

SUPERANNUATION DEATH BENEFITS – CONSIDER THE CHILDREN

A relatively unpublicised aspect of the 2017 Superannuation Reform legislation is the potential limitation on paying death benefit income streams to children.

The introduction of Transfer Balance Caps for superannuation members from 1 July 2017 included limits on the amount of income stream death benefits a dependant could receive following the death of a member.

Whilst a lot of consideration has been given to the issue of the spouse as the beneficiary, and the impact of the Transfer Balance Cap limits on their death benefit income stream, significantly less consideration appears to have been given to the impact of the Transfer Balance Cap if the beneficiaries are minors.

In other words, when the benefits are to pass to underage children of the deceased member, the impact of the Transfer Balance Cap can force the decision as to whether the benefits are paid as an income stream, whether they must be paid as a lump sum, or a combination of both.

Potential Death Benefit Income Stream Beneficiaries

The SIS Act limits the ability to pay death benefits as one or more income streams to the following dependants of the deceased member:

- Spouse
- Children
 - Aged under 18
 - Aged 18 to 25 and financially dependent on the deceased
 - Any age, but who has a prescribed disability
- A person in an Interdependency Relationship with the deceased
- A person who was financially dependent on the deceased

Transfer Balance Caps

Overlaying the entitlement to receive a death benefit income stream is the Transfer Balance Cap rules.

For all but the children of the deceased member, the Transfer Balance Cap rules will basically limit the amount of death benefits they may receive as an income stream to the amount of 'space' they have available in their personal Transfer Balance Account.

For an adult dependant, who has not previously had a Transfer Balance Account, that amount will be \$1.6m. For someone who already has a Transfer Balance Account, that amount could be more or less than \$1.6m,

depending on their circumstances.

Modified Transfer Balance Caps

Because the situation with children is different, in that their income stream will need to be paid out at age 25 at the latest (unless they suffer from a prescribed disability), different rules apply so that their Transfer Balance Account, when they retire, will not have been affected by any benefits they received as a child.

Unfortunately, there are potentially significant downsides to the Transfer Balance Cap rules when they are applied to child pension recipients.

Children have a Modified Transfer Balance Cap which, in many instances, will limit the amount of capital which can be applied to commence an income stream for them.

The Explanatory Memorandum to the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 provides guidance for a range of circumstances, which are summarised in the following table:

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Income Streams Post 1 July 2017	Transfer Balance Cap		Surplus
	Amount	Notes	
From parent's Accumulation Phase (no TBA)	\$1.6m	Shared proportionately with other beneficiaries	Lump sum to beneficiary(ies)
From parent's Accumulation Phase (had TBA)	Nil		Lump sum to beneficiary(ies)
Parent had Retirement & Accumulation Phase interests	Retirement Phase balance (proportion)	Shared proportionately with other beneficiaries	Lump sum to beneficiary(ies)
Parent had Retirement Phase interests only	Retirement Phase balance (proportion)	Shared proportionately with other beneficiaries	No surplus, regardless of RP balance

The table indicates a significant variation in the entitlements for children, depending on the Transfer Balance Cap of their deceased parent. For example, the bottom row indicates that, regardless of the amount of the deceased parent's retirement phase balance (i.e. possibly well in excess of \$1.6m through investment growth) the child can take that balance as an income stream.

Conversely, if the parent had previously had a Transfer Balance Account but, for instance, had commuted that retirement phase balance to accumulation (2nd row under heading), then the child could not take any of their benefits as an income stream.

What happens to the rest?

That is the major concern and, we would hope, an unintended consequence of the legislation.

Each of the top three rows indicate there is potential that benefits for underage children must be paid out of superannuation. When considering this relates to underage beneficiaries, there can be serious consequences, as the

trustee could not pay the benefits directly to the children – they must be paid to someone for the 'benefit' of the child.

Example of misuse

If we consider the example of a young girl named Cinderella, whose father, a widower, remarried. The father directed that his superannuation benefits be held for Cinderella and, because of circumstances detailed in the table above, those benefits were required to be paid out of superannuation. The trustee proceeded to pay the benefits to Cinderella's step mother, to be held in trust for Cinderella's benefit. We can all imagine, given the personalities, how that would have worked for Cinderella.

Planning Options

What steps should Cinderella's father have taken to ensure the benefits passed to Cinderella on his death?

Prior to the Superannuation Reform changes from 1 July 2017, he could have directed the funds be paid as an income stream to her, or else directed

them to a Superannuation Proceeds Trust for her benefit.

Following the changes, a Superannuation Proceeds Trust, with the right trustee, should have taken a higher priority.

The moral of the story - early planning will assist in ensuring the forced payment of benefits is not a waste of the beneficiary's money.

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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