

# Planning for the worst scenario

Super funds must be set up to cope with the serious illness or premature death of a member

MICHAEL LAURENCE

MANY couples establish self-managed super funds in their mid-50s when both spouses are in excellent health and extremely optimistic about the future.

They often don't think of the times when one spouse may become seriously ill — perhaps with dementia — or die, leaving a partner who may know nothing about how the fund operates. These difficulties are often magnified because under superannuation law, all fund members must be either trustees of an SMSF or directors of its corporate trustee.

Anyone setting up an SMSF needs to think about the sad times as well as the fund's potential, says Graeme Colley, national technical director of financial group OnePath and vice-chairman of the Self-managed Super Fund Professionals' Association of Australia.

Colley says a potential nightmare for a surviving spouse and family can potentially be avoided if a fund's trustees undertake sufficient planning for a mem-

ber's serious illness or death of a member.

For instance, Colley provides advice regarding a husband-and-wife SMSF where the dominant member, in terms of running the fund, dies leaving a widow in her 80s with no interest in super and who wants to rollover all of the benefits into a big fund.

However the fund's main asset is a valuable commercial property rented to their adult children's business. The asset can not be quickly sold for a fair price and, in any case, is essential for the successful operation of the family business.

The children face the challenge of either trying to borrow a large amount to buy the property or deciding whether the property is an appropriate and affordable asset for their own SMSF.

Colley says the problem could have been avoided if the parents, as part of their overall estate planning, had negotiated for the children or the children's SMSF to progressively buy the property during both parents' lifetime.

An alternative strategy may have been for the parents to allow their children to join their fund.

The children's holding in the fund would have risen over the years, perhaps to the extent of the fund having enough liquid assets to pay out the parents' retirement and death benefits.

And the business premises could have remained in the fund without any drama. But in this case, the parents did not want the children to become members.

## Enduring power of attorney

Numerous SMSF specialists consider an enduring power of attorney an essential part of preparing for the possible serious illness or old age of a fund trustee or trustee director. An enduring power of attorney grants the authority to another person to make financial decisions on their behalf even when the fund members lose mental capacity.

Meg Heffron, co-principal of SMSF specialist administrator Heffron, says an ill or elderly member could resign as an individual fund trustee or trustee director, yet remain a member. And the person who holds their enduring power of attorney, such as an adult child, could act in their place as a trustee.

Heffron says one of the exceptions to the provision in superannuation law that all members must be trustees or trustee directors is when a member grants an enduring power of attorney to another person. "The person holding your enduring power of attorney doesn't have to have money in your fund [to act as a trustee in your place]."

Colley warns that an enduring power of attorney must meet the laws of the relevant state as it is state-based legislation.

## Intergenerational SMSFs

Heffron says a noted strategy aimed at husband-and-wife SMSFs involves accepting adult children as members. Broadly, the strategy involves the SMSF becoming the children's fund when both parents die. And the children could increasingly guide the fund as their parents grow older.

However, Heffron has reservations about intergenerational funds. "There is always the risk when you get someone else involved in your financial affairs that they won't do what you want," she says.

"You will have a committee making the decisions with an intergenerational fund whereas before you would have had two people.

"The parents and the children may



SMSF membership: growing older

Age ranges	Male (%)	Female (%)	Total (%)	%
Up to 25	1.1	1.1	1.1	100
25-34	4.3	4.5	4.4	80
35-44	13.2	15.4	14.3	60
45-54	24.8	27.4	26	40
55-64	33.3	34.1	33.7	20
Over 64	23.2	17.5	20.6	0

Source: Self-managed Super Fund Statistical Report, published by the ATO. Members as at June 2010

have different financial objectives, and they would have different timeframes for retirement, and different risk tolerances."

But Heffron says there may be circumstances where an intergenerational SMSF is appropriate. For instance, the parents and, say, two adult children may operate a business together and already make many investment decisions together. "It may make perfect sense for them to share a super fund."

## Death-benefit nominations

Depending on a SMSF's trust deed, a member can make a non-binding or binding death benefit nomination regarding the distribution of their superannuation death benefits. The decision about which to use is basic estate planning for SMSF members.

While fund trustees would take a deceased member's non-binding death benefit nomination into consideration,

they have the discretion to decide which eligible dependants, as defined in superannuation law, receive a deceased's superannuation death benefits.

Alternatively, with a non-binding nomination, the trustees may decide to pay the benefits to the deceased's legal personal representative (executor) for distribution in accordance with the will.

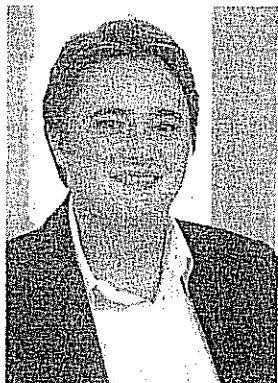
Daniel Butler, managing director of SMSF specialist DBA Lawyers, says a binding death benefit, in which the member nominates which eligible dependants will receive the death benefits, removes the trustees' discretion.

There is considerable debate within the superannuation industry about the advantages and disadvantages of binding death benefit nominations.

For instance, Butler says that while binding death benefit nominations can have advantages, they have inherent risks and lack flexibility. One of the risks

"There is always the risk when you get someone else involved in your financial affairs that they won't do what you want"

MEG HEFFRON (pictured)



## Retirees' age a threat to self-managed super

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plan comprehensively for what will happen to their SMSF following the death or serious illness of a trustee, particularly the most active trustee of a two-person fund.

"Trustees bear the responsibility with a SMSF," he stresses. "And people should bear this in mind with their planning."

Fortunately, SMSF trustees can adopt practical strategies to help prepare for the illness or death of ageing members so a fund's efficient operation and the super savings of surviving members remain as unscathed as possible.

These strategies include switching from individual trustees to a corporate trustee, and having a trusted person ready to step in as a temporary or permanent replacement trustee (depending on the circumstances and provisions in superannuation law).

Other strategies include younger members (usually adult children) joining the fund or both spouses, with a husband-and-wife fund becoming involved with the fund's operation. (These strategies are discussed in detail elsewhere on this page.)

Bryce Figot, a senior associate with SMSF specialists DBA Lawyers, says the ageing of much of the SMSF membership is "most definitely" a looming problem. "It is certainly an issue when one person [in a two-member fund] takes an interest and the other is passive."

Michael Rice, managing director of Rice Warner Actuaries, emphasises that with retirees already holding more than half of assets in SMSFs, it is going to reach the point in the next decade where many SMSF members reach their 70s.

"Once SMSF members hit their 70s, they will start asking themselves whether they want to continue with the fund," he says. "One member [of a husband-and-wife fund] may die and the other may not be as interested and not want to continue with the fund."

Rice Warner has triggered much debate within the SMSF sector by forecasting in its Superannuation Market Projections Report that self-managed funds' share of total superannuation dollars will fall from one-third today to 22 per cent with 15 years.

Michael Rice says the forecasts are based partly on the closure of more SMSFs, with the ageing of their membership and the cutting of the annual cap on

concessional contributions. He says the cutting of the caps will inhibit the build-up of large balances to roll over into new SMSFs and he expects industry super funds to increasingly target ageing SMSF members by streamlining their products.

Until now, at least, ATO statistics appear to suggest that people are reluctant to close a SMSF unless forced by illness or death of a member. In the seven years to June last year, 211,208 funds were set up and only 33,742 were closed. And in the 12 months to June, just 2376 of Australia's 440,000 funds were wound-up.

Meg Heffron, co-principal of SMSF specialist administrator Heffron, disagrees with the forecast by Rice Warner that the ageing of the population will lead to the closure of a significant proportion of self-managed funds. Indeed, Heffron expects that as large numbers of the population keep reaching their 50s — a popular age group for establishing SMSFs — the numbers of funds will keep being rejuvenated.

Further, Heffron points out that self-managed super really became popular during the past decade, and anyone establishing a SMSF, say, 10 years ago at 65 or younger would be 75 at most today, with typically a long life expectancy ahead of them.

Heffron also emphasises that a person retiring in 20 years would have had compulsory superannuation for all of their working lives with balances "that only rich people" have today, and many could choose to establish a SMSF.

"Everyone on average is going to have a much bigger balance than the retirees of today," she says. "I can't see how the number of SMSFs is going to decline."

Heffron says three things usually lead to the winding up of SMSFs: the members become too old to manage their own affairs; balances become smaller as the fund's assets are spent to finance retirement, making an SMSF less financially feasible; and the members die.

"I think the death of the first member [of a two-member fund] would lead the surviving member to think about winding up the fund," she says.

Heffron stresses that an adult child can assist ageing parents with their SMSF. "When my parents are in their 80s, they will still have their SMSF but I will be a trustee [allowable with an enduring power of attorney granted by her parents]."

marriage and wanted them to get my super, I might well have a binding nomination to my estate or to them."

### Corporate trustee

Some leading SMSF specialists believe that having a corporate trustee is superior to having individual trustees for dealing with an ageing membership and the death of a member. Butler says that in the event of death or serious illness of a member, a trustee director can more readily and efficiently be replaced than an individual trustee. With individual trustees, fund assets are held in the names of all of the individual trustees but with corporate trustees, the assets are in the name of the corporate trustee.

Heffron says if one individual trustee dies or is replaced, the names on the titles of all fund assets have to be laboriously changed. By contrast, a corporate trustee continues to legally hold a fund's assets regardless of such a change.

### Involvement and simplification

DBA Lawyers senior associate Bryce Figot sometimes asks clients who make most of the decisions relating to their husband-and-wife SMSFs whether their less-involved spouses should participate more in the funds' decision-making. This involvement would better prepare the other spouses for the death or illness of the more-involved trustee.

A broad discussion could be held between spouses, Figot says, regarding the options for the fund if the more-involved spouse were to die or become ill.

These options include taking quality professional advice and continuing with the fund or closing it, if appropriate, and rolling the super into a large fund.

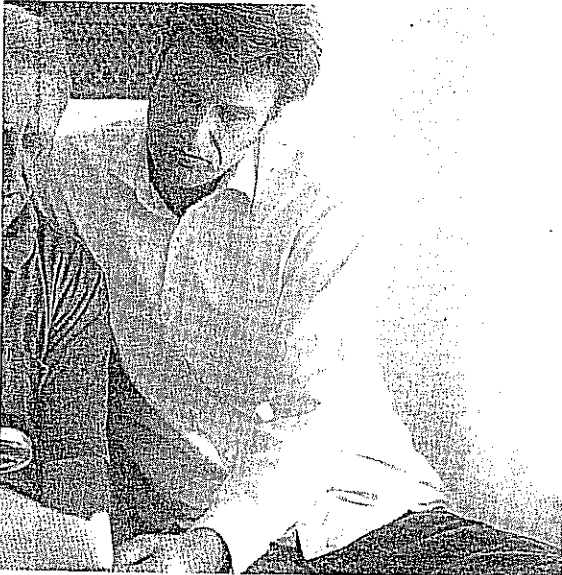
Butler says one way to help prepare for the illness or death of the dominant trustee is to streamline the fund's administrative systems and possibly switch to simpler investments, such as managed funds instead of direct shares.

### Temporary trustee

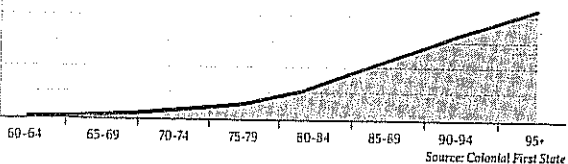
A valuable strategy when preparing for the possible death of a member is to nominate a person in your will to stand in as a temporary individual trustee or director of the corporate trustee.

Colley says the person should be trusted to look after your interests and administer the fund just as you would have done. The temporary successor trustee is typically the executor of your estate, but you can nominate a different person to fill in as trustee of your SMSF.

The temporary trustee or personal legal representative can only act in your place as trustee until the death benefits begin to be paid, either as a pension or lump sum.



the prevalence of mental incapacity increases with age



is that members may forget to update their binding nominations when their circumstances change. Heffron says she is "terrified" at the number of times some people opening SMSFs are sent, as a matter of course, forms to sign for making binding death benefit nominations.

"And many people would not realise that by making a binding nomination they have just made a will for their superannuation," she says.

"They have just given a binding set of instructions to the fund trustees."

"And people — who do not have a great appreciation of the way tax rules work — may leave half to their husband and a quarter to each of their financially independent daughters without realising it's a tax disaster."

Superannuation death benefits paid as lump sums are tax-free if received by a spouse (including de facto), children 18 or under, financial dependants and a person

with an "independency" relationship with the deceased.

These are called tax dependants.

But the "taxable component" of a lump sum benefit — which includes salary-sacrificed and compulsory employer contributions, and fund earnings — is taxed at 16.5 per cent if paid to non-tax dependants. This means that financially independent children can face a heavy tax bill on your super.

"Philosophically, I am not attracted to binding death benefit nominations," Heffron says, "because I think people have SMSFs to give them flexibility, including to get the best possible tax results that apply at the time." Binding nominations worked against that flexibility.

"With a binding death benefit nomination you are swapping flexibility for certainty, which for some people is a good thing," she says.

"So if I had children from a previous