

SUPERANNUATION DEPENDANTS – AN EXAMINATION OF DEPENDANTS UNDER SIS AND THE TAX ACT

It's important to understand the range of individuals who may be entitled to receive a superannuation death benefit. This paper considers those who would be classified as dependents under superannuation law and under taxation law

When attending to the estate planning requirements of members of a SMSF, or paying superannuation death benefits following the passing of a member, it is important for trustees of SMSFs and their advisers to understand the range of individuals who may be entitled to receive superannuation death benefits.

Definition of 'dependant'

The *Superannuation Industry (Supervision) Act 1993* ('SIS Act') lists three main categories of persons who may be classified as a dependant of a deceased member ('SIS dependant') as:

- a Spouse¹
- a Child
- any person with whom the deceased member had an interdependency relationship.

¹ Spouse includes *de facto* and *same sex spouses*.

Because the definition of dependant in the SIS Act is an 'inclusive' definition, other kinds of dependency, such as financial

dependency, are also able to be considered.

Restrictions on the payment of death benefits in the form of income streams

Superannuation death benefits can be paid to one or more SIS dependants in the form of an income stream (pension), including an automatic pension reversion, subject to the following restrictions applying to children of the deceased.

A death benefit may only be paid as an income stream to a child of the deceased member if the child, at the time of the death of the member:

- is under the age of 18; or
- is under the age of 25 and financially dependent on the member; or
- has a disability.

In addition, such an income stream must be commuted in full at or before the child's 25th birthday, unless the child suffers a specified level of disability (tested at the death of the member and again at the time they turn 25 years of age).

A child, over the age of 25 at the death of the parent who was either financially dependent on the deceased or in an interdependency relationship with the deceased, is not entitled to receive their superannuation death benefit entitlement in the form of an income stream unless they meet the test to show they were also suffering a disability.

This means that the only beneficiaries who can receive a death benefit in the form of either an income stream or a lump sum are:

- a spouse of the deceased;
- a child who meets the restrictions outlined above; or
- any other person (not being a child of the deceased) who was financially dependent on the deceased or with whom the deceased had an interdependency relationship at the time of their death.

This restriction effectively prohibits the payment of a death benefit in the form of an income stream to children of the deceased over age 25 in all cases,

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unless they are disabled. Those children who are not entitled to receive their death benefit entitlement in the form of an income stream have only one option available - to take their benefit as a lump sum payment.

Test as to actual relationship occurs at date of death of the deceased member

Although a person may meet the definition of dependant at the time the estate planning is undertaken, such as when an automatic pension reversion nomination is made, the nomination will only be valid if the relationship remains the same at the death of the member or, if the relationship has changed, it fits one of the other criteria to enable a pension to be paid to the particular individual.

For example:

- a child under age 18 at the time of the nomination is 26 years of age at the death of their parent (invalid nomination); or
- a spouse at the time of the nomination is no longer a spouse at the death of the member, but is financially dependent on the member (valid nomination).

What if no SIS dependants survive the deceased?

In circumstances where no SIS dependants survive the deceased

member of a SMSF, the benefits may be paid to a broader group, usually under the discretion of the trustee of the SMSF in accordance with the provisions of the trust deed and/or the SIS Act. Such payments could only be in the form of one or more lump sum payments.

There is also another test to meet

Having determined who may or may not be classified as a SIS dependant, a separate test deals with the taxation of benefits paid to recipients of the deceased's superannuation death benefits. A person who meets that test is known as a 'tax dependant'.

Definition of 'tax dependant'

A 'death benefits dependant' is defined in the Income Tax Assessment Act 1997 (ITAA 97) as:

- a Spouse or former spouse¹;
- a Child, aged less than 18 years;
- any other person with whom the deceased person had an interdependency relationship just before he or she died; or
- any other person who was a dependant of the deceased person just before he or she died.

¹ Spouse includes *de facto* and *same sex spouses*.

The SIS Act lists three main categories of SIS dependants. It

can be noted that the tax definition of dependant differs to some extent from the SIS definition.

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Spouse

The tax definition is the same as the SIS definition, with the addition of 'former spouse'.

A trustee cannot pay a death benefit to a former spouse simply because they are a former spouse. However, if the former spouse meets a definition of dependant under SIS legislation, such as financial dependency, any payment made by the trustee to that former spouse would be treated as a payment to a spouse for tax purposes.

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Child

The tax definition of child is the same as the SIS definition, except for a distinction between minor children and those over 18 years of age.

Under the tax definition, a child is considered to be a dependant of the deceased only if he or she is under age 18. If the child is over 18 years of age, he or she would need to meet one of the other definitions of tax dependant, such as financial dependency or interdependency, to be treated as a dependant for tax purposes.

This means that a trustee is able to pay a death benefit to a child of the deceased who is over 18 years of age, but the payment will be treated as a death benefit payment to a non-dependant for tax purposes, unless that child meets the tax definitions for financial dependency or interdependency.

Interdependency Relationship

The tax definition of an interdependency relationship is the same as the SIS definition.

Financial Dependency

Financial dependency is not defined in ITAA 97. The ATO, in an Interpretative Decision ID 2002/731 (although somewhat out of date), provides a summary of the ATO's view of financial dependency, to be considered when determining whether a

person was financially dependent on a deceased member of a superannuation fund.

Whilst the ATO will look for 'substantial' financial support, the Superannuation Complaints Tribunal has taken a broader view of what constitutes financial dependency, when applying provisions of the SIS Act.

Therefore, in rare cases, it may be that a trustee could determine that a person was financially dependent on the deceased under the SIS definition, but not a dependant under the tax definition. In other words, the trustee would be able to pay a death benefit to such a person, but the benefit may be taxed as a payment to a non-dependant for tax purposes.

Test as to actual relationship occurs at date of death of deceased member

As with the definitions under the SIS Act, the test to determine if the relevant individuals meet the tax definition of dependant will be applied at the time of the death of the member.

There is also another test to meet

For trustees attending to the payment of death benefits from a SMSF, the first consideration is to determine who may or may not be classified as a SIS dependant. The issue of taxation of the benefits paid to recipients of the

deceased's superannuation then needs to be considered.

For members and advisers involved in planning for the eventual passing of a member, both the SIS definition and the tax definition of dependant should be taken into account as a vital component of the planning process.

It is important for trustees of SMSFs and their advisers not only to understand the range of individuals who may be entitled to receive superannuation death benefits, but the tax consequences in paying benefits to dependants of the deceased member.

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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