any child (including adopted, stepchild, ex nuptial) of the deceased (see tax note below)
  - any person with whom the deceased person had an 'interdependency relationship' (may include a same sex partner)
  - any person financially dependant on the deceased at death (may include grandchildren)
  - LPR (*may* avoid Medicare levy and your Will might be drafted to direct superannuation benefits to people not on this list)



Tax Note: Benefits paid to adult children will be taxed (15% plus Medicare levy) unless being financially dependent on or in an interdependency relationship with their parent.

Interdependency relationship:

- close personal relationship **and**
- live together **and**
- one or each of them provides the other with (substantial) financial support, **and**
- one or each of them provides the other with domestic support and personal care (excludes a contract for services)

PAYING OUT A SUPERANNUATION DEATH BENEFIT

The new rules make it more difficult to distribute superannuation death benefits in a way that minimises tax for *superannuation* dependants.

Death benefit dependants

(see Tax Note below)

- the deceased member's spouse or former spouse (can include de facto, excludes same sex partner)
- any person with whom the deceased person had an 'interdependency relationship' (may include a same sex partner)
- any child of the deceased aged less than 18 years
- any other person who was a dependant of the deceased person before they died
- any person financially dependant on the deceased at death (may include grandchildren)
- any person who is in receipt of a pension following the death of a member, where the member died before 1 July 2007.

Acknowledgements: National Tax and Accountants' Association

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Tax Note: You will notice that the definitions of *superannuation* dependant and *death benefit* dependant differ slightly – this difference means that for families with children over 18 years, a tax free benefit on death will usually only arise for the spouse unless the children were still at home and financially dependent on, or in an interdependency relationship with the member prior to death.

Death benefit

- lump sums paid to *death benefit* dependants will be tax free
- lump sums paid to non-*death benefit* dependants such as children of the deceased who are over 18 and not dependent on the deceased for support, will be taxed at 15% plus Medicare
- may be paid as pensions to a *death benefit* dependant child – however, when the child reaches age 25 the pension must be converted to a tax free lump sum except where the child is permanently disabled
- a death benefit paid to a non-*death benefit* dependant must be paid as a lump sum

Lump sum death benefits

Recipient	Component	
	Tax-Free Component	**Taxable Component**
Death Benefit Dependant	Tax Free	Tax Free
Non-*Death Benefit* Dependant	Tax Free	15% plus Medicare levy

PENSION EXEMPTION CEASES UPON DEATH

CRITICAL DEADLINE FOR PLANNING

Income and capital gains in respect of assets supporting a superannuation pension are generally exempt from income and capital gains tax in the superannuation fund. In single member funds with non-reversionary pensions, this tax exempt status may cease on death of the member. If you are in this scenario, it might be **prudent** to realise capital gains periodically during the fund's tax free pension mode - discuss with your financial advisor and accountant.

DRAWING BENEFITS OUT FOR ADULT CHILDREN PRIOR TO DEATH - MEMBERS OVER 60

The de facto death tax (16.5%) applying to death benefit lump sums paid to adult children and the ability to access benefits tax free once a member is aged 60 years or more provides an incentive for members at least 60 years of age to withdraw their benefits during their lifetime rather than leave their moneys in the superannuation environment. **Be aware** though that if funds are withdrawn during the pension phase for the benefit of adult children prior to the member's death, then the *earnings* on those funds will lose their tax-free status. **Also be** aware that if you are over 65 years of age (and not working) it would be difficult to re-contribute these funds as undeducted (or tax free) contributions.

DEATH AND OTHER RELATED MATTERS

WILLS & SUPERANNUATION DEATH BENEFITS NOMINATIONS

Death is a compulsory cashing event. This means that upon the death of a member, their superannuation must be paid 'as soon as practicable' as either a lump sum or a pension (refer to the listings and tables for who can receive a pension and when the benefit must be paid as a lump sum; also note the tax effect of the different scenarios). This further means that a member's minimum benefits cannot simply remain in the fund and be allocated to other members.

Are you also aware that superannuation falls **outside** a member's estate, and therefore is not included in the list of assets dealt with under the Will and that the Trustee of your superannuation fund has the discretion, obligation and power to decide on the dependants who receive your superannuation benefits? The only exception to this rule is if the benefits are paid specifically by the superannuation fund to the estate by a **Binding** Death Benefit Nomination (BDBN) made by the member in favour of the their estate. Some superannuation funds do not offer **binding** DBNs and for those funds that do, sometimes your BDBN will expire every three years.

Of course sometimes it is more tax effective to **not** pay your superannuation death benefits to your estate. In balancing tax effectiveness and estate fairness in your estate planning, this is usually achieved by a conciliatory partnership approach between you, and your solicitor, financial advisor and accountant. At Beneath the Surface we are always willing to work in unison with you and your other professional advisors.

Action for you to take: If you are a member of a public superannuation fund, call them **today** to find out who you have nominated in your DBN and whether it is current and binding on the trustee so that you know where you stand. If you have a self managed superannuation fund (SMSF), call your accountant today to discuss.

How up-to-date is your current Will? Can you answer these questions?

- Does your Will reflect your current wishes?
- Where is the latest copy of your Will?
- Which legal firm drew up your most recent Will?
- Who are the executors?
- Do the executors know they have been nominated by you?
- Do the executors know where the latest copy of your Will is?

Enduring Power of Attorney - a must for all SMSF members

A power of attorney is a document whereby one person (the donor) gives power to another person (the attorney) to step into their shoes legally and do legal actions on the donor's behalf. An **enduring** power of attorney continues to be effective even if the donor loses legal capacity (eg loses mental capacity, lapses into a coma, etc). Some lawyers we deal with believe that having a current *enduring* power of attorney is even more vital than a Will.

Action for you to take today: Call your solicitor if your Will needs updating. Let your executor/s know where your Will is filed. Call our office if you would like us to liaise with you and your solicitor in getting your Will and enduring power of attorney up to date.

Testamentary Trusts

If a recipient is young or you wish to protect the capital being caught-up in a divorce or subject to attack by creditors, then it is often more prudent for the superannuation death benefit to form part of a testamentary trust.

PAY OUT DEATH BENEFITS ON DEATH AS A PENSION FROM 1 JULY 2007

Under the new rules, if a member dies on or after 1 July 2007, a pension can now only be paid to a *death benefit* dependant. For non-*death benefit* dependants the payment must be paid as a lump sum. The position for a *death benefit* dependant of a taxed fund is summarised in this table:

Age of Recipient	Pension: deceased aged under 60 years	Pension: deceased aged 60 years or more	Death Benefit Lump Sum
60 or over	Tax free	Tax free	Tax free
Under 60	Taxable Component: Marginal tax rates 15% tax offset (low rate cap may be available if beneficiary has reached their preservation age) Tax free component: Tax free	Tax free	Tax free

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HOLIDAYS

Our office will be closed for annual holidays from 11-21 April 2008 inclusive.