

BDBNs – peace of mind

Binding death benefit nominations ('BDBN') are often needed as a Will does not cover super benefits on death. A BDBN is akin to a Will as it binds the trustee as to whom to pay the member's death benefit to. The following steps can result in more effective BDBNs and provide greater peace of mind.

1. Proper execution

The BDBN must be properly executed in accordance with the fund's governing rules. Thus, it is vital that you carefully review the governing rules to comply with each requirement. Typically, the following is required for proper execution:

- the BDBN must be signed and dated by the member in the presence of two independent adult witnesses; and
- the BDBN must contain a declaration signed and dated by each witness stating that the BDBN was signed by the member in their presence.

Many BDBNs are in a standard form with no room to add extra requirements. However, a BDBN for an SMSF may allow special wording (like in a Will) to provide for contingencies, eg, if there is no surviving spouse, the super is to be paid to the member's estate.

2. Nominated beneficiaries are permissible

Remember that upon death, super benefits can generally only be paid to:

- dependants (eg, spouse, children, financial dependants, etc); and/or
- the legal personal representative ('LPR', eg, the executor(s) of the deceased's estate).

If a BDBN nominates a non-dependant (eg, grandchildren or a friend) then it is usually invalid. If a member wants to nominate a non-dependant their BDBN should direct their super to their LPR. Their Will should then give their super to that person.

3. Clear

It is vital the BDBN is clear. An ambiguously worded BDBN can result in costly litigation to determine its meaning. Remember that the wording in a BDBN is as crucial as the wording in a Will.

Moreover, the fund's governing rules need to be able to withstand challenge (the foundation stone). If the deed supplier, eg, simply supplies a deed upgrade

without complying with the variation power or obtaining the requisite consents (as many suppliers do), then the BDBN is invalid. This is why DBA reviews all prior deeds when completing an SMSF deed upgrade to ensure BDBNs will be effective.

4. Integration with other plans

BDBNs should integrate with the member's overall estate plans. Consider a member with a \$1 M farm in the fund and \$1 M of shares outside super. The member might make a BDBN giving the farm to one child and a Will giving the shares to another child. However, what if the fund sells the farm by the time the member dies? An equalisation clause in the Will can be invaluable in these circumstances.

5. Read the governing rules

Be aware of governing rules of SMSFs that specify that BDBNs must be completed 'to the trustee's satisfaction'. For example, a surviving spouse may say they don't like their deceased spouse's BDBN.

Also, review each and every clause in the deed. DBA is aware of one supplier's SMSF deed that has a BDBN clause and another clause specifying that the trustee is not bound by a member's written direction.

If it's not 100% clear to you, a deed update is needed. Do it once and do it right — before you die!

Change of trustee case

A recent Victorian supreme court case highlights the need to properly document changes of SMSF trustees.

The case, *Moss Super Pty Ltd v Hayne* [2008] VSC 158, involved a set of governing rules under which the SMSF's founder was empowered to appoint and remove the trustee. However, the member (not the founder) purported to appoint a new trustee. This was held to be invalid even though the member was actually a director of the founder. In particular, the court noted that where parties act in multiple capacities and with different entities, 'they must respect the conflicts which may arise'.

This case involved a costly mistake regarding a relatively simple document. (Incidentally, DBA often reviews incorrect change of trustee documents.) This case highlights the need to have changes of trustee prepared by lawyers with SMSF expertise.

New draft ruling on residency

The ATO's draft ruling TR 2008/D5 provides useful guidance on the residency rules applying to SMSFs (refer to DBA's September 2007 news which outlined the tests for when a fund is an 'Australian' (formerly 'resident') fund and the significant tax penalties imposed when a fund loses (or regains) its 'Australian' status). While there are no surprises, the draft ruling offers some useful insight into the ATO's interpretation of the law, particularly the 'central management and control' ('CMC') test.

What are the 'strategic' decisions?

The CMC of an SMSF must ordinarily be in Australia for it to be an Australian fund. This means the 'strategic and high level decisions' for an SMSF (as opposed to mere day-to-day activities) must ordinarily be made in Australia. The ATO explains that formulating and revising an SMSF's investment strategy is a strategic, high-level decision, while the actual investment of the SMSF's assets will generally *not* be a strategic decision.

SMSF trustees should therefore be mindful that an investment manager or adviser who carries out all or some of the investment activities (eg, trading shares) is unlikely to be making the fund's strategic decisions.

The '2 year rule'

The CMC must 'ordinarily' be in Australia, and the CMC can ordinarily be in Australia even if it is *temporarily* outside Australia for period of not more

than 2 years. Unfortunately, the 2 year rule is sometimes misunderstood: it is not an exception available to all trustees irrespective of the facts and intentions surrounding the absence.

The draft ruling confirms that if an absence is *permanent* then the 2 year rule does not apply. Even an absence of less than 2 years could be 'permanent' and the CMC could therefore be outside Australia (eg, if trustees departed, intending to be away indefinitely, but returned after only 18 months due to ill health).

Conversely, in some situations a departure greater than 2 years will be ok (eg, if trustees depart with an intention to be away for a defined period of less than 2 years, but due to unforeseen circumstances must remain overseas in order to fulfil the specific purpose for which they departed, then the CMC could still ordinarily be in Australia).

Some other key points include:

- In relation to the 2 year rule, an absence is only 'temporary' if it is defined in advance or related to the fulfilment of a specific purpose.
- If 50% of the trustees are in Australia and 50% overseas, the CMC is in Australia if both *equally* participate in exercising the CMC, however the ATO considers this would rarely be the case.

The draft ruling reinforces the need to examine each SMSF in light of all relevant facts and circumstances. Given the significant penalties that can be suffered, trustees should seek expert advice prior to departure.



Keep SMSF governing rules up to date forever

DBA Butler offer an Annual Update Service (www.smsf.com.au). This service provides annual updates to SMSF governing rules in an efficient, cost effective and legally sound manner.

Every SMSF subscriber has its own secure homepage containing current governing rules, viewable only by the trustee and their adviser. Every July, new governing rules and accompanying PDS materials are placed on the homepage, along with tailored trustee resolutions adopting the new governing rules. This provides advisers with efficiency and the invaluable knowledge that all SMSF clients have the same governing rules that are up-to-date with the most current laws.

To register an SMSF to receive governing rules updates just tick the appropriate box on the new super fund/deed upgrade order form. For a small annual fee of \$150, you can ensure the fund always has up-to-date governing rules.

For more information, please visit www.smsf.com.au or contact Bryce Figot of our office.

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