Philanthropy – adding value for High Net Worth Australians...cont.

distributed free of charge to over 56,000 individuals nationally – including 46,000 solicitors, more than 2,000 accountants and financial planners, senior personnel in the top 1,000 companies, wills and bequest specialists, philanthropic trusts and foundations and other major decision-makers and professional bodies.

"This latest research by CPNS reflects issues arising from the rising profile of philanthropy. It means professional advisors are more often being asked by clients about what their philanthropic options may be. Professional advisors too should no longer feel a cringe about asking about clients philanthropic intentions, but need to ensure they are informed about the options", said Ms Mahlab.

Wills and Bequests Principal with Williams Winter Solicitors in Melbourne, Kathryn Liddell, says it's important to have at least a general knowledge of the philanthropic options available to clients even if we cannot provide a full range of philanthropic services.

"We see our role as informing our clients of the options available to them and steering them in the right direction to obtain the correct advice if it is not within our area of expertise."

"We regularly work with our clients' accountants and other professional advisers and will refer our clients for expert taxation advice where necessary."

Looking for the 'Value-Add': Private Advice Needs of High-Net-Worth Australians, Working Paper No. CPNS 44 by Kym Madden and Wendy Scaife, is available for free download at www.cpns.bus.qut.edu.au. Enquiries to katie.mcdonald@qut.edu.au.

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The Vital Link between Super and Estate Planning

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When it comes to drafting a will, many solicitors are unsure exactly how superannuation fits in. This article looks at how superannuation and estate planning fit together.

1. Who is able to receive the superannuation benefit when a member dies?

Often a large sum is payable from a superannuation fund when a person dies (particularly as many funds contain life insurance policies and also as a result of recent super reforms). However, many practitioners are surprised to know that death benefits from superannuation funds do not by law form part of the deceased's estate. Death benefits are not automatically distributed according to the deceased person's will or necessarily in accordance with any nomination they have made to the trustee (subject to narrow exceptions discussed below).

Usually, it is up to the trustee of the superannuation fund to determine to whom the benefit should be paid (although the *Superannuation Industry (Supervision) Act 1993 (Cth)* ('SISA') and the Superannuation Industry (Supervision) Regulations 1994 ('SISR') restrict this discretion).[1]

Generally, death benefits can only be paid from a superannuation fund to:

- the deceased's spouse (including a defacto);
- the deceased's child (of any age[2], including adopted, step children and ex nuptial children);
- a person who was in an interdependency relationship with the deceased (including relationships such as same-sex partnerships and two elderly sisters living together);[3]
- a person who was financially dependent on the deceased; and/or
- the deceased's estate,

in such proportions as the trustee determines.

Only if the superannuation fund trustee, after making reasonable enquires, has not found either a legal personal representative or a dependant of the deceased, can payment be made to another person.[4] This rarely arises in practice.

When a deceased has validly nominated a preferred beneficiary before his or her death, the trustee will consider the nomination, but is not bound by it (except in the case of a binding nomination, which is explained in the following section of this article).

It is beyond the scope of this article to examine how trustees exercise their discretion with respect to distribution of death benefits among dependants. However, in the authors' experience, the following principles generally

apply:

- trustees consider the wishes of the deceased, the financial circumstances and needs of the potential beneficiaries and the nature of the relationship between the beneficiaries and the deceased;
- trustees are likely to consider who would be most likely to have continued to receive the income of the deceased had s/he not died;
- trustees also generally take into account who would have been likely to participate in the benefit with the deceased had s/he lived to retirement;
- financially independent adult children are unlikely to be included in a superannuation distribution where there are other dependents who are in a position of financial need;
- it is not the role of superannuation to compensate for inequities that occurred during the life of a deceased member (for instance, where the deceased failed to pay maintenance during the childhood of a claimant who is now an adult); and
- it is also not the function of superannuation to act as a cheap alternative to a Testators Family Maintenance ('TFM') claim. In other words, death benefits are not distributed in order to satisfy potential dependants who feel they were treated inadequately under the deceased's will.

If a deceased had life insurance cover through his or her superannuation fund, the proceeds of the life policy are paid to the trustee of the superannuation fund and form part of the superannuation death benefit. They are therefore distributed in accordance with the above principles.

2. When is superannuation paid to the estate?

Superannuation benefits can only be paid to the estate of a deceased member when:

- the superannuation fund's trust deed stipulates that payments on death must go to the estate (which is not a common provision);
- the trust deed gives the superannuation fund trustee a discretion with respect to payment of the death benefit and the trustee exercises this discretion to pay the benefit to the estate; or
- the fund allows members to make binding nominations and a member has validly nominated his or her estate.

Although the first of these three situations is self-explanatory, the second and third require explanation.

Discretionary payments to the estate

Trust deeds usually give the trustee discretion with respect to distribution of superannuation death benefits.

If a person dies without leaving any dependants, the fund trustee will have no choice but to pay the death benefit to the legal personal representative (if any). However, if there are dependants, trustees usually distribute the superannuation death benefit directly to the dependants rather than to the estate for the following reasons:

- The estate may be insolvent or subject to litigation. In these situations the benefit might be lost to creditors or exhausted by the costs of litigation.
- It potentially contravenes the trust law duties to give real and genuine considerations[5] and

Continued page 46

to exercise powers for a proper purpose,[6] particularly if the trustee has decided to pay the death benefit to the legal personal representative, in order to avoid making a decision as between potential dependants.

- Even if those who benefit under the will are the same as those dependants who could have received the benefit directly from the superannuation fund, if the death benefit is paid via the estate, the amount of the benefit might be reduced if the estate is insolvent. Payments directly from a superannuation fund are not generally available to creditors of the estate.

- If those who benefit under the will are the same as those dependants who could have received the benefit directly from the superannuation fund and if the death benefit is paid via the estate, there is another basis for complaint by the beneficiaries. If there are no other assets in the estate, they are disadvantaged by the costs and delay involved in obtaining probate or letters of administration. If the payment is made directly to them as dependants, these costs and the time required to obtain a grant would be unnecessary.

There is generally no disadvantage from a tax perspective in paying a superannuation death benefit to a tax dependant via a deceased members' estate as opposed to paying it to the tax dependant directly.[7] Broadly, a tax dependant includes a spouse, child under 18 years and a person who is financially dependent and a person who is in an interdependency arrangement. However, the will should be carefully drafted to ensure the benefit will go to a tax dependant, and there can be some taxation timing issues (if a pension is commuted to a lump sum outside certain time periods) associated with paying a benefit to an estate.

The above concerns mean that trustees generally prefer to pay death benefits directly to dependants to minimise their exposure to review by the courts or by the Superannuation Complaints Tribunal.

Binding Nominations

As previously stated, most trust deeds give the trustee discretion with respect to the beneficiaries of death benefits (within the statutory limitations previously outlined). Often, on joining a fund the trustee will provide members with a nomination form, to allow them to nominate their preferred beneficiaries. There are two types of nominations namely, non-binding and binding death benefit nominations. The trustee will take a valid non-binding nomination into account when exercising its discretion to distribute the superannuation death benefit, however it is not bound to follow it.

This contrasts with the situation where a person has made a valid binding nomination. As the name suggests, such nominations are binding on the trustee, provided that they are valid. For instance, they are updated every three years (unless the fund is a self managed superannuation fund with an appropriately worded trust deed which allows for a non-lapsing or indefinite binding nomination) and only nominate dependants.[8]

While binding nominations provide certainty, they can produce results that are unfair or undesirable from the deceased's point of view - particularly if they are not up to date (eg. a deceased separates, has a child or marries). For these reasons, binding nominations have not been as popular as it was anticipated they would be when they were introduced in 1999.

Most superannuation funds still give the trustee discretion with respect to distribution of death benefits, rather than adopting binding nominations or where a binding nomination has a three year sunset, such nominations may not be renewed every three years thereby making them invalid.

3. Is a provision in a will about distribution of superannuation therefore ignored?

No. A member's wishes are relevant but not determinative for a superannuation fund trustee when deciding how to carve up a superannuation death benefit.[9] The member's will can be a helpful guide as to their wishes regarding the distribution of their assets, although wills do not always reflect members' wishes as to their superannuation. Many people die without a recent will, and many make a simple will without taking advice about the treatment of their superannuation.

When drafting a will, it is appropriate to consider how the testator wishes his or her superannuation to be dealt with, as the fund trustee might exercise its discretion to pay the death benefit to the estate. Should this be the case, care should also be taken when the will is drafted to ensure that death benefits are held in a separate trust and are only able to be paid to suitable tax dependants. Otherwise, there may be tax of up to 15% payable on the taxable component.

However, it should be borne in mind that superannuation benefits do not usually form part of the estate and are usually paid directly to dependants.

4. Is it necessary to obtain probate or letters of administration?

If a superannuation fund trustee wants to pay benefits to the legal personal representative and there are no other assets in the estate,

difficulties often arise. Potential beneficiaries and potential legal personal representatives regularly ask superannuation fund trustees to waive the requirement that they obtain probate or letters of administration, due to the costs and delay involved.

Most trustees will deal with the person nominated as executor under the will or the person who is best placed to obtain a grant of letters of administration, even before probate or letters of administration have been granted. However, generally trustees insist that the legal personal representative obtain a grant of probate/letters of administration before they will pay the benefit. This is because SISR specifies that death benefits can generally only be paid to a dependant or the legal personal representative.

5. What if there is a testators family maintenance ('TFM') claim against the estate?

As superannuation does not usually form part of a member's estate, those claiming under the TFM provisions in the various jurisdictions cannot generally include superannuation benefits in such a claim.[10] Naturally, TFM laws such as NSW's 'notional estate' provisions can affect superannuation as it can count as an estate asset for TFM purposes.

It may however be relevant for the superannuation fund trustee to be made aware of claims against a deceased member's estate. This is because the financial circumstances of dependants are relevant to a fund trustee when deciding to whom a benefit should be paid. For instance, a trustee might consider that a spouse has been adequately provided for under the will and decide to pay the whole of the superannuation fund death benefit to children from a former marriage. A TFM claim by one of those children could impact on the certainty of the financial security of the spouse. It would, therefore,

be relevant for the trustee when considering the distribution of the death benefit.

6. Conclusion

When drafting a will, solicitors should bear the following in mind:

1. Superannuation death benefits do not automatically form part of the estate. Although a provision in a will can be of assistance in indicating persons' wishes, it is not usually binding on the trustee of a superannuation fund.

2. A superannuation fund trustee might exercise its discretion to pay the death benefit to the estate, even though it would not generally be bound to do so.

3. Clients should indicate their wishes with respect to the distribution of their superannuation by updating their nomination of beneficiary form with the superannuation fund. This is essential if the fund offers binding nominations but also important for non-binding nominations.

4. Updating nomination forms is particularly important if a client experiences a change in circumstances, such as a divorce or breakdown in a defacto or other relationship or if the client has a child.

5. Recent changes to the law also mean that those in same-sex relationships (and other interdependency relationships) can be eligible to receive a superannuation death benefit. This innovation means that affected clients should be advised to update their nomination forms.

As a result of superannuation reforms, it is anticipated that superannuation will become the preferred investment for Australians. As the amount of money in superannuation increases, so too does the risk of litigation in respect of superannuation death benefits. It is already the second most common basis of dispute in the Superannuation Complaints Tribunal (with the most common relating to disablement claims).[11]

It is vitally important that legal advisers are aware of the issues that arise in relation to superannuation death benefits in order to minimise the confusion and angst of clients, maximise their benefits and minimise the risks to the adviser. Solicitors preparing wills and estate plans ignore superannuation at their peril.

Footnotes

1. SISA s 62 - the sole purposes test and SISR Reg 6.22

2. This differs from the definition of dependant in s 302-190 of the Income Tax Assessment Act 1997 (Cth), which generally is the same as the SISA defintiion except in the case of adult child/ren. Adult child/ren are excluded from the definition of dependant for tax purposes and are therefore taxed at a higher rate.

3. Section 10A of SISA

4. SISR Reg 6.22(3)

5. Re Gulbenkian's Settlement [1970] AC 508, 518; Vidovic v Email Superannuation Pty Ltd, unreported Bryson J NSW Supreme Court, 3 March 1995, 11

6. Cowan v Scargill [1985] Ch 270; Hillsdown Holdings PLC v The Pension Ombudsman [1996] PLR 427, English High Court of Justice

7. By virtue of s 302-10 of the Income Tax Assessment Act 1997 (Cth).

8. SISA s 59A(1A) and SISR reg 6.17A

9. Other than in the 3 situations outlined in paragraph 2 above.

10. Subject to bankruptcy avoidance legislation in various jurisdictions.

11. The Superannuation Complaints Tribunal does not have jurisdiction in relation to self managed superannuation funds, although it can determine matters relating to small APRA funds.