

SMSF INCOME STREAMS - REVERSIONARY PENSIONS AND ESTATE PLANNING

This technical article explores reversionary pensions and estate planning through a practical scenario.

Joe is a single parent who has recently turned 60 years of age and retired. He has 2 adult children, Peter and Claire, from his first relationship, both of whom have generated significant wealth from owning and operating successful businesses, and a 15 year old son, Tim, from a relationship which has also ended. Joe has full custody of Tim.

Joe has a significant balance in his superannuation, which forms a large part of his overall wealth. He is the sole director of the corporate trustee of his SMSF. He has been advised to commence drawing an Account Based Pension, particularly as the fund income and pension payments will be tax free.

Because of the different financial positions between Peter and Claire and Tim, Joe's adviser suggests to him, as part of an estate planning exercise, to:

- establish the Account Based Pension with an automatic reversion to Tim, on the basis that Tim will receive:
 - an income stream for a period of time; and
 - the balance when he turns 25; and
- prepare a Will leaving the remainder of his estate to

pass equally between all 3 children.

Joe is pleased with the suggestion, as he feels that divides his wealth in quite appropriate proportions, based on individual needs.

He proceeds with:

- the commencement of the Account Based Pension;
- the automatic reversion of the Account Based Pension to Tim; and
- the drafting of a Will, with Peter and Claire as Executors.

He then forwards copies of all documents to his adviser for his records.

What went wrong?

Each year, Joe draws his minimum pension amount, and continues to be pleased with the arrangements he put in place on the suggestion of his adviser, which he documents for each annual meeting with the adviser.

Also pleasing for Joe is the fact that Tim, now aged 22, has completed his apprenticeship, is fully independent of Joe and is running his own house with his fiancée.

Subsequently, Joe discovers he has a terminal illness. In his final meeting with his adviser, Joe is

assured that his estate plan is still effective, so he passes away in the belief that he has looked after his family appropriately.

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Peter and Claire, as Executors of Joe's Will, step in as directors of the corporate trustee of Joe's SMSF.

They seek advice from their solicitor in regards to the automatic reversion of the pension.

After detailing Tim's age and living arrangements, they are advised that the automatic reversion is invalid.

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Tim, being between the ages of 18 and 25, must have been a financial dependant of Joe at the time of Joe's death for the automatic reversion to be effective.

The solicitor refers to the ATO Taxation Ruling TR 2013/5 and quotes:

"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."

On the basis that the automatic reversion to Tim cannot occur, Peter and Claire need to consider how the SMSF will treat the superannuation death benefit.

In the absence of a Binding Death Benefit Nomination, and after checking that they have discretion under the SMSF Trust Deed, they resolve to pay the balance of the SMSF to Joe's estate.

Under the terms of Joe's Will, his estate is divided equally between Peter, Claire and Tim.

For Peter and Claire, that means they receive some of the benefit originally destined for Tim.

For Tim, he effectively receives 1/3rd of the superannuation balance, rather than the total amount.

Tim decides to discuss the position with his solicitor who, once armed with copies of relevant documentation going back to the time of Joe's estate planning exercise, advises Tim:

- Peter and Claire have carried out their roles as required; and
- the adviser, potentially, has a number of areas of fault, including:
 - not initially pointing out to Joe the limitation of the automatic reversion option;
 - not advising that Joe initiate a Binding Death Benefit Nomination in favour of Tim as a 'fallback'; and
 - not picking up Tim's situation when conducting the annual reviews of Joe's structure and investments.

Following that advice, Tim engages his solicitor to pursue his lost entitlement, and is eventually successful.

Important outcomes for accountants and advisers

Estate planning, including automatic reversion pension instructions and Binding Death Benefit Nominations, must not be a 'set and forget' exercise.

A regular review of the entitlements of potential beneficiaries, and the validity of the documentation in place, can save much wasted time and money at a later date.

More information

Should you have any queries, or require more information, please contact the team at Topdocs on 1300 659 242.

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