

CAUTION! The pension strategy discussed below is now superseded by draft regulations of 21 December 2006. Please obtain expert advice.

Estate planning tool

We have received very positive feedback from advisers regarding the pro-forma letter in our November newsletter. We have received numerous requests asking for a similar tool in respect of estate planning. Accordingly, we include a similar tool in this issue of DBA News (see page 3).

This letter can also be downloaded in MS Word format and tailored for the adviser's own letterhead. The letter can be downloaded from: www.dbabutler.com.au/download/ep_letter.doc

Child reversionary pensions: window of opportunity

A potential window of opportunity exists to set up reversionary pensions to non-tax dependant children prior to 1 July 2007.

From 1 July 2007, adult children can generally only be paid a lump sum. Pensions that commenced after 30 June 2007 will no longer be allowed to revert to non-tax dependants. Moreover, many with allocated pensions have made them non-reversionary to obtain a higher deduction from their undeducted contributions. Unless the reversion of such pensions is locked in, the new rules are likely to restrict their flexibility.

From 1 July 2007, pensions will only be able to revert to one tax dependant, namely:

- a spouse;
- a child under 18 years. Pensions will only be able to be paid to a child until the child attains 25 years of age and must then be paid out as a lump sum; and
- a person who qualifies as a financial dependant or a person who is in an interdependency relationship.

An important SMSF estate planning strategy potentially exists. Those who plan properly and promptly may benefit from this strategy. However, before any strategy is recommended, each factor must be considered in view of each client's circumstances, etc.

Example

Bob and Mary are married with two independent adult children. Bob and Mary both commence allocated pensions on 1 December 2006 from their SMSF.

Before starting their pensions, Bob and Mary carefully planned how they want their super to be treated upon death.

They both decided that they wanted their pensions to continue upon death.

Specifically, Bob and Mary both want each of their pensions to flow to the surviving spouse. Upon the death of the surviving spouse (or if there is no surviving spouse) they want their pensions to revert to their two children in equal shares.

Because Bob and Mary were careful to set up their pensions as reversionary pensions, upon their death, their adult children may receive the pensions. Naturally, Bob and Mary have proper documentation recording this position.

This strategy can give significant peace of mind as it:

- ensures the surviving spouse has immediate cash flow upon the death of their spouse;
- ensures that the adult children are treated equally upon the death of the last surviving spouse; and
- can have tax and cash flow advantages.

When must this strategy be set up by?

New pensions

Ideally, *as soon as possible* as a change in law may occur at any time, but no later than 30 June 2007. After 30 June 2007, SMSFs will only be able to commence paying one type of pension: the 'new pension' announced in the 2006 Budget.

The new pension can only revert to one 'tax' dependant. In other words, the new pension will not be able to revert to independent adult children.

Also, the pre-1983 component can only be converted to an exempt component if you commence a new pension. Thus, the downside of locking in a pension before 30 June 2007 is that you miss out on the pre-1983 component becoming tax-free.

Existing pensions

Existing pensions that already nominate adult children as reversionary pensioners should also be reviewed as further documentation such as a binding nomination may be required. There are many pensions in place that do not nominate reversionary pensioners or that leave the discretion to the trustee to revert or are totally unclear on what the terms of the pension are.

We strongly recommend that those wishing to use this strategy review the documentation establishing their pension (eg, trustee minutes/resolutions, member requests, PDSs, etc) and their SMSF deeds. It is important to determine whether the documentation in place is sufficient and has terms that are clear and enforceable.

Consideration should then be given to whether the pension be made reversionary. If, after due consideration, the member decides to make their pension reversionary, the reversionary pensioner should be nominated *as soon as possible*. Appropriate documentation should also be put in place. The reason for the urgency, again, that as a change in law may occur at any time. Note that any change to a defined benefit pension can be dangerous.

Tax

If the original pensioner is aged at least 60 at death, the reversionary pensioner should be able to receive the pension tax-free after 30 June 2007. This will occur regardless of the reversionary pensioner's age. If the original pensioner is under 60, then the pension will turn tax-free upon the reversionary pensioner attaining 60 years.

Pension documentation

Proper pension documentation and trust deeds are always recommended. DBA Butler offers special kits to establish Allocated Pensions and Market Linked Pensions setting out details of each reversionary options. Moreover, DBA Butler SMSFs provide an excellent platform that caters for pension and estate planning strategies. Our pension kits can be tailored to be reversionary. DBA Butler is pleased to advise on and draft documentation for complex situations.

Risks involved

Traditionally, the government has been reluctant to cut across provisions of existing pension contracts. Thus, grandfathering relief generally depends on the pension's commencement date. The overall effectiveness of this strategy however will only be known when the legislation is finalised.

Need to establish a new pension?

DBA Butler provides pro-forma documentation to establish new SMSF pensions.

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I want to order a (tick):

Pension Kit (\$440): Allocated Pension Market Linked Pension

Signature _____ Name of person ordering _____

Name of Firm _____

Postal address of firm _____

_____ State _____ Postcode _____

Tel _____ Fax _____ Email _____

Send or fax to DBA Butler Pty Ltd. Don't send any money. You will be invoiced upon receipt of documentation.

Prices include GST, exclude postage disbursement. Pension documentation is sold subject to the condition that one pension is rolled back/commenced per kit purchased.

For further information please contact:

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✓ Superannuation ✓ Tax ✓ Succession Planning

<Date>

<Client Name>

<Postal Address 1>

<Postal Address 2>

<SUBURB> <STATE> XXXX

Dear <Client Name>

Re: Planning for the inevitable

It is an important consideration, although people rarely like to think about it. Everyone will die. Although you cannot change that fact, you can ensure that upon your death your wealth passes smoothly and efficiently to your loved ones.

Many already have started looking at their superannuation planning in light of the recent superannuation changes. Now is also an important time to plan for death. We summarise below some important considerations:

- **Current Will** – do you have a Will? If you do have a Will, is it current? Have your circumstances changed since your Will was drafted? Remember that marriage generally invalidates Wills and Wills may be wholly or partially ineffective due to the death of a beneficiary, or a specifically gifted asset no longer existing.
- **Trusts established by Wills** – does your current Will set up trusts upon your death? Leaving assets on trust instead of giving them directly to a dependant can be very desirable. Trusts in Wills are often used where beneficiaries cannot manage money themselves, have addictions, are being sued, etc. Trusts in Wills can also allow tax effective planning.
- **Family trusts** – the person who can hire and fire the trustee of a family trust has ultimate control of the trust. Do you have this role? Who will have the role after your death?
- **Powers of Attorney** – do you have any in place? These can be invaluable if you lose the capacity to make decisions or are overseas.
- **Individual trustees** – do any of your trusts and/or your DIY super fund have individual trustees instead of a company acting as trustee? Companies never die and changing the directors of a company is a lot easier than changing individual trustees of a trust where someone has died.
- **Superannuation** – remember that a Will does not automatically govern your superannuation. Upon death, the trustee of your super fund generally has discretion as to who receives your superannuation. Are you happy with the trustee of your super fund having this discretion? Generally, you can bind the discretion of a trustee with special documentation that is like a Will for your superannuation.
- **Superannuation pensions** – do you receive any superannuation pensions? Upon death, what will happen to them? Do you want your pension to continue to be paid upon your death (eg, to your spouse)? Or, are you happy for your pensions to be paid as a lump sum?

We would like to meet with you to discuss the above. A Wills and estate planning lawyer may need to be involved to provide legal advice and draft documentation. Please contact our office to arrange an appointment.

Yours sincerely

<Insert Name of Firm>

Note that as an <accounting/financial planning> firm we are unable to provide legal advice.