DBA Butler Pty Ltd Lawyers

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SMSF Succession – an issue for all SMSFs

Whether an SMSF has individual trustees or a corporate trustee in place, it is vital to know what will happen to a member's benefit if a member dies or becomes incapacitated. In particular, who will be in control of the funds?

The law provides that a legal personal representative ('LPR') can step in the place of a member as trustee/director of a corporate trustee until the deceased's member's benefit commences to be paid out or during a member's lifetime if an Enduring Power of Attorney ('EPOA') is in place. Although this is permitted by law, it does not occur automatically and appropriate provisions need to be included in the SMSF deed and constitution of a corporate trustee to enable this to occur.

So what does your SMSF deed say? What does your constitution say?

An appropriate SMSF deed should:

- enable trustees to nominate a successor trustee during their lifetime to ensure the appropriate person steps in as trustee on their death or incapacity and to also, eg, alleviate the need for the surviving spouse to appoint an additional individual trustee once the death benefit commences to be paid;
- enable members to have their LPR step in on their death; and
- ensure that where multiple persons comprising the LPR are appointed, the voting rights of those persons are adequately addressed.

For example, things can easily turn pear shaped if a member has two (or possibly more) LPRs or two people have been appointed under an EPOA. This could result in the unfortunate situation where two people could step in and vote as two persons, even though they have only been appointed in respect of one member, and thereby potentially take control of the SMSF (this is the case under most deeds).

If the trustee is a corporate trustee, then the SMSF consititution should:

- enable a director to nominate a successor director to step in on their death or incapacity (a director ceases to be a director on death or incapacity);
- have the flexibility to enable greater control to be placed in the hands of shareholders; and
- have the ability to include, eg, guardian shareholders whose consent is required for all decisions, particularly where there is a need for a guardian to step in and exercise greater control, eg, if there is a heightened risk of a dispute regarding payment of a death benefit.

These features of an SMSF deed and constitution are essential for sound planning, particularly if there is no Binding Death Benefit Nomination ('BDBN') in place as a member's benefit on death can be distributed at the trustee's discretion. In this case it is vital that the deceased has someone stepping in to look after their interest.

Note, even if a BDBN is in place, trustee succession is still relevant. Although a BDBN is binding on any trustee, greater confidence can be obtained by ensuring the BDBN will be followed by a reliable trustee who will not dispute the BDBN or delay payment. This is particularly the case for poorly written deeds that state that the trustee has the option to reject a BDBN.

To ensure that control of the SMSF passes to the right person following a member's death or incapacity, the following steps should be followed:

1. Make a valid BDBN. Ensure that it is reviewed every three years (and re-drafted, unless it is a non-lapsing BDBN).
2. Ensure a valid EPOA is in place to enable a person to step in if you become incapacitated.
3. Appoint a corporate trustee to the SMSF to ensure that after death, the company can continue in place as trustee. This avoids the need for the surviving spouse to transfer assets and decide who to appoint as (individual) co-trustee.
4. Ensure the SMSF deed has appropriate succession provisions.
5. Ensure the corporate trustee has a constitution appropriate for SMSF trustees and has appropriate succession provisions.

The DBA deed has appropriate BDBN and succession provisions and our latest 2008-09 deed allows 'successor trustee' nominations.

In addition, DBA is pleased to announce the launch of a DBA constitution which has been designed specifically with SMSF succession planning in mind.

Lump sums for terminally ill

New measures have been passed allowing members with a 'Terminal Medical Condition' ('TMC') to access their super tax-free.

A member may access their benefits provided:

- two registered medical practitioners (at least one of whom is a specialist practicing in an area related to the illness or injury) have certified that the member suffers from an illness or injury that is likely to result in their death within 12 months of the date of the certification; and
- that 12 month period has not expired.

The full amount of the lump sum will be non-assessable, non-exempt income provided the member has a TMC (as defined above) when the lump sum is received or within 90 days after receiving it.

The new rules apply from 1 July 2007 and as part of the transitional measures, those who received a lump sum in the 2007/08 financial year will qualify for nil tax if they had a TMC within 90 days of receipt or by 30 June 2008, whichever is longer.

Anti-detriment deductions

Anti-detriment deductions allow for large tax deductions to be claimed by a fund where a death benefit is paid out and certain conditions are met.

This can result in large deductions being claimed in the fund's income tax return and in some instances, these deductions result in substantial carried-forward losses. These stand out in the ATO's computer systems. Accordingly, anti-detriment deductions are often followed up with a 'please explain' letter from the ATO.

When claiming these deductions, advisers must ensure they comply with all of the rules as there is a significant chance of ATO scrutiny.

The next DBA seminar will cover:

- how to use anti-detriment payments to add value for clients;
- planning issues to ensure anti-detriment payments can be made, eg, using reserves;
- frequently asked questions and most common mistakes; and
- we will work through a practical case study to explain how the rules work and the tips and traps.

For information on our next seminar, visit www.dbabutler.com.au/index.php?p=DNW.

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