

SMSF Succession Planning - Considerations

Legislative background

Section 17A of the *Superannuation Industry Supervision Act 1993* (Cth) (**SIS**) fundamentally requires all self-managed superannuation fund (**SMSF**) members to be trustees (or directors of a trustee company) and all trustees (or directors of the trustee company) to be members and limits the number of members to no more than four.

For a single member fund, a member's relative is permitted to share the trusteeship with the member. If a single member fund has a corporate trustee, then the member must:

- be the sole director of the trustee company; or
- the member can have a second director (provided that the director is not the member's employer) and there are only the two directors; or
- the second director can be the member's employer provided that the second director is "related" to the member and there are only two directors.

If the single member fund does not have a corporate trustee, then the fund must have two individuals as trustees. In that case, the sole member must be trustee with:

- any person that is not the member's employer; or
- provided that the member's employer is related to the member, then that employer is able to be the second trustee.

Each fund member is, therefore, given every opportunity to participate in the fund's decision making process and to protect all fund members, no member can be the employee of another member unless the members are "related".

These "trustee/member rules" have significant implications for the succession and control of SMSFs upon the death or incapacity of members who are also the fund's trustees or directors of the corporate trustee. Timing and compliance are essential considerations in any successful SMSF succession plan, and the consequences of not attending to these considerations up front can be severe.

SMSFs a big part of the super scene*

Advisers and SMSF members/trustees alike are becoming increasingly aware of the importance of addressing timing and compliance issues in relation to succession and control of SMSFs with certainty.

Traditionally, SMSFs have largely been retirement savings vehicles for couples in the older-aged brackets, with 69% of funds having two members and 51% of funds having members aged 55 years or older. Currently, fewer than 6% of fund members are aged under 35 years. However, indications are that the number of younger people choosing SMSFs to manage their retirement incomes is increasing.

The SMSF sector continues to grow, with new registrations this financial year up approximately 9% on the same period last year. There are now more than 400,000 funds in existence. This means about three-quarters of a million Australians currently provide for their retirement by means of their SMSF and the SMSF sector currently accounts for about one-third of all superannuation funds under management in Australia.

Total assets held in SMSFs are approximately \$326 billion, with average assets per fund more than \$900,000. The average member holding is about \$490,000 (ATO figures based upon the situation prior to the global financial crisis).

Therefore, there will be a massive generational asset shift from superannuation over the next few decades. In addition to succession and control issues, consideration must also be given to tax and stamp duty consequences as well as potential issues regarding the prohibition against acquisition of assets from related parties in section 66 of SIS.

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A number of issues relevant to SMSF succession are discussed below:

Can the holder of an enduring power of attorney make a binding nomination?

A binding death benefit nomination (**BDBN**) is not a testamentary instrument. It is, therefore, at least arguable that the holder of an enduring power of attorney can make, confirm, amend or revoke a BDBN for the person on whose behalf they hold the enduring power, particularly if there is an express power in the enduring power of attorney authorising them to do so.

Fund member capacity and directorship:

What happens when a fund member loses capacity?

SMSF members are generally also trustees or directors of the corporate trustee of their SMSF. Where a trustee or director of a corporate trustee becomes incapacitated, then the position of trustee or director may become vacant. As a result, the SMSF risks being made non-complying by the ATO unless the trustee either rolls over the incapacitated member/trustee/director's benefits to a public offer fund or arranges for a replacement APRA-approved trustee.

Section 17A(3)(b)(ii) of SIS permits a person holding an enduring power of attorney in relation to a member to be a trustee in that member's place. The matter of a replacement trustee/director must be resolved within 6 months of the incapacitated member ceasing to be a trustee/director; otherwise the SMSF will no longer satisfy the SIS requirements to be an SMSF.

Can the Legal Personal Representative (LPR) of a deceased member be a trustee?

Section 17A(3)(a) of SIS provides that a superannuation fund does not fail to satisfy the conditions specified in subsection (1) or (2) by reason only that:

- a member of the fund has died and the legal personal representative (**LPR**) 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:
 - beginning when the member of the fund died; and
 - ending when death benefits commence to be payable in respect of the member of the fund;

Subject to section 17A(3)(a) and the trust deed for the fund, therefore, the LPR of a deceased member can be a trustee or director of the corporate trustee in their place.

Exit strategies:

When a member dies and their spouse/partner does not want to continue the fund

When a member dies, death benefits arise in respect of that member's entitlements still held in the fund. Death benefits are either paid as a lump sum or as a pension direct to the beneficiary or to the LPR of the deceased's estate. In this regard, it is important to determine whether the trustee has a discretion in respect of the distribution or is bound by the deceased's BDBN.

The surviving spouse/partner may not wish to continue as a trustee or director of the corporate trustee of the fund. If that is the case, then exit strategies may be employed to enable the surviving spouse/partner to enjoy the superannuation benefits without having to remain as trustee of the fund or alternatively may wind up the fund altogether.

An alternative to winding up the fund is to change the trustee of the SMSF to become a Small APRA Fund in accordance with section 17A(4)(a) of SIS.

Can a pension or reversionary pension be transferred to another fund?

Broadly, the superannuation and tax rules do not contemplate the transfer or roll over of pension benefits from one fund to another. In our opinion, therefore, subject to the type of pension, the pension paperwork and the governing rules of the fund, it may be possible to commute a pension, transfer or roll over the resulting lump sum to another fund and commence a new pension, but a pension or reversionary pension cannot be transferred directly from one fund to another.

The portability of benefit rules that allow a member to request the trustee of a super fund to transfer benefits from one fund to another do not apply to SMSFs or pension benefits other than an allocated pension. Consistent with the above, our interpretation of this is that an allocated pension cannot be transferred directly from one fund to another; rather, it can be commuted, the resulting lump sum transferred or rolled over to another fund and a new pension (likely an account-based pension) commenced.

Planning for succession and fund control

It is essential to consider the SMSF deed and constitution of any corporate trustee regarding:

- Who has power to appoint and remove trustee/directors?
- Who owns shares in the corporate trustee?
- What happens to the shares on death?

Death and incapacity (including bankruptcy) of members/trustees/directors should always be considerations for advisers.

It is also important to be alert to the ban of having a trustee/director who is a “disqualified person” and therefore prevented from acting as a trustee of a super fund by sections 120 and 126K of SIS.

Delays after death (eg probate)

In attending to the estate administration, it is often necessary to obtain a grant of probate. However, the SMSF trustee does not always have to wait before distributing super directly to fund beneficiaries. BDBNs requiring the SMSF trustee to distribute directly to spouses/partners and/or children are governed by the SMSF deed and the legislation rather than the Will.

However, delays may occur when the fund trustee has a discretion to distribute and the deceased had expressed the intention that the death benefits be paid into the estate and there is a risk that the estate will be challenged. Alternatively, the SMSF itself may be subject to attack on the basis that a BDBN is invalid, or where the valid exercise of the trustee’s discretion is being challenged and advisers should be aware of potentially significant tax implications of delay; refer, for example to section 307-5 of the *Income Tax Assessment Act 1997* (Cth).

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