DBA Butler Pty Ltd Lawyers

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ATO confirms key binding nomination issues for SMSFs

The ATO has recently released a draft SMSF determination (SMSFD 2008/D1) examining how the laws governing binding death benefit nominations (or BDBNs) apply to SMSFs.

This area of superannuation law has been the subject of debate for some time and DBA welcomes the ATO's correct analysis. This determination should provide greater certainty moving forward for SMSF members in their succession planning.

Certain BDBN laws do not apply to SMSFs

The ATO confirms that the various requirements in the SIS regulations about making a BDBN and when it is revoked do not apply to BDBNs made by SMSF members. These requirements apply only to members of other funds (eg, public offer funds).

Notably, this means that an SMSF member can make an indefinite BDBN that does not expire after three years, provided this is allowed by the SMSF's deed.

Warning: many SMSF deeds impose a three year expiry date on BDBNs, even though this is not required by law. BDBNs made under some deeds could even be void for uncertainty because it is not clear whether they last for three years or indefinitely, or in many cases due to other weaknesses.

It is therefore critical that a deed is reviewed and amended if necessary to enable members to validly make indefinite BDBNs.

In any event, DBA recommends that members review their BDBN every three years or so to ensure it remains appropriate for their circumstances.

Note also that some SMSF deeds typically provide that a BDBN is automatically revoked when a 'triggering event' occurs such as divorce.

SMSF trustees not bound to pay out death benefits in a way that would breach SIS

The ATO also confirms that if a member dies and has a BDBN in place which directs benefits to be paid in a way which would breach SIS restrictions, the trustee is not bound to follow this.

Even if an SMSF deed states that a BDBN must be followed by the trustee in all circumstances (ie, even if it would breach SIS), the ATO notes that section 55A of the SIS Act provides that a deed is invalid to the extent that it allows death benefits to be paid in a way which breaches SIS. In summary, the main SIS restrictions are that:

- super death benefits may only be paid out to the estate or to 'dependants' (a spouse, children and other persons who qualify as dependants, eg, under the 'interdependency' test); and
- since 1 July 2007, death benefits paid to adult children generally cannot be paid as pensions (ie, must be paid as lump sums) except in the case of children under 25 years who were financially dependent on the deceased or children who are disabled.

The ATO confirms that to the extent that a BDBN directs benefits to be paid in a way that would breach these restrictions, the decision about how to pay those benefits reverts to the trustee's discretion.

SMSF members should therefore review their BDBN and prepare a new one if needed. In particular, some members may have BDBNs pre-1 July 2007 directing benefits to be paid to adult children as pensions.

The deed is critical

The recent determination highlights the importance of the SMSF's deed as the key document which determines how the BDBN operates.

There are some deeds in the marketplace with inadequate or ambiguous BDBN provisions, including deeds which do not correctly address the issues discussed in this newsletter. This is unfortunate for members with those deeds, given that BDBNs and payment of death benefits are issues which can be hotly disputed after death and where the deed may be subject to close legal scrutiny by a court.

So although payment of death benefits is a high-risk area for disputes, it is also commonly poorly covered in many SMSF deeds.

Restructuring in the downturn

The current market downturn presents an ideal opportunity to review strategies that were implemented when markets were rising.

We will be covering a range of strategies and provide practical solutions in our next national road show taking place in October to December. For more information on our seminars, please visit our website.

Unless corrective action is taken, significant opportunities may be lost forever.

One example is where certain clients may be better served by rolling back their existing pensions and

restructuring their affairs. However, appropriate planning must generally occur before rolling back a pension to ensure there are no adverse impacts.

Furthermore, while many have previously adopted a segregated pension approach, it may now be worth considering whether to unsegregate. Each approach produces different tax outcomes based on whether there are capital gains or losses.

The ideal timing to crystallise is also impacted for those with pensions in place prior to 30 June 2007 who have not yet attained 60 years of age.

Naturally, appropriate documentation can also be put in place for those who may be uncertain about their future solvency. A strategic SMSF deed and appropriate supporting documentation can make a significant difference in a bankruptcy matter.

DBA's lawyers are ideally placed to guide you through these uncertain times.

Traps in borrowing documents

The laws permitting trustees to borrow have now been in place for one year. Although these remain sophisticated transactions, a concerning number of generic borrowing documents have hit the market.

Advisers should be aware of the risk of additional stamp duty arising on the GST-inclusive value of property if a borrowing arrangement has been incorrectly implemented. In many cases this extra duty arises after the loan is repaid.

Stamp duty and property laws differ between States and Territories and the contents and timing of 'bare' or 'security' trust deeds, sale contracts and other documentation requires expert local advice. State revenue authorities generally impose duty on any transfer unless all the requirements of an exemption have been met. These authorities typically show little leniency if documents do not stack up under local law.

Suppliers who offer 'one size fits all jurisdictions' packages such as stand alone bare trust deeds and related documents may not have considered how stamp duty will apply in each jurisdiction.

DBA is also aware of documents available that claim to be suitable for almost any kind of asset. Note that:

- borrowings to acquire units in unit trusts are problematic and SMSF trustees should seek expert advice beforehand; and
- a single bare trust used to trade shares runs a risk of breaching the SIS borrowing laws. This may also create a taxpayer trust, which could give rise to CGT when shares are transferred to the SMSF after the loan is repaid.

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