Structuring
& Tax

Ensuring your plans for your super become a reality

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December 2015

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Why should you read this paper?

If you are one of the growing number of Australians with self-managed superannuation funds, it is important for you to have a sound understanding of the benefits associated with them. Who is entitled to what, both during your retirement and after your death, varies greatly from situations where assets are held directly.

This critical part of estate planning should be considered sooner rather than later. Where you fail to plan, your superannuation benefits could end up with unintended individuals, family disputes and result in inefficient and adverse taxation implications.

Koda Capital can help you implement strategies that ensure your superannuation wealth is managed efficiently, and is passed on to future generations according to your wishes.

This report provides a general outline of:

- the taxation implications of cashing superannuation benefits during your lifetime, and
- the potential taxation implications for the recipient(s) in the event you have not cashed all your benefits prior to your death.

It also covers:

- the fundamental matter of who will benefit from your superannuation,
- the potential implications should your strategy not be documented or implemented as intended, and
- high level strategies that have assisted Koda Capital clients in the past.

Background

Appropriate advice should be sought to minimise the likelihood of your superannuation benefits ending up with unintended beneficiaries.

In the past decade, Australians have accumulated significant amounts on wealth through superannuation, and in the year ended 30 June 2015 disputes over superannuation death benefits formed the second largest number of complaints (after administration) received by the Superannuation Complaints Tribunal.

An ATO statistical overview published in December 2014 showed that:

- The number of self-managed superannuation funds increased by 29 per cent to 534,000 in the five years to the financial year ended 30 June 2013, with total assets growing to $557 billion,
- Self-managed superannuation funds account for 99 per cent of the total number of superannuation funds and 30 per cent of the $1.9 trillion total superannuation assets in Australia,
- Over the same five-year period, contributions to self-managed superannuation funds averaged $24.9 billion a year, which were made on behalf of 64 per cent of self-managed superannuation fund members,
- Over the five years to the year ended 30 June 2013, member contributions increased by 5 per cent, and in the 2013 financial year exceeded employer contributions by approximately three to one, and
- In the 2013 financial year, self-managed superannuation funds experienced a positive return on assets of 10.5 per cent, the highest over five years and the fourth consecutive year of positive returns.

This overview indicates that superannuation benefits are forming a significant part of estates, and appropriate advice should be sought to avoid disputes and the possibility of your benefits not being distributed in accordance with your wishes.

As you work through the various stages of your life, Koda Capital can assist with your wealth accumulation, superannuation, and estate planning strategies and integrate these important issues with investment, taxation, and structuring advice.

Issues to consider during your three primary stages of life include:

I. Accumulation of wealth

- Concessional and non-concessional contributions are subject to ‘caps’
- Contributions are taxed within the superannuation fund, unless you are considered a high income earner for Australian tax purposes, whereby a surcharge of 15% is levied on your concessional contributions
- Fund earnings are taxed within the superannuation fund

II. Access to superannuation benefits during your lifetime

- Benefits in super are preserved until 65, or a condition of release has been met
- Access to your superannuation is possible prior to retirement if you have met your preservation age and you commence a transition to retirement pension
- Where you are 60 or over, the receipt of a lump sum or a pension from superannuation would be tax free
- Earnings on assets that support a pension would be tax free

III. Following Death

- A member's benefits must be cashed out as soon as possible
- The tax applicable on the payment of death benefits depends on the tax status of the ultimate beneficiary and the components of your superannuation benefits
- How your death benefits will be dealt with will depend on a number of factors, including whether you have made a non-binding or binding death benefit nomination to a specified individual or your legal personal representative, or subject to the super fund deed provisions

Why does superannuation form an integral part of estate planning?

It is very important that you take a holistic and integrated approach when considering the superannuation component of your estate plan. As outlined below, taxation implications differ according to who receives the benefits following your death.

The first thing to note is that superannuation benefits do not automatically form part of your estate.

Generally, only assets owned personally such as your house and personal investments form part of your estate and can be dealt with under your will.

Superannuation benefits, on the other hand, are held in trust for your benefit by the trustee of your superannuation fund. Therefore, different rules apply and it can be up to the trustee to decide how your superannuation benefits are paid following your death.

In general, superannuation benefits are dealt with through a Death Benefit Nomination.

How can you access superannuation benefits during your lifetime?

Contributions to a superannuation fund will be preserved in the fund until you are 65 years old. However you can access benefits earlier if you meet a condition of release, the most common of which is having reached a preservation age and being retired. Preservation age is the age which you can access your super if you are retired or have commenced a transition to retirement pension.

Preservation age is dependent on your date of birth and begins at 55 if you were born before 1 July 1960, and gradually increases to aged 60 for those born after 30 June 1964.

Voluntary cashing

Once you have satisfied a voluntary cashing condition, you can withdraw your benefits either as a lump sum or as a pension. The most common conditions of release are when a member:

- has reached their preservation age and retires,
- has reached their preservation age and begins a transition-to-retirement income stream,
- ceases an employment arrangement on or after the age of 60,
- is 65 years of age (even if they have not retired), or
- has passed away

Under certain special circumstances such as terminal illness, financial hardship, temporary or permanent incapacity, part of a member's benefits can be released prior to a member reaching their preservation age.

After the age of 60, upon cessation of a period of gainful employment you are considered to be retired; even if you subsequently return to gainful employment.

It is only necessary for you to cease an arrangement in which you were employed for gain or reward; you don't have to cease all gainful employment. For instance, if you are a director on a number of boards, ceasing from one board will be considered as the 'cessation of an arrangement' required to satisfy voluntary cashing conditions.

Minimum and maximum amounts when accessing a pension

If you are drawing a pension, the rules require you to draw a minimum amount annually from the member account balance supporting the pension.

The minimum amount is based on your account balance at 1 July each year; and penalties can be incurred if the minimum pension amount is not paid each financial year.

When accessing a pension (but not a Transition to Retirement Pension, which is described below), there is no upper limit on the amount you can withdraw as a fund member, subject to your account balance.

What happens after death?

Compulsory cashing

The superannuation provisions provide that a member's benefits must be cashed as soon as practicable after their death. The Australian Taxation Office has publically indicated that this will generally need to be in the form of a cash payment.

How are lump sum superannuation payments taxed?

If you are under the age of 60, all lump sum benefits paid to you from a 'taxed source' are taxable. The payment is divided into two components:

1) The exempt component is tax free and comprises various components of your account including, but not limited to, the non-concessional contributions.

2) The taxable component is generally the balance of your superannuation benefits and is included in assessable income. You will pay nil tax up to the low rate cap ($195,000 for the 2015/16 year) and 15% tax on a payment in excess of the cap (via a superannuation income tax offset).

If you are over the age of 60, lump sum payments are tax-free.

How are superannuation payments received in the form of a pension taxed?

If you are under the age of 55, it is very unlikely you would receive pension benefits. However if you do, the taxable component of the payment will be added to your taxable income and taxed at your marginal tax rate.

If you are between the ages 55 and 59, there is no tax payable on the tax exempt component of any benefits paid. The taxable component will be added to your taxable income and taxed at your marginal tax rate, less a tax offset equal to 15% of the taxable portion of the payment.

If you are 60 or older, the receipt of the pension benefits will be tax-free.

What is a Transition to Retirement Pension?

As of 1 July 2005, people who have reached their preservation age are able to access their superannuation benefits in the form of a Transition to Retirement pension, without having to retire. This means you can continue working part-time and use part of your superannuation to supplement your income.

A Transition to Retirement pension is non-commutable (cannot be converted into a lump sum), and you will be limited to receiving the calculated pension payments only.

Once you satisfy the retirement condition of release or attain the age of 65 (whichever is earlier), your Transition to Retirement pension is commutable. At this point you can commute the pension to a more advantageous income stream.

Under the conditions of Transition to Retirement Pensions, annual pension payments must be received each year and the pension drawdowns must not exceed 10% of your account balance.

You can set up a Transition to Retirement pension if you are between 55 and 74 years of age.

How are Transition to Retirement Pension receipts taxed?

If you are between 55 and 59 years of age, you will pay tax at your marginal rate on pension payments made, with a 15% tax rebate on the non-concessional contributions (if the pension is paid from a taxed fund).

Once you reach 60 years of age, pension payments will be tax free, if they are paid from a taxed fund.

If you choose to cease a Transition to Retirement Pension, you have the flexibility to commute your balance back to the accumulation phase in your fund.

What is the taxation status of superannuation funds when benefits are being paid?

Generally, during the accumulation phase superannuation funds pay tax on their income at a rate of 15%. Capital gains on assets held for more than twelve months are discounted by one third to give the assessable capital gain.

However, once a pension has commenced and you start receiving benefits from it, the superannuation fund is said to be in 'pension phase', and the income and capital gains generated by assets supporting the pension are exempt from income and capital gains tax.

Conversely, that proportion of expenses of the fund that would otherwise be deductible becomes non-deductible.

It should be noted however that any income from investments that are held by your superannuation fund to support accumulation accounts *will* be subject to tax, even if a pension is being paid from a portion of the fund assets.

Your superannuation fund will also be entitled to receive a refund of any franking credits from Australian dividends earned on shares supporting the pension. This will be in the form of cash from the Australian Taxation Office. Provided that the Australian companies have paid 30% tax and the rate of tax in pension mode is nil, the entire franking credits are refundable to the fund.

What else do you need to consider?

The Trustee of your superannuation fund must ensure that there are sufficient funds to enable pension payments as and when required. This means you may wish to carry out a review of the fund's investment strategy and investment mix.

If you continue to work while receiving superannuation benefits, your fund may accept contributions such as superannuation guarantee payments at the same time.

The two ways of accounting for a superannuation fund with pension and accumulation interests are the segregated method and the unsegregated method.

Under the segregated method, the trustee separates the assets that will be used to pay a pension into a separate pool. Under this method, 100% of the superannuation fund's income that is derived from those assets is exempt from tax.

Under the unsegregated method, all the pension and accumulation assets are held together and are managed as a single pool. To calculate the amount of the superannuation fund's income that is exempt from tax, the average value of the superannuation fund's pension liabilities is divided by the average value of the superannuation funds total superannuation liabilities. Under this method, an actuarial certificate will be required each year to verify the percentages.

What are the different types of death benefit nominations?

Binding and non-binding

Upon death, if you have a binding nomination in place, the trustee must pay out your superannuation according to your nomination.

If you do not have a binding nomination in place, the trustee can use their discretion.

Lapsing and non-lapsing

A non-lapsing binding death benefit nomination does not expire.

A lapsing nomination is valid for up to three years. If your nomination has lapsed at the time of your death, your superannuation benefits will be dealt with by your trustee at their discretion.

Regardless of whether you have a lapsing or non-lapsing death benefit nomination in place, you should regularly review your nomination for any changes in circumstance or your intentions. This is a really important part of the process, it often gets missed and could result in unindented consequences.

What are the estate planning and taxation implications following death?

The taxation treatment of death benefits can vary depending on various factors, including who receives the benefits, whether they are paid as a lump sum or a pension, and the tax components of the benefits.

Benefits paid to a tax dependant are generally taxed more favourably compared to benefits paid to a non-tax dependant.

A tax dependant includes:

- a spouse,
- your child under 18, or
- someone that is financially dependent on you.

In the event of your death, if the benefits are in the accumulation phase, your fund will determine the balance of the components. If you are in the pension phase, the components would have been calculated at the time you commenced your pension.

How are death benefits taxed?

Lump sum payments to your estate

If, following your death, a lump sum is paid to your estate, the taxation implications will depend on the tax status of the ultimate beneficiary:

Beneficiary	Tax-free component	Taxable component
Tax dependant	Tax free	Tax free
Non tax dependant	Tax free	Taxed element – 15% (plus Medicare levy) Untaxed element – 30% (plus Medicare levy)

Death benefit pensions

If you are in receipt of a pension, it could have been arranged for the pension to be reversionary, which allows the pension to be paid to a dependent beneficiary after your death until the current account balance is exhausted.

Tax treatment of death benefit pensions are:

Age	Tax-free component	Taxable component
Deceased or tax dependant aged 60 or older	Tax free	Taxed element - tax free Untaxed element – marginal tax rate (plus Medicare levy) less 10% tax offset
Deceased and tax dependant younger than 60	Tax free	Taxed element -Marginal tax rate (plus Medicare levy) less 15% tax offset Untaxed element – marginal tax rate plus Medicare levy

Types of untaxed superannuation funds

The untaxed element of a fund includes amounts where a fund has not paid any tax on the contributions or earnings. Untaxed superannuation funds fall into two broad categories:

1. public sector superannuation schemes, and

2. constitutionally protected funds (which are generally run by Commonwealth, State, and Territory government departments).

What happens if you have not made a death benefit nomination or yours has expired or is invalid?

In a recent review of self-managed superannuation fund deeds, we have noted that the following provision appears to be a common clause relating to how superannuation death benefits will be dealt with:

Unless a Member has provided a binding nomination, the trustee may pay any death benefit that becomes payable under this clause to anyone or more of:

- *The Member's dependents, and*
- *The Member's legal representative*

This means that unless you have provided a binding death benefit nomination, the following could occur:

- The death benefit payment will be at the trustee's discretion, and the benefits may *not* be dealt with in accordance with your intentions
- The fund may pay the benefits to a dependent or to the estate
- If paid to an estate, there could be tax repercussions unless the benefits are paid to a tax dependent
- A conflict of interest could arise if the trustee is left with the decision-making, in particular if the trustees can indirectly benefit from the superannuation proceeds if they are beneficiaries of the estate

For these reasons, it is very important to double-check your self-managed superannuation fund deed.

If a clause similar to the above is active, the potential ramification could be adverse taxation implications, and your superannuation death benefits could ultimately end up with people that are not in accordance with your wishes. This could lead to litigation if disputes arise.

Beneficiary when in receipt of a revisionary pension

Where a decision has been made that the recipient of your benefits will receive them in the form of a pension, consideration should be given on how they can deal with the benefits. Therefore this aspect of your estate planning should be checked too.

Both general superannuation provisions and self-managed superannuation fund deeds typically state the following regarding pension payments:

The pension may be commuted and the residual capital value may be payable by the Trustee subject to all the requirement of the Law.

This means that following your death, the recipient could be entitled to draw down 100% of the capital amount that is left to them.

If you have significant wealth accumulated in superannuation, you may consider placing a cap on the reversionary pension amount and the capital that can be drawn by a nominated beneficiary. This may be relevant if you also have an intention or desire for other beneficiaries such as your children to benefit from the capital in the future, following the death of your initial nominated beneficiary.

It is important to seek advice on drafting appropriate wording, as the recipient of the reversionary pension may have differing intentions to you when it comes their time to deal with the superannuation balance.

Getting greater control of what happens to your super benefits post death

If you wish to ensure your superannuation benefits are dealt with according to your exact wishes, you may consider the inclusion of a specific clause in the fund deed that states how superannuation benefits are to be paid on your death.

For instance, you can make a binding non-lapsing death benefit nomination to your legal representative. This means your superannuation benefit will be paid to your estate, which will then be paid out according to your will (as long as your will is up to date and reflective of your intended strategy). This could include the use of a testamentary trust, which is a trust established on death.

Testamentary trust example 1

One reason you may consider this strategy is if you believe the intended beneficiaries are too young to inherit your superannuation proceeds directly.

It is important to consider the tax status of the beneficiaries of a testamentary trust. If you would like to maintain the tax concessions available to tax dependants, the beneficiaries of the trust should be limited to individuals who are tax dependants and exclude other entities (such as companies, trusts, charities or other tax-exempt organisations).

The testamentary trust may also provide for other tax efficiencies where income from investments is distributed to minor beneficiaries; which would not be the case if, for example, the investments were held via a discretionary family trust.

Testamentary trust example 2

Another scenario when this strategy could be helpful is if you would like to provide for someone, where typically you would not be able to directly do so, such as a sibling, niece or nephew, (given that death benefits can only be left to a dependent or your legal representative). However, as they do not qualify as tax dependents, the superannuation benefits may be subject to tax.

Other examples

Other specific clauses in the superannuation fund deed, such as nominating alternative beneficiaries in the event that certain events occur (e.g. a person attaining a certain age or marital status), could also be considered.

Adding an appropriate clause to your fund deed

While a specific clause in your self-managed superannuation fund deed has advantages, it will generally require complex legal tailoring. Care should also be taken to ensure that subsequent trust deed upgrades do not override these provisions.

One of the most important things to remember is that there are risks involved if your superannuation benefits are paid to your estate, as the superannuation death benefit automatically forms part of your estate. This means that should a person make a claim against your estate, they will have the opportunity to make a claim for your superannuation benefits too.

What is the next step?

There are a number of important factors that should be taken into consideration when you are working through your estate plan.

Your superannuation benefits may constitute a significant proportion of your overall wealth, so great care should be taken to ensure your estate planning strategy encompasses this component.

The advisers at Koda Capital have the experience and expertise to help guide you through the complexities of estate planning, and can help ensure your wishes for the future are accurately met.

How to use this paper

- Review your estate planning and superannuation strategy using this paper as a guide
- Give it to your accountant/tax advisor to apply the areas covered off in this paper to your personal circumstances and help him/her to identify issues that are relevant to your circumstances
- Contact Koda Capital's Tax and Structuring team to discuss whether you are structured appropriately
- Use it as a discussion starter with your spouse to discuss your estate planning and superannuation strategies
- Share it with your family and friends or business contacts to help them work through their estate and superannuation strategies

About the author

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Ben Andreou specialises in advising high net wealth families, and senior executives of public and private companies in relation to their strategic personal financial services to maximise after-tax wealth. Ben has advised a diverse range of clients, including passive investors, retailers, property developers, medical specialists and other private ventures.

Ben has experience in:

- Personal planning and tax effective wealth creation strategies;
- Asset protection;
- Estate and succession planning;
- International relocations;
- Structuring including private companies
- Family Trusts and their effective use for asset protection and tax planning;
- Superannuation and retirement planning;
- Employee Share Scheme advice; and
- Capital Gains Tax issues arising from transactions and restructures.

Ben has worked with families to appropriately manage their tax risk and has extensive experience helping clients manage their relationship with the ATO on a variety of issues. He is a member of the Institute of Chartered Accountants and a Member of the Tax Institute Australia and has advised families for over 14 years.

Prior to joining Koda, Ben was a Director at PricewaterhouseCoopers and the trusted adviser for a number of key ultra-high net wealth and high net wealth clients of the Private Clients business.

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About Koda Capital

At Koda Capital we are taking an innovative approach to wealth management - an approach that puts your needs first. We are proud to be pioneers, offering professional services unencumbered by pre-existing ownership structures and practices. Our sole focus is giving our clients tailored financial solutions that are well-informed, independent, and transparent.

We act as an investment adviser to philanthropic, charitable and non-profit organisations. We go beyond the provision of tailored investment services, to provide expert advice on best practice, governance, regulation, investment strategy and relevant trends in the sector.

Koda's Commitment to Clients

- We will always be independent, and free from conflicts of interest that affect our advice.
- We will always put our clients' best interests first – across the full range of investment, execution and advice services we provide.
- We will agree, in writing, the services we will provide and deliver those services to the standards we promise. Our clients will have access to the best solutions available - not just a list of products restricted by commercial interests
- We will only earn fees which are paid directly and transparently by our clients, and if we were to receive any commissions they will be fully rebated to our clients for their benefit. We will detail the basis on which the fees are charged and will discuss them with clients at any time. Clients have – and will always have – full discretion to choose the type of fee structure that works best for them: be that on a fee for service basis, transaction basis, or asset basis. We believe that as advisers we should be rewarded according to the quality of advice and services we provide, not by our ability to promote specific products.

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