



## The SMSF Academy Podcast – Transcript

Episode	30
Topic	Why not all death benefit nominations are the same
Date	23 January 2018

### **Disclaimer:**

The SMSF Academy Pty Ltd have taken reasonable care in producing the information found in this podcast (and transcript) and believes that the information is correct at the time of compilation but does not warrant the accuracy of that information.

Changes in circumstances may occur at any time and may impact on the accuracy, reliability or completeness of the information and we exclude liability for any decision taken on the basis of the information shown in or omitted from this podcast and transcript.

Save for statutory liability which cannot be excluded, The SMSF Academy disclaims all responsibility for any loss or damage which any person may suffer from reliance on this information or any opinion, conclusion or recommendation in this podcast or transcript whether the loss or damage is caused by any fault or negligence on the part of host or otherwise.

Aaron Dunn: You're listening to the SMSF Academy podcast and this is Episode 30.

Speaker 2: Welcome to the SMSF Academy podcast. The show designed to help professionals stay ahead of the curve. Now here's your host, the man that's in the know, and shows you how SMSF is done right, Aaron Dunn.

Aaron Dunn: Hi there, folks. Aaron Dunn here and thank you again for joining me in this week's podcast. We are very much into the full swing of things in 2018 and have had, once again, some great feedback on our most recent episode. In particular, the documentation that we need around taking more than minimum pension. We have seen over the past week ASIC come out and provide some information around the importance of appropriately documenting death benefit nominations and today, I have a guest, Chris Hill, where we spoke about not only the issues that ASIC raised about the formulation and documenting of those binding death benefit nominations but more importantly what it means for SMSFs in the context of not only documenting them but really looking at the flexibility in how the governing rules of a fund could determine what type of death benefit nomination and the way in which that death benefit nomination may ultimately play out.

We work with Chris and his firm Hill Legal in addition to Ian Glenister (co-founder) within the SMSF Academy as part of the oversight to our SMSF document suite. I think you're going to get a lot of value out of this week's podcast. Like I said, where Chris and I not only go through some of the issues that ASIC raises, we look at some of the recent case law history and again, the lessons learned from that. What you as an advisor or practitioner really need to understand throughout this process and really understanding what it is that is unique and different around the deed you need to be looking out for to ensure that the binding death benefit nomination gives you the outcomes that you're looking for. I hope you enjoy this week's podcast, if you do have any questions, please feel free to reach out to me.

Thanks for joining me today Chris. In this podcast we're going to spend a bit of time today discussing ASIC's recent media release and focus on the completion of death benefit nominations by professionals and their involvement and where, in many instances, they're finding there's a failure to correctly witness those documents. I'd really be interested in your comments around what implications this might have, more specifically to SMSFs but we know this is far broader than the SMSF marketplace. Maybe if you could elaborate a little bit on what ASIC is really drilling down on here when it comes to binding death benefit nominations.

Chris Hill: Thank you Aaron and hello everyone. ASIC's concern is very much focused on the way nominations are completed and signed. This is a follow on from a number of cases that we're seeing particularly over the last two to three years where the courts are throwing out nominations, particularly binding death benefit nominations because they don't follow the governing rules of the deed which specify certain requirements for the nominations to be binding and effective. ASIC is echoing some of the concerns that they're seeing out there in the market where nomination forms are not properly signed or they're not properly completed and it's as they say, is a red flag for closer scrutiny where there's going to be a lot of disappointed beneficiaries.

Aaron Dunn: And that's important when we look at the, in particular the blended families and that's where we've seen a lot of the case law lessons come from haven't we? Where it may be the children from the initial family are the aggrieved ones because of an inconsistency to the governing rules of the fund in terms of how documents have been created or have become invalid by not following what is due process.

Chris Hill: Especially when you mention the blended family, that's a very interesting and topical issue. A lot of people may not be aware that when one member dies, the relationship between the stepchild and the other member ceases. The ATO's confirmed in a previous determination that as a result of that stepchild relationship ceasing, they are no longer SIS dependants and yet we do see many clients particularly in my practice where they've nominated a stepchild that's been in the family for many, many years and quite naturally are considered the same as their blood related children but for SIS Act purposes upon their death, that relationship ceases. If their spouse who survives them have also nominated that child, they're no longer a SIS dependent. You can have unwittingly an invalid nomination and then the question becomes well is the nomination wholly invalid or partially invalid if there are people that are eligible and some are not, what does that mean? To date we haven't seen any clear case law on that issue.

Aaron Dunn: Therefore, when we look at SMSFs one of the findings when we look at documentation here is that there is our payment standards and what we need to follow in section 59A of the SIS act and 6.17A of SIS Regs. But SMSFs don't need to naturally follow those requirements. Rather we need to look at what the governing rules of the funds say. And we've got SMSF Determination (SMSFD) 2008/3 give us the guidance that really open up the planning opportunities and the way in which therefore the deed needs to be constructed to enable a death benefit nomination to achieve outcomes that particular members would want to see.

Chris Hill: Indeed, both ATO in that determination and in more recent case law, the courts have made it very clear that for an SMSF they don't have to follow the prescribed form of binding nomination in the SIS reg 6.17A. It's open for any fund to write its own rules on how a binding nomination is to be made binding. As you point out, that highlights the importance for advisors particularly to be acutely aware of the what the deed says on how a nomination is prepared and indeed how it is signed.

Aaron Dunn: And that's follow due process. We regularly see Chris, where there may be a requirement for that death benefit nomination to be accepted. That may need some minute or resolution and if again you haven't got due process, it could come into question whether that nomination was in essence a valid nomination because whilst it had followed the requirements of the deed, the fact that it wasn't ultimately accepted by the trustees means that it wouldn't come into force anyway. There are a range of processes and stuff that practitioners really need to be acutely aware of and be looking for inside the deed to ensure that if it says you got to jump a hurdle, do a back flip off the table before I can be accepted, they're the things that you actually have to do.

Chris Hill: The case that we saw last September of last year, the Cantor Management case acutely highlights the importance of making sure what the deed says as to how a nomination that is indeed signed is actually made binding.

Aaron Dunn: Therefore when we think about the greater flexibility that is offered to an SMSF around the construction of the death benefit nomination, what are some of the things that practitioners and trustees should ultimately be looking for in the deed to allow for that death benefit nomination to be created? I'm thinking here like stepped-nominations, the lapsing or non-lapsing nature of them and so forth.

Chris Hill: That's a good question Aaron. A death benefit nomination is like the proverbial shoe and foot. It's very important for advisors to ensure that the nomination meets the client's requirements. The standard nomination required under a SIS reg 6.17A which is quite frankly in most deeds of Australia is just a recitation of a form of nomination, in my view is wholly inadequate because it just stipulates the percentage of member's death benefit who it's to be paid to. You touched on the question of stepped nominations and for our listeners we should perhaps clarify that. A stepped nomination is where you say if in first instance your nominated beneficiary is your spouse, the nomination would specify if your spouse should die before you, who is to receive the death benefit. That's really important and that's missing in the standard form of nomination that's in SISR 6.17A and in most deeds around the country.

That can cause catastrophic consequences. For example, if you've got mum and dad who have a single car accident and they both die together and they have a standard nomination that nominates each other and to receive their death benefit on the death of both of them, if there's no stepped nomination, you have no binding valid nomination. What that would mean is that the executor, most likely, of the younger of the two, because under the laws of succession, it's presumed that the older dies first. The younger of the two would jump into the settle as replacement trustee and exercise a discretion to pay death benefit, like we saw in Katz and Grossman, to themselves. Stepped nominations in my view, are critical to ensuring that client's wishes are made effective.

Aaron Dunn: And even in a very, what I call 'vanilla' mum and dad scenario, it would be dad to mom and then mom to the legal person representative.

Chris Hill: Exactly.

Aaron Dunn: But it provides that definitive stepped process or cascading in terms of what happens when one party dies, what has to happen next.

Chris Hill: The point you're making is one of certainty. What I think most clients want is they want to know that there's some control of where their money goes when they die, when they die and when their spouse dies that it ultimately goes to their beneficiaries. For mum and dad, for most people they would nominate their spouse and then if their spouse predeceases them, then their LPR and then their Will would then cash out all the super, or the super would be cashed out to the estate rather and then it would be distributed to children, grandchildren or other beneficiaries. That quite a simple process but it's important because without a

stepped nomination if there was conflicts in the family, particularly with blended families you could have a disastrous outcome.

Aaron Dunn: One of things with the super reforms has obviously highlighted the importance of these estate planning issues. One of the concepts that we thought through and have now incorporated into the deed and very much relates to this topic, is the concept of a paramount document. We've brought this into this process of, or decision making process of binding death nominations as we have with reversionary pensions. Do you want to elaborate on why we think this paramount document becomes so critical with the introduction of the new super reforms?

Chris Hill: That's a very good question and it's a big topic. What we've seen with the reforms as we all know is that if someone has got, if a member who survives the death of another member in the fund is going to receive an excess transfer balance amount, then there has to be a compulsory cashing in or cashing out of the fund of any excess benefits. Assuming that they are, that the surviving member cannot rollback any existing retirement phase income streams or if they're in accumulation phase, they can't receive any more than their transfer balance cap. What we're going to see moving forward with many clients is some money reverting to the survivor and excess balances coming out of the fund. You're going to need to have clients complete a binding death benefit nomination that will deal with excess balances and a reversionary pension for non-excess balances.

We're going to see multiple documents that need to be prepared and we're also going to have potential conflicts between documents if we don't specify which takes priority. The idea of the paramount document concept is to really put some priority on how benefits are to be distributed or dealt with. Particularly if there is silence when consistency in the way clients have pensioned amounts that are reverting or non-reverting.

Aaron Dunn: When they test it against their transfer balance cap, the big issue, like you touched on there, is that you could have someone that already has reached their \$1.6 million cap for example and he's to receive money as well. They may decide to roll back part of their interest on the basis that it was all in pension phase they may have been solely relying upon the fact that they had a reversionary income stream in place. And relying on the fact that it would continue onto their spouse. If they don't have a death benefit nomination in place for that accumulation interest now there's no way in which that benefit would be dealt with as opposed to potentially where they're relying on the auto reversion of that income stream.

We need to look at the both the death benefit nomination and the reversionary pensions very much in tandem when we have these issues being confronted but like you said, the paramount document concept gives us some certainty as to which one we want to take precedent, particularly where there may be some dispute or inconsistency in that approach and it's not uncommon, I should probably say, that we see an inconsistency in terms of what may have been documented by an accountant or financial advisor that the pension is to revert but Chris you may go and see someone and quite clearly the way in which a death benefit nomination might have been done is clearly not aligned to what the

interests of that would be. When push comes to shove, if we don't have any form of definitive outcome, well then what one is going to take precedent? We may have to go back to the deed and reference what one would actually take place in that circumstance.

Chris Hill: There's another issue too Aaron in that's this. As we know, from the ATO perspective, if you've got two members that are in pension phase or let's say retirement phase or at least receiving retirement phase income streams, and if the member who is dying reverts their pension to the other spouse and there's going to be an excess transfer balance, from the ATO's perspective there's a choice. The choice can be that the receiving member can rollback any excesses to accumulation phase or cash out of the fund. We might have client who says, "I don't to give them that choice. I want to have the choice where that excess goes. I want it to go to my estate." Maybe for the children of another relationship. I don't want my spouse, with all due respect to her or him, to make that election.

We may want to specify, for example, a non-reversionary pension up to the transfer balance cap and any excess be paid pursuant to the death benefit nomination. In other words, we want to remove the choice by the surviving member as to how that excess is dealt with. Well we can do that with a binding death benefit nomination and if we make it a paramount document, the trustee then.

Aaron Dunn: Is bound by that decision.

Chris Hill: Is bound by that decision in respect to the excess.

Aaron Dunn: Correct.

Chris Hill: That excess can't be determined because obviously at the time of death the member may have spent their, they may not have an excess or their spouse may have inherited money or rolled over other benefits. We may want to regulate or the member may want to regulate where that excess goes. For most people who are in non-blended families, they may be happy to leave that choice to their surviving spouse but for a blended family it might be different. This is where the paramount document, can work very well in regulating those excesses particularly with in conjunction with a binding death benefit nomination.

Aaron Dunn: That is very much the reason why when we started making the updates in February I think it was last year and started to identify the importance of these issues coming about. Only now as practitioners are working through and revisiting all these transfer balance cap issues and so forth that these issues are going to start to rise to the top in conversation with clients because we are, not only are we seeing deed upgrades and the fact that we need to make sure that we comply with a lot of new measures that are come in place but now we're going to need to make sure we go back and ensure that death benefit nominations are done properly or whether we want to have that as binding or non-binding or lapsing or non-lapsing or whether we have a SMSF Will for example. As something that's going to be important that covers off the instructions that individuals need on an ongoing basis.

Chris Hill: It highlights, these all of these reforms highlight the need for flexibility in the deeds and that's why as you point out Aaron, we sat down with Ian Glenister and the three of us, we really thought through the importance of the deed, having maximum flexibility to deal with the unique client circumstances to address these sorts of issues of excess transfer balances, potential conflicts in documents and making sure that the money ends up where it's supposed to at the right point in time. This also underscores the importance of advisors having some sort of discussion with their clients about their estate planning because often as we'll see with excess transfer balances, it's going to flow into the estate probably a lot earlier than what would've been the case prior to the reforms.

Aaron Dunn: I couldn't agree more. Just in closing there, any other guidance you would have for accountants and planners who obviously work quite extensively with them around this process, is there any things that most importantly you think that they should be looking out for or a way in which they should be engaging with their clients and solicitor in terms of the preparation of this type of paperwork?

Chris Hill: We've made the point that they need to understand and read the deed that's the start here. The Cantor case which I eluded to earlier was simply one really about whether the nomination was given to the trustee for it to be made binding. Our deed doesn't require that but some deeds do require that and that's a hurdle. The Cantor case really focused on what was the form of service of the nomination and whether it was made under the Corporations Act or whether it was validly given. Fortunately in this case it was effectively served, it was served on the office of accountant. If it wasn't served at all, according to the judge from that case, it would be invalid.

Again, it underscores the importance of understanding the deed. This is all black letter law at the moment. There's no discretion to the court to waive these sorts of requirements. Fortunately the deed and the binding nominations that we've written give a lot of flexibility to advisors to get this right and to also add value to clients. That's the key point of all this is a binding nomination is not just a bit of paper that says where their super goes, it actually encompasses consideration of the client's wealth and when it goes and how it's distributed.

You eluded to the SMSF will which can deal with in specie asset transfers, that's another really important issue that we see with particularly family businesses where there's business real property and one of the children are working in the business and mum and dad says, "Well look I want my son is running the business to get the factory," we can do in specie transfers and we can consider the impact of that with other assets and so forth. It really gives the advisor the foray and the opportunity to add more value to their relationships with their clients and to demonstrate their skills in this area.

Aaron Dunn: What we've seen is the importance to really take a strategy based, and risk management approach to the way in which the deed is constructed and that's very much the part of what we've spent time, effort and energy in building in there and the flexibility in the nomination to be lapsing or non-lapsing, some of that flexibility we've built into it. We've spoken about the ability to not only look at it in percentage terms but dollar terms and be somewhat more prescriptive than we

ever have. And then the next step is to then go, well do you need to be even more prescriptive in terms of how SMSF will would actually play out as well? The best piece of advice is be very clear in terms of what the deed requires you to do because the courts will take a very process-driven approach to work out whether it is valid or not as well.

Chris Hill: Absolutely. The Cantor case is just one of a series of cases where the courts are just saying, "What does the deed say?" If it hasn't been followed, and if not it's not binding. If it has it's binding and it's black letter, simple.

On that point, it's easy for advisors to get it right if they just follow the process but it's also easy for them to get it horribly wrong. If they're not aware of what the deed says. Obviously with programs and seminars you're running and the education that's available through the SMSF Academy, that's going to add a lot of value and support to advisors who tremble in this area. There's lot of resources available and there's a lot of flexibility available.

Aaron Dunn: And we work together closely in terms of not only an ongoing construct of the deed but with yourself and Ian, you do a lot of work supporting our members so if you do have any questions to any of our members or those that use our platform, people like Chris are there to support and provide that legal background.

Chris, thank you for your time today. We're going to have several discussions upcoming. We've got plenty of things that we want to be talking about. Not only SMSF specific but in terms of telling our listeners what we've done in terms of how the deed can really help benefit practitioners out there. Thank you very much for your time today.

Chris Hill: You're welcome. Thanks Aaron and good afternoon everyone.

Aaron Dunn: Thank you for joining us today and I'll look forward to you joining us for next week's podcast. Take care and have a great day. Bye for now.

Speaker 2: Thanks for listening to the SMSF Academy podcast. Please note that the podcast provides general advice only and is based upon our understanding of the law at the time of the recording. If you have any comments or questions from this podcast or wish to subscribe to the series, you can find us at [thesmsfacademy.com.au](http://thesmsfacademy.com.au). Tweet us at the SMSF Academy, like us on Facebook or connect with us on LinkedIn.