SUPERANNUATION DEATH BENEFIT PLANNING

A paper presented by Michael Bennett for Legalwise Seminar

Friday, 11 March 2016

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1 Introduction

1.1 Context of Superannuation

Superannuation, being a concessionally taxed vehicle through which investments can be made, is an opportunity to all of our clients. But the benefits are not limited to the commonly understood concessional tax treatment. There are also asset protection advantages for investing in superannuation.

A trade off of such advantages in accumulating wealth in the superannuation environment is the complexity of the systems regulating superannuation funds, including the relevantly recent “simpler super” changes, the impact trust law principles equity imposes because of the trust relationship involved, and restrictions on what a superannuation fund can do (though importantly borrowings are now widely permitted in the superannuation environment).

1.2 Focus of the paper

Despite the policy intent to be the accumulation of savings to be consumed in retirement, it is commonly the case that a superannuation fund member will pass away with a superannuation balance. The significance of the member’s death benefits planning then comes to the fore.

This paper will focus on these death benefits planning issues. Specifically the paper will consider:

- the restrictions on accumulating wealth in a superannuation environment;
- once it begins to accumulate, the nature of a beneficiaries interests in a superannuation environment;
- estate planning issues in a superannuation environment including death benefits;
- binding death benefits nominations, when they are to be used, advantages or disadvantages of them and cases showing how they can be challenged;
- blended families and how they can be addressed;
- the nature of a trustee’s ability to exercise discretion where no binding nomination is in place;
- enduring powers of attorney and self-managed superannuation funds; and
- how a superannuation proceeds trust can be used for dealing with death benefits.

This paper will discuss a number of discreet issues or areas, on both sides of the trade off, that impact on the use of superannuation as a wealth accumulation vehicle.

2 Overview – the Old System and the "Simplified System"

The taxation of superannuation was significantly reformed with a package of eleven Bills that were introduced into Parliament in December 2006 and February 2007. They generally took effect from 1 July 2007. There are commonly referred to as the 'simpler super' or 'simplified super' reforms.

With the introduction of the simpler super reforms the focus of the regulations changed from 'back end' to 'front end' restrictions. This makes sense from a policy perspective – the concessional environment of superannuation previously permitted the accumulation of great wealth, beyond that needed to stay off of the Government pension, to be concessionally taxed.

Previously, the whole emphasis was one that let members go along at whatever pace suited them throughout their contribution period (including contributing millions of dollars at a single time) – the member's excessive accumulation of wealth was penalised through increased tax rates upon and after retirement. The new 'simplified' system does not seek to penalise excessive wealth upon and after retirement; rather it restricts the contributions that can be made to superannuation.

From 1 July 2007, contributions for which a deduction is allowed are referred to as a 'concessional contributions'. Concessional contributions, whether made by the member or an employer, are included in the assessable income of the superannuation fund. Undeducted contributions are referred to as 'non-concessional contributions'.

2.1 Concessional Contributions

Generally speaking, concessional contributions are either employer contributions or deductible personal superannuation contributions that are included in the assessable income in the recipient's superannuation fund.

Self-employed or substantially self-employed persons may be entitled to a deduction for contributions into a complying superannuation fund or an RSA. Generally speaking, being substantially self-employed means that the individual earns less than 10% of their income in a year from employment-related activities. If the individual satisfies the deduction conditions, then there is no limit on the amount of deductible contributions that may be made. However, excess contributions tax may be imposed if the contributions exceed the contributions cap for the year.

That is, despite the full deductibility of 'concessional contributions' to the contributor, there are limits on the amount of concessional contributions that can benefit from concessional treatment when paid to the fund (i.e. subject to 15% tax when contributed into the fund and potentially 0% when paid from the fund as a superannuation benefit).

Concessional contributions that exceed the relevant contributions cap are subject to excess concessional contributions tax. Since 1 July 2013 they are included in the individual's assessable income and taxed at the marginal rates together with an interest component: Division 291 of the *Income Tax Assessment Act* 1997 (Cth) (the '**1997 Act**'). The taxpayer can then elect to release up to 85% of the excess concessional contributions from the superannuation fund as a credit to cover their personal tax liability: Divisions 95 to 97 of Schedule 1 to the *Taxation Administration Act* 1953 (Cth).

2.2 Non-concessional Contributions

A non-concessional contribution is not assessable to the Superannuation Fund to which it is contributed: Subdivision 295-C of the 1997 Act.

Non-concessional contributions are also subject to an annual cap, which is currently $180,000: *s 292-85 of the 1997 Act.* Taxpayers under 65 years of age may roll up to three years of non-concessional contributions to a single transaction: ss 292-85(3) and (4) of the 1997 Act. It is a rolling total, so, for instance, only two years could be 'brought forward' where the balance of the $540,000 had previously be used.

Excess contributions tax at 49% is imposed on non-concessional (i.e. undeducted) contributions where those contributions exceed the relevant cap amount for the year: s 5 of the *Superannuation (Excess Non-concessional Contributions Tax) Act* 2007 (Cth) and s 292-80 of the 1997 Act..

2.3 The Caps

Contribution caps for the financial year ending 30 June 2016 are therefore:

Type of contribution	Age requirement	Cap amounts	Tax on contributions over the caps
Concessional	Less than 50 years old	$30,000	Individual's marginal rate AND Ability to release 85% of contribution from the Fund to pay the tax
	50 years old or more	$35,000	As above
Non-concessional	65 years old or more (to contribute you must satisfy certain criteria)	$180,000	49%
	Less than 65 years old	$540,000 over a 3-year period	49%

2.4 Planning Required

The change in the concessional contribution cap amount, coupled with the tax effectiveness and asset protection advantages of superannuation, have caused gearing in superannuation to become a popular method of increasing superannuation balances. This attractiveness has been further heightened given the volatility with respect to equities and the preference of many towards real estate investments.

With the reduction in the concessional contributions from 1 July 2009 an appropriate strategy to contribute to super and maximise the balance is more important than ever.

There can be seen from this change that there is one group who have done very well from the simplified super reform. Anyone who had contributed excessive amounts to superannuation before the change, which took effect on 1 July 2007, is ahead of the curve because they have wealth in a concessional environment that is no longer assessed at increased (if any) rates of tax upon and after retirement.

3 What interest does a beneficiary of a superannuation fund have in the assets held by the superannuation fund?

Given the increase in the value held in superannuation funds in this country it is becoming more important, though it was never unimportant, to know exactly what interest a member of a superannuation fund has.

In *CSR v The Chief Commissioner of State Revenue* [2006] NSWSC 1380 Gzell J referred to (amongst others) the decision of *CPT Custodian Pty Ltd v Commissioner of State Revenue* (2005) 224 CLR 8 in finding that no members of a superannuation fund '... *had any beneficial ownership of any of the underlying investments ...*' held within the superannuation fund. Justice Gzell observed that:

> The trust deed was amended on a number of occasions in the period from 30 June 2002 to 30 June 2004. Key provisions, however, remained constant. The assets of the Fund were held by the trustee upon trust to be applied in accordance with provisions of the deed pursuant to cl 4.2. Clause 6.3 provided that no person should have any claim, right, or interest to or in respect of the fund, or any contributions thereto, or any interest therein, or any claim upon or against the trustee or an employer, except under and in accordance with the provisions of the deed. Members had to elect between a pension and a lump sum. The pension was calculated as a percentage of the final three years' average salary, the percentage increasing with the number of years of service. Likewise, the lump sum was calculated as a multiple of the final three years' average salary, the multiple increasing with the number of years of service. Upon termination of the Fund, cl 13, and later cl 13A, provided that any surplus should be applied by the trustee in any manner reasonably consistent with any of the objects of the Fund. Clause 7.4 provided that if the trustee should determinate at any time, on the advice of the actuary, that the value of the assets of the Fund exceeded 120% of the amount required to meet actuarial liabilities, the trustee might agree with CSR to apply all or part of the excess to CSR, to augment benefits payable to members, or as they might otherwise agree.
>
> Clause 13 and cl 13A of the deed vary the usual situation in which an ultimate surplus in a superannuation fund is prima facie held on a resulting trust for those who contributed to it (*Air Jamaica Ltd v Charlton* [1999] UKPC 20; [1999] 1 WLR 1399 at 1411, *Wrightson Ltd v Fletcher Challenge Nominees Ltd* [2002] 2 NZLR 1 at [23]).

> None of the members of the Fund had any beneficial ownership of any of the underlying investments including, in particular, the top-up contributions (*CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53; (2005) 79 ALJR 1724 at [25], *Halloran v Minister Administering National Parks and Wildlife Act 1974* [2006] HCA 3; (2006) 80 ALJR 519 at [75]).
>
> Until the happening of a prescribed event that crystallizes a member's right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of any amount that stands to the credit of the member's account from time to time (*Re Coram; Ex parte Official Trustee in Bankruptcy v Inglis* (1992) 36 FCR 250 at 253, *Wrightson* at [28]).

Similarly, Heerey J in *Re John Sloane Kirkland; Ex Parte: Official Trustee in Bankruptcy* [1997] FCA 684 held that the rule in '*Saunders v Vautier*' does not apply in the context of a superannuation fund. The Court observed that:

> The Official Trustee in Bankruptcy, as trustee of the bankrupt estate of John Sloane Kirkland (the bankrupt), seeks payment of a benefit to which the bankrupt is entitled under the TNT Group Retirement Fund (the Fund). In essence the Official Trustee contends that the amount in question, although payable at a future date, has unconditionally vested in the bankrupt and that he can call for immediate payment under the Rule in *Saunders v Vautier* (1841) Cr & Ph 240, 49 ER 282.

Justice Heerey found that:

> I conclude that at the date of the bankrupt's resignation, the date of sequestration, and the present time, the bankrupt was and is not entitled to payment of the Preserved Withdrawal Benefit. The rule in *Saunders v Vautier* does not apply. Because superannuation funds in Australia enjoy substantial tax benefits there is a complex statutory regime which restricts the access members may have to benefits. Speaking very generally, the object of superannuation is to make provision for death, disablement or retirement at normal retiring age, or earlier if there are exceptional circumstances. It would conflict with that objective if members of funds could treat their entitlements as though they were funds on deposit, available at call.
>
> The bankrupt could not on resignation or at the date of sequestration, and cannot at the present time, obtain payment of those benefits. The applicant can be in no better position than the bankrupt.

That is, a member of a superannuation fund does not have an interest in the assets held subject to a superannuation fund. Rather, the member's interest is the interest in the superannuation fund.

4 Estate planning and superannuation

A member's interest in a superannuation fund does not automatically form part of their estate. This fact is often misunderstood in practice. However, in the context of estate planning and superannuation, there are a number of considerations, including:

- when benefits must be paid;
- who can receive the benefits;
- in what form should those benefits be taken; and
- the taxation implications for the beneficiaries.

4.1 What is a 'death benefit'?

Regulation 6.21 of the *Superannuation Industry (Supervision) Regulations* 1994 (Cth) ('**SIS Regulations**') provides that a trustee of a regulated superannuation fund is required to cash a member's benefit as soon as practicable after a member's death. Except if there is an effective death benefit nomination, the superannuation fund's trustee has discretion as to which dependants it should distribute a deceased's benefits. As will be seen, this is a wide discretion.

The term 'superannuation death benefit' is defined in section 307-5 of 1997 Act. Amongst other things, item 1 of column 3 in that section defines a 'superannuation death benefit' as '*A payment to you from a superannuation fund, after another person's death, because the other person was a fund member.*' Section 307-10 of the 1997 Act sets out the payments which are not considered 'superannuation death benefits'.

4.2 Payment of death benefits

Regulation 6.22 provides that a payment from a superannuation fund in consequence of the death or a member can be paid either:

1. directly to a beneficiary; or
2. to the executor of the deceased's estate or a trustee of a testamentary trust, with the amounts then paid to a beneficiary as a distribution from the estate or the trust.

Broadly speaking, upon death a member's superannuation interest is transferred from the member's fund, being a 'death benefit'. Subject to the terms of the particular trust deed of the superannuation fund, the transfer may be affected by either a lump sum payment, an income stream, or a combination of the two.

Subregulation 6.21(2) of the SIS Regulations provides that a lump sum must not be paid in more than two instalments. Further, there are limitations with respect to the payment of income streams.

Subregulation 6.17C(c) of the SIS Regulations provides that if a regulated fund does not meet the payment standards of r 1.06(2), (7) or (8) of those regulations, the trustee must not pay or commute a pension in breach of those standards.

To further effect to these provisions s 55A of the *Superannuation Industry (Supervision) Act* 1993 (Cth) ('**SIS Act**') provides that the fund's governing rules must not permit a fund member's benefits to be cashed after the Member's death, other than in accordance with the operating standards and any such governing rules[1] are deemed to be invalid to the extent that they purport to permit benefits to be cashed, other than in accordance with the operating standards.

4.3 Timing of payment of death benefits

Subregulation 6.21(1) of the SIS Regulations provides that '*... a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the member dies.*' That is, there is no prescribed time in which a death benefit must be paid. All that is required is that the payment must be made as soon as practicable after death.

4.4 Lump sum payments

Section 302-60 of the 1997 Act provides that lump sum payments received by a dependant of the deceased is tax-free. The amount is treated as non-assessable non-exempt income of the dependant.

However, if a lump sum is paid to a person that is not a dependant, then the tax free component will not be subject to tax (see s 302-140 of the 1997 Act), but the taxable component of the lump sum is included in the recipient's assessable income and subject to tax at marginal rates. Section 302-145 of the 1997 Act provides for a tax offset mechanism; this ensures that the rate of tax on the untaxed element of the tax free component does not exceed 30% (plus Medicare levy), whereas the rate of tax on the taxed element of the tax free component does not exceed 15% (plus Medicare levy).

Superannuation lump sum death benefit	**Dependent**	**Non-dependent**	
		Taxed element	**Untaxed element**
Tax free component	Tax free	Tax free	Tax free
Taxable component	Tax free	15%	30%

The possible methods of transfer of a member's interest upon death depend on the character of the recipient, with the possibilities being:

[1] Governing Rules are defined in s 10 of the SIS Act to mean in relation to a fund or Trust any rules contained in a trust instrument, other document or legislation, or combination of them, or any fund's written rules.

Recipient	Permitted benefit
Spouse	Either or both a lump sum and/or income stream
Dependent children under the age of 18	Either or both a lump sum and/or income stream. However, income stream must cease at 25.
Non-dependent children over the age of 18	Lump sum
Dependent children between 18 and 25	Either or both a lump sum and/or income stream. However, income stream must cease at 25.
Dependent child over the age of 25	Lump sum
Dependent grandchildren	Either or both a lump sum and/or income stream
Non-dependent grandchildren	Lump sum (made via estate)
Non-dependent (i.e. not child or spouse)	Lump sum (made via the estate)
Estate	Lump sum

4.5 Income streams

Section 302-65 of the 1997 Act provides that a superannuation income stream is tax free if either the deceased or the dependant is aged at least 60 as at the time of death.

If a superannuation income stream is paid to a dependent upon death, and neither the deceased nor the dependant is aged at least 60 at the time of death, then:

- that part of the income stream which is the ***tax free component*** is tax free;
- that part of the income stream which is paid from a ***taxed component*** is assessable income for the dependent. The dependent is entitled to a tax offset equal to 15% of the element taxed in the fund. The income stream becomes tax free when the recipient turns 60 years of age; and
- that part of the income stream which is paid from an ***untaxed component*** is assessable income for the dependent. The dependent will receive a tax offset of only 10%, but only when they attain the age of 60.

A non-dependent is unable to receive a superannuation income stream. Such income streams must be commuted, and paid to the non-dependant as a lump sum.

4.6 Who is a dependent?

The term 'death benefits dependent' for taxation purposes is defined in section 302-195 of the 1997 Act. Subsection 302-195(1) of the 1997 Act provides that:

> '(1) A **death benefits dependant**, of a person who has died, is:
>
> (a) the deceased person's spouse or former spouse; or
>
> (b) the deceased person's child, aged less than 18; or
>
> (c) any other person with whom the deceased person had an interdependency relationship under section 302-200 just before he or she died; or
>
> (d) any other person who was a dependant of the deceased person just before he or she died. '

That is, a 'death benefit dependant' with respect to a deceased includes:

- the deceased's spouse;
- the deceased's former spouse;
- the deceased's child, provided that at the time of death the child is under the age of 18;
- a person with whom the deceased had an 'interdependency relationship' just before the deceased died;[2]
- any other person who was a 'dependant' of the deceased just before the death of the deceased; and
- under section 302-195 of the 1997 Act, a death benefits dependant also includes a person who receives a superannuation pension or annuity if the annuity or pension commenced before 1 July 2007 as a result of the death of another person.

4.7 Proportioning Rule

Due to the proportioning rule in s 307-125 of the 1997 Act it is not possible to effectively stream the tax-free component to non-dependents and taxable amounts to death benefits dependents so as to escape tax. For this reason tax planning strategies must be entered during the particular member's lifetime, before they pass and their benefits become death benefits. These strategies can be a recontribution strategy or withdrawing the member benefits in their lifetime and gifting them to the desired recipient.

[2] See s 302-200 of the 1997 Act and r 302-200.01 of the *Income Tax Assessment Regulations* 1997 (Cth).

4.8 Interdependency relationship

The term 'interdependency relationship' for the purposes of paragraph 302-195(1)(c) of the 1997 Act is provided for in section 302-200 of the 1997 Act:

> **'What is an interdependency relationship?**
>
> (1) Two persons (whether or not related by family) have an **interdependency relationship** under this section if:
>
> (a) they have a close personal relationship; and
>
> (b) they live together; and
>
> (c) one or each of them provides the other with financial support; and
>
> (d) one or each of them provides the other with domestic support and personal care.
>
> (2) In addition, 2 persons (whether or not related by family) also have an **interdependency relationship** under this section if:
>
> (a) they have a close personal relationship; and
>
> (b) they do not satisfy one or more of the requirements of an interdependency relationship mentioned in paragraphs (1)(b), (c) and (d); and
>
> (c) the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.
>
> (3) The regulations may specify:
>
> (a) matters that are, or are not, to be taken into account in determining under subsection (1) or (2) whether 2 persons have an **interdependency relationship** under this section; and
>
> (b) circumstances in which 2 persons have, or do not have, an **interdependency relationship** under this section.'

That is, two individuals have an independency relationship if they satisfy ***all*** of the following conditions (see section 302-200 of the 1997 Act):

- they have a close personal relationship;
- they live together;
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.

4.9 Life insurance and superannuation funds

An important part of a financial plan is life insurance. Generally speaking, a life insurance payout can:

1. form part of the deceased's estate;

2. be directed to a specific beneficiary; or

3. be paid to the policy owner.

The purpose of life insurance is to provide a lump sum benefit upon death of the life insurer. Life insurance which is 'term insurance' is guaranteed to be renewable (i.e. the policy cannot be changed) whilst the premiums continue to be paid. Such a policy can be held within a superannuation fund, with the result that upon death of the individual insured, the proceeds are paid to the fund. This has the result of increasing the death benefit payable.

Upon death, the proceeds of life insurance policies held by the superannuation fund are paid directly to the fund (as the policy owner). The proceeds are allocated to the member's fund as a taxable component.

The death benefit is paid tax free as a lump sum to a death benefit dependent. However, such a payment made to a non-financial dependant will be taxable (with no low rate threshold for the taxable component.

The taxable component paid from insurance proceeds may be either a taxed component or an untaxed component. A higher rate of tax is payable on an untaxed component received by a non-death benefit dependent. If:

- the superannuation fund **has not** claimed a tax deduction for the premiums paid for the insurance policy, then the ***taxable component*** is a ***taxed component***; and

- the superannuation fund **has** claimed a tax deduction for the premiums paid for the insurance policy, then the ***taxable component*** is an ***untaxed component***.

Further, in the year that a death benefit is made, the trustee can choose to claim a deduction for the future service period of that member instead of claiming a tax deduction for the premium paid on the insurance policy. This strategy will only be beneficial if the fund is in accumulation (i.e. tax paying) phase, and not income phase.

5 Binding nominations in the context of self-managed superannuation fund

Through a valid binding death benefit nomination a member can circumscribe the discretion a fund trustee otherwise has to distribute death benefits of that member. I will first set out the legislative regime for those nominations, then discuss their appropriateness and when they are to be used, consider some cases on the effect and effectiveness of certain nominations, then – based on the examples of the cases discussed – consider how to rectify them in case they are currently deficient.

5.1 Provisions for a Binding Death Benefit Nomination

Section 59 of the SIS Act provides that:

> ‘(1) Subject to subsection (1A), the governing rules of a superannuation entity other than a self managed superannuation fund must not permit a discretion under those rules that is exercisable by a person other than a trustee of the entity to be exercised unless:
>
> (a) those rules require the consent of the trustee, or the trustees, of the entity to the exercise of that discretion; or
>
> (b) if the entity is an employer-sponsored fund:
>
> (i) the exercise of the discretion relates to the contributions that an employer-sponsor will, after the discretion is exercised, be required or permitted to pay to the fund; or
>
> (ii) the exercise of the discretion relates solely to a decision to terminate the fund; or
>
> (iii) the circumstances in which the discretion was exercised are covered by regulations made for the purposes of this subparagraph.
>
> (1A) Despite subsection (1), the governing rules of a superannuation entity may, subject to a trustee of the entity complying with any conditions contained in the regulations, permit a member of the entity, by notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person or persons mentioned in the notice, being the legal personal representative or a dependant or dependants of the member.
>
> (2) If the governing rules of a superannuation entity are inconsistent with subsection (1), that subsection prevails, and the governing rules are, to the extent of the inconsistency, invalid.’

Further, section 31 of the SIS Act provides that regulations may be made so as to provide operating standards for superannuation fund. Relevantly, r 6.17A of the SIS Regulations provides that:

> **‘6.17A Payment of benefit on or after death of member**
> **(Act, s 59 (1A))**
>
> (1) For subsections 31(1) and 32(1) of the Act, the standard set out in subregulation (4) is applicable to the operation of regulated superannuation funds and approved deposit funds.

(2) For subsection 59(1A) of the Act, the governing rules of a fund may permit a member of the fund to require the trustee to provide any benefits in respect of the member, on or after the death of the member, to the legal personal representative or a dependant of the member if the trustee gives to the member information under subregulation (3).

(3) The trustee must give to the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to provide the benefits.

(4) Subject to subregulation (4A), and regulations 6.17B, 7A.17 and 7A.18, if the governing rules of a fund permit a member of the fund to require the trustee to provide any benefits in accordance with subregulation (2), the trustee must pay a benefit in respect of the member, on or after the death of the member, to the person or persons mentioned in a notice given to the trustee by the member if:

(a) the person, or each of the persons, mentioned in the notice is the legal personal representative or a dependant of the member; and

(b) the proportion of the benefit that will be paid to that person, or to each of those persons, is certain or readily ascertainable from the notice; and

(c) the notice is in accordance with subregulation (6); and

(d) the notice is in effect.

(4A) The trustee is not required to comply with subregulation (4) if the trustee:

(a) is subject to a court order that has the effect of restraining or prohibiting the trustee from paying a benefit in respect of the member in accordance with a notice of the kind described in that subregulation; or

(b) is aware that the member of the fund is subject to a court order that:

(i) requires the member to amend or revoke a notice of that kind that the member has given the trustee; or

(ii) has the effect of restraining or prohibiting the member from giving a notice of that kind.

(5) A member who gives notice under subregulation (4) may:

(a) confirm the notice by giving to the trustee a written notice, signed, and dated, by the member, to that effect; or

(b) amend, or revoke, the notice by giving to the trustee notice, in accordance with subregulation (6), of the amendment or revocation.

(6) For paragraphs (4) (c) and (5) (b), the notice:

(a) must be in writing; and

(b) must be signed, and dated, by the member in the presence of 2 witnesses, being persons:

(i) each of whom has turned 18; and

(ii) neither of whom is a person mentioned in the notice; and

(c) must contain a declaration signed, and dated, by the witnesses stating that the notice was signed by the member in their presence.

(7) Unless sooner revoked by the member, a notice under subregulation (4) ceases to have effect:

(a) at the end of the period of 3 years after the day it was first signed, or last confirmed or amended, by the member; or

(b) if the governing rules of the fund fix a shorter period — at the end of that period.'

However, in Self Managed Superannuation Funds SMSFD 2008/3, entitled *Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) legislation on a self managed superannuation fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?*, the Commissioner of Taxation observed that:

> '1. … Section 59 of the Superannuation Industry (Supervision) Act 1993 (SISA) and regulation 6.17A of the Superannuation Industry (Supervision) Regulations 1994 (SISR) do not apply to self managed superannuation funds (SMSFs). This means that the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A of the SISR.
>
> 2. However, a death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards in the SISR. The relevant operating standards are mentioned in Appendix 1 of this Determination.'

As a result, before a death benefit nomination is made, regard should be given to the particular constituent documents for the superannuation fund so as to determine what (if any) death benefit nominations can be made. In the event that the constituent documents are silent on the matter, then no nomination can be made.

5.2 Binding Death Benefit Nominations – When To, and Not, Use Them

It is common for accountants, financial planners and superannuation administrators to offer pro forma nominations to their respective clients. I caution against this. In its most common form it states '*everything to my spouse and if he/she fails to survive me to the legal personal representative of my estate'*. The issue arises because providing this nomination suggests that (a) some consideration has been given to the appropriateness of it to the particular client, and (b) it carries the suggestion that the nomination is binding. These would suggest legal advice has been given to the client, thereby triggering the provisions of the relevant *Legal Profession Acts*. For non-lawyers a professional indemnity issue may arise.

A further issue relates to the inflexibility of binding death benefit nominations. They circumscribe an otherwise available discretion of the fund trustee. This could cause issues if:

- a member has lost capacity and is unable to amend a binding nomination;
- circumstances change (such as deaths, births, marriages or relationship falling apart);
- the law (in particular the tax law) changes;
- the nomination is to the estate and the prospect of a family provision claim is real.

For these reasons a binding nomination should not be adopted until it is considered, on appropriate material, the right course for the client.

Circumstances where a binding nomination may be appropriate are:

1. a blended family exists and second marriages cause the member to want their superannuation benefits to go to children of a prior relationship;[3]
2. the potential beneficiaries are young adults as the Superannuation Complaints Tribunal has a preference for awarding death benefits to spouses to the expense of young adult children;
3. where a widowed person or recently divorced person wants to ensure their death benefits are not paid to a deemed spouse;
4. where a testamentary trust has been established and s 102AG of the 1997 Act will afford substantial tax benefits going forward through that trust.

A binding nomination, at least so far as they relate to a self manage superannuation fund, is only limited by the payment standards of the SIS Act and SIS Regulations, trust law and the terms of the fund deed and the commercial drivers of any taxation consequences. Therefore, providing the fund deed and the binding nomination are appropriately worded there is no reason by the nomination cannot:

1. direct specific assets to be paid in specie to a particular member;
2. give other direction to the trustee with respect to the payment of death benefits;
3. provide for the form of the payment of a death benefit (for example, by way of a pension on certain terms or by way of a lump sum);
4. contemplating that a member may have more than one spouse (if this happened to be the case);

[3] As to Blended Families see heading 6 below.

5. providing the payment of certain assets be subject to life interests or occupancy rights (this commonly occurs in a will).

It is now convenient to considers real life examples, via litigated cases of purportedly binding nominations being challenged. It will be seen that most of these challenges are successful.

5.3 Challenging Binding Death Benefit Nominations – Case Law

There have been a number of significant decisions in the last decade dealing with binding death benefit nominations. It is convenient to consider them chronologically, though they deal with issues such as what happens if the nomination is not binding or, if binding, if the trustee nonetheless seeks to ignore it.

From the cases, however, it seems that a binding nomination may be challenged on the following grounds:

1. that the fund deed proscribed how the nomination was to occur and the nomination in question did not confirm to those requirements. A trick to addressing this is ensuring the deeds are permissive in their language rather than mandatory.

2. that the nomination does not specify a 'death benefit dependent'. These would automatically fail as falling foul of the payment standards of the SIS Act and the SIS Regulations.

3. that one of a series of amendments to the fund deed (which occurs over the ordinary life of a fund) such that the operative deed that the trustee and members were applying was not in fact applicable. Thorough and diligent recordkeeping will address this issue.

4. related to the previous issues, is where the fund deed is amended after the nomination is entered and the nomination no longer remains binding due to the rule change. A cross-check of outstanding nominations at the time of a deed amendment will address this issue.

5. that the fund deed provides that the nominations lapse after a period of time. A common period is three years.

6. the nomination contains the wrong description (see the, possibly, harsh result in *Munro v Munro* below).

7. the member or the trustee lacked capacity at the time the nomination was made. This gives rise to the capacity issues and arguments one normally sees in a probate context.

8. the member or the trustee was subject to undue influence at the time the nomination was made. This gives rise to the equitable issues and arguments one normally sees in a probate context.

9. that although the nomination be binding, the trustees of the fund fail to disclose its existence to the potential beneficiaries. Having the fund's professional advisors aware of the fund's documents or status of its member's nominations will address this issue.

It is now appropriate to consider specific examples in the decisions of the above issues.

5.3.1 Katz v Grozman – Breadth of Trustee's Discretion

It should also be noted that if the decision as to who will receive the death benefit is made by the remaining trustee(s) of the self-managed superannuation fund, the death benefit may be paid in a way which is contrary to the deceased member's wishes. Consideration should be given to the decision in *Katz v Grossman* [2005] NSWSC 934, which according to the first sentence of the judgement was: '*…a contest between a brother and a sister over the control of a superannuation trust fund established at the behest of their late father Ervin Katz. The assets of the fund exceed $1 million.*'

Katz v Grossman is authority for the proposition that in the event that binding directions are not provided to the trustee of a self-managed superannuation fund, then the trustee of a fund has complete discretion with respect to dealings with superannuation benefits. Such discretion includes the trustee providing the benefits to themselves, notwithstanding that they are not dependants of the deceased.

Ervin Katz was a member of the E. Katz Employees Trust Fund, which was a self-managed superannuation fund. Both Mr Katz and his daughter, Linda Ann Grossman were trustees of the self-managed superannuation fund. Mr Katz had made a non-binding nomination, in which he expressed the desire for his death benefit to be divided equally amongst his daughter (the co-trustee) and his son.

However, following the death of Mr Katz, Mrs Grossman appointed her husband as a co-trustee. The trustees then resolved to pay the whole of Mr Katz's death benefit to Mrs Grossman.

Mr Katz's son took action in the New South Wales Supreme Court arguing that:

- Mr Katz had not validly appointed Mrs Grossman as a trustee; and
- Mrs Grossman was not validly appointed as a member.

With respect to the first issue, after reviewing the terms of the superannuation fund's deed, the relevant documentation and consideration of the *Trustee Act 1925* (NSW) , Smart AJ held that Ms Grossman had been validly appointed. As a result, Mrs Grossman's decisions were held to be valid, which included the payment of the death benefit referable to Mr Katz's interest in the fund to herself.

With respect to the issue of whether Mrs Grossman was validly appointed as a member of the fund, Smart AJ considered that because the fund's deed required an appointment as a member to be effective the trustee had to consent to it, as there was no documentary evidence which showed that the trustee had consented to Mrs Grossman becoming a member, it was held that Mrs Grossman was not a member of the fund.

As a result, in order to ensure that the wishes of a member with respect to the payment of their interest in a self-managed superannuation fund occurs, either a binding death benefit nomination should be executed, or there should be a trust deed direction which provides for such wishes.

5.3.2 Donovan v Donovan – Breadth of Trustee's Discretion

The decision of *Donovan v Donovan* [2009] QSC 26 from the Supreme Court of Queensland highlights the importance of the form a superannuation trust deed and the implications of whether a death benefit nomination is binding on the trustee of a super fund.

In this case, Mr Donovan established a superannuation fund with a corporate trustee, of which Mr Donovan was a member at all material times. Mr and Mrs Donovan (his wife by a second marriage) were also the respective director and secretary of this corporate trustee. The revised trust deed of Mr Donovan's super fund required a corporate trustee to be bound by a binding death benefit nomination, where such binding death benefit nomination satisfies the "Statutory Requirements".

Mr Donovan signed a letter addressed to the corporate trustee, advising that, upon his death, he wished to have his superannuation entitlements distributed to his legal personal representative for inclusion in his estate assets. On Mr Donovan's death, his daughter by his first marriage, Lynda (who was the beneficiary under his will), brought an application to seek the court's determination that Mr Donovan's nomination was binding on the corporate trustee, of which Mrs Donovan had control.

The Court found that the intent of the particular trust deed was to require Mr Donovan's letter to be in the form described in subregulation 6.17A(6) of the SIS Regulations, and so further held that Mr Donovan's letter was not binding on the trustee. As Mr Donovan's letter was a non-binding death benefit nomination, the corporate trustee was not obliged to distribute his superannuation entitlements to his legal personal representative for inclusion in his estate assets.

Further, if the constituent documents provide that binding death benefit nominations may be made under the SIS Act, and because the relevant binding death benefit rules in the SIS Act do not apply to self-managed superannuation funds, such a provision will not allow a member to make such nominations.

It should be noted that the jurisdiction of the Superannuation Complaints Tribunal does not extend to decisions made by trustees of self-managed superannuation funds or certain public sector superannuation schemes. As a result, self-managed superannuation funds are a valuable mechanism to ensure that a death benefit is paid as directed by the deceased member.

Further, because death benefits are not dealt with under a will, legal challenges can be greatly reduced by directing payments from a self-managed superannuation fund upon death directly to a person specified by the deceased, as opposed to having such payments directed to the estate of the deceased.

5.3.3 Wooster v Morris – A Rare Win for the Nomination

In *Wooster v Morris* [2013] VSC 594 the Victorian Supreme Court was asked to consider the validity of a binding nomination prepared in respect of a self-managed superannuation funds that allegedly failed to comply with the terms of the fund deed. It also had to consider whether the trustee was entitled to indemnity.

Two years before his death Mr Morris had executed a binding nomination in favour of his daughters from his first marriage. They were to receive all of his death benefits. Mr Morris was survived by his second wife, being the only surviving member and trustee of the relevant fund.

The second wife appointed her son (of another relationship) as co-trustee and member of the fund. A corporate trustee then replaced them both.

The fund deed required that a valid, binding nomination must be delivered to the trustee. It can only be assumed from the judgment that the second wife alleged that the binding nomination was never served on her and therefore was invalid. She and her son exercised the trustee's discretion and resolved to pay, and subsequently paid, the death benefits to the second wife via transfer to her member balance.

The daughters, who were also executrixes of Mr Morris' estate, commenced proceedings seeking a declaration that the binding nomination was in fact valid and, if so, the death benefits should have been paid to them.

The parties agreed that the issue be referred to a referee for determination. The referee filed a report determining that the biding nomination was both valid and binding. Consequently the daughters were to be paid the death benefits and interest.

Interestingly, in seeking to avoid a costs order the second wife relied on the corporate trustee as the entity against whom the order should be made. The Court held that such an outcome would cause the death benefits to be impacted by the order that, in circumstances where the second wife solely benefited from the trustee's actions, was inappropriate.

This case is one of the rare lights in a sea of judicial darkness for binding nominations.

5.3.4 McIntosh v McIntosh – Capacity of the Receipt

Although not expressly challenging a purportedly binding nomination, the following case is of significance in the area of disputes over death benefits.

In *McIntosh v McIntosh* [2014] QSC 99, in yet another Queensland case, the Supreme Court answers what was (so far as my research has shown) a novel question. It was expressly considered by a court: If a person is eligible to receive a deceased's super both as the deceased's legal personal representative and also in his or her personal capacity, and the person receives the super personally, must he or she transfer it to the estate?

Mr and Mrs McIntosh were married in 1968 and divorced in 1979 with one son of the relationship, James. Mrs McIntosh and James lived together for the bulk of his life. James was killed on 14 July 2013 without a surviving spouse or children. He also died intestate.

Mrs McIntosh applied to be the administrator of James' estate. She stated in an affidavit that she understood that, if she were so appointed, she was required to collect her son's assets and distribute his estate by dividing them equally between herself and the father. She said 'I propose faithfully to do this.' She was granted 'Letters of Administration' (ie, appointed as the administrator).

The net assets of James' estate were about $80,000. However, he had significantly more in various super funds, totaling approximately $454,000.

On 30 September 2013 the mother then applied to James' super funds to have his super death benefits paid to her personally, describing the interdependency relationship that existed between her and her son. Each super fund agreed to do so. This meant that it appeared that all of the super (ie, about $454,000) would be paid directly to the mother and none of it to Mr McIntosh. Mr McIntosh would receive only half of the estate (ie, half of about $80,000).

Mr McIntosh's lawyers wrote to the mother stating:

> As administrator, I note that your client will make her best endeavours to maximise the size of the estate. Bearing this in mind, please advise whether your client intends to seek any or all of the deceased's superannuation entitlements to be paid entirely to her in her personal capacity.

Mrs McIntosh's lawyers wrote back stating:

> … we do not hold any instructions in relation to the superannuation as it does not form part of the estate … If you are able to direct us to the law that requires our client as personal representative to make such an application to the super funds then we will take instructions in this regard

Mr McIntosh's lawyer replied that:

> … as personal representative, your client has a fiduciary obligation to maximise the return for the estate. Clearly your client is in breach of her obligation if she has actively sought payment to herself direct in lieu of the estate.

Mrs McIntosh then filed this application. The Court held that:

> … there was a clear conflict of duty … contrary to her fiduciary duties as administrator. When the mother made application to each of the superannuation funds for the moneys to be paid to her personally rather than to the estate, she was preferring her own interests to her duty as legal personal representative to make an application for the funds to be paid to her as legal personal representative. She was in a situation of conflict which she resolved in favour of her own interests. As such she acted … in breach of her fiduciary duty as administrator of the estate …

Accordingly, the Court held that the mother was required to account to the estate for the super death benefits (ie, 'hand over' the benefits).

This case shows the importance of dovetailing your binding nominations and, possibly, your testamentary dispositions (the will) to ensure the outcome suits. If James' wanted Mrs McIntosh to receive the funds – which may have been the case given their interdependent relationship – these two steps would have assisted.

5.3.5 Ioppolo v Conti – Breadth of Trustee's Discretion

In *Ioppolo v Conti* [2015] WASCA 45 the Western Australian Court of Appeal confirmed the breadth of the trustee's discretion. In that case the deceased, Mrs Conti, was a fund member and joint trustee with her husband, Mr Conti.

Although she had not prepared a binding death benefit nomination, Mrs Conti's will directed as to the payment of her death benefit to her children. It specifically stated that her husband was not to receive any of the death benefits.

However, during her lifetime Mrs Conti had prepared two binding nominations (29 July 2002 and 10 April 2006). The later of the two lapsed on its third anniversary. Both directed the trustee of the self-managed superannuation fund to pay her death benefits to Mr Conti.

Mr Conti (as director of a corporate trustee appointed to the fund after Mrs Conti's death) caused the death benefits to be paid to himself to the exclusion of the children. The children, who were also executors of Mrs Conti's estate, brought proceedings seeking to clarify:

1. was Mr Conti obliged to appoint one of the executors as trustee of the self managed superannuation fund?

2. whether the corporate trustee, in resolving to pay the death benefits to Mr Conti, do so in a bona fide manner?

The Court held that s 17A(3) of the SIS Act allows for, but does not require, the appointment of an executor as trustee of a self managed superannuation fund. As there is a six month period of grace, and Mr Conti had caused a corporate trustee to be appointed within that grace period, there was no breach of s 17A.

The Court also held that executors' argument, that failure to comply with the direction in the will evidence a lack of bona fides, had no merit. It held that there was no evidence to support the argument. It is to be noted that Mr Conti had sought advice on this issue and complied with that advice.

The case also addressed whether an executor could be appointed as fund trustee under s 77 of the *Trustee Act* 1962 (WA) and whether the trustee's discretion can be reviewed. Both issues were resolved against the executors.

5.3.6 Munro v Munro – Technical Breaches are Sufficient

In *Munro v Munro* [2015] QSC 61 – in Queensland, the nomination dispute capital of Australia – Mr Munro died in 2011 survived by his second spouse, her daughter Ms Pooley and Mr Munro's two daughters of his earlier marriage (Vanessa and Elke).

In 2009 Mr Munro had signed a binding death benefit nomination to direct his fund trustee to pay his death benefits to his estate. The deed of that fund required the trustee to pay any benefits in accordance with any binding nominations. One of the provisions of this was that the nomination had to specify who it was to be paid to (reflecting the require of superannuation law). If this requirement was not satisfied, the trustees were not bound by the nomination and could pay the benefits at their discretion (but obviously still subject to the terms of the fund deed and the law).

In 2012 Ms Pooley became a co-trustee with her mother (the second spouse). They gave notice to the two daughters, who were executrixes of Mr Munro's estate, that the trustees intended to exercise their discretion as trustees in paying Mr Munro's death benefits on the basis that they nomination was not binding.

The executrixes sought a declaration of the court that the nomination was binding on the trustees. In doing so they argued the description in the nomination, 'Trustee of Deceased Estate' meant Mr Munro's executrixes.

The Court held the nomination of 'Trustee of Deceased Estate' as the nominated beneficiary was insufficient to direct the trustees to pay the benefits to Mr Munro's 'legal personal representative', being his executrixes. It was noted that while the terms 'executor' and 'trustee' may be used interchangeably in a colloquial sense, the terms are distinct.

The Court held that the nomination was not binding. One may think this outcome both harsh and against the clear factual matrix underpinning the case.

6 Blended Families

As the cases above (see heading 5.3) make clear, blended families – those arising from one or more subsequent marriages – are ripe for family discord. More significantly, they are ripe for the trustee to exercise discretion where the other family members were to benefit but did not.

In the instance of second marriages where the member has children of an earlier relationship for whom the members wishes to provide, the member may use a binding death benefit nomination as part of their estate planning process. They could to so seeking to achieve any of the following:

Action	Advantage	Disadvantage
Nomination to the legal personal representative with benefits to be paid to a testamentary trust with independent trustee. The surviving spouse receives annual income of a set minimum amount.	No need to consider SIS Act and SIS Regulations The benefit (that becomes trust corpus) is not property of the marriage, but only a financial resource for Family Law Purposes	Likely to be death benefits tax Surviving spouse may be unhappy and make a family provision claim for inadequate provision. The benefit has left the concessionally taxed superannuation environment
Outright gift in the proportions the member wishes the spouse and children to benefit	Achieves finality With pension planning and re-contribution strategies, can be tailored to minimise or avoid	There may insufficient money to do this and it may leave insufficient money for the surviving spouse

	death benefits tax Avoids prospect of family provision claim with respect to superannuation benefits	It may not provide optimum asset protection An asset for Family Court purposes
Mutual Wills and binding nominations Under this option the pension is commuted or commenced to the surviving spouse and the surviving spouse agrees to make binding nominations and Wills which assures this benefit when the surviving spouse dies is directed to the original member's children (or testamentary trust for their benefit)	Gives the spouse the benefit of the entire superannuation savings whilst helping provide some assurances that what is left over goes to the original member's children and not the surviving spouse's children	Relies on the original member's children to litigate to protect their rights Unless carefully constructed can still be the property of the surviving spouse or family law benefits and therefore may be lost to a subsequent spouse of the surviving spouse Without careful planning, the surviving spouse may still be able to waste all of the superannuation benefit, thus leaving nothing to which the binding nomination attaches Inflexible and does not deal with unforseen circumstances and the usual problems with mutual and contractual wills Family provision claim could still be made
Creating special pension terms whereby the surviving spouse is paid a minimum income stream throughout the term of the pension but has no ability to commute or rollover the pension or draw any greater capital of the pension. Upon the death of the surviving spouse, the remaining benefits are directed towards the original member's children	May achieve client's objections	Complicated and expensive There may be breaches of the payment standard if benefits are thought to be paid from the surviving spouse directly to original member's estate or original member's children Surviving spouse may be bitter due to lack of control Surviving spouse still needs to be represented at trustee level

7 What Restrictions are there on a Trustee's discretionary powers?

In the author's experience entirely too little attention is given to the equitable obligations a trustee of a superannuation has when exercising a discretion provided by the superannuation fund documents. This is an area that requires attention and will, it is predicted, become more and more relevant as challenges to superannuation trustees decisions are made; these challenges are inevitable given the increasing degree to which intergenerational wealth is now held in super.

In the most general terms, a trustee is someone who has title to property, subject to obligations to deal with it faithfully or the benefit of a person or purpose other than the trustee. But to aim for more specifics, and say what a trustee must do, and what a particular trustee is free to do if he, she or it so chooses, you need to look to the facts about the particular superannuation fund concerned and the particular circumstances of the case that the trustee is determining. It has even been held that the identity of the trustee can be relevant to the construction of the trust instrument and how a trustee's discretion is to be exercised.[4]

Despite this requirement to always go back to the trust documents, a paper of this nature can only deal with more generalities. The discussion that follows is therefore of cases and issues that have arisen and would, in practice, need to be localised to the circumstances of a particular superannuation fund.

7.1 What is "discretion"?

The concept of "discretion" involves making a choice from a number of available alternatives, amongst which the decision-maker is free to choose. Some decisions of superannuation trustees are clearly discretionary in this sense – such as if the trustee has power to pay a death benefit to such one or more of the dependants of a deceased members as the trustee chooses, or such as a decision about whether to invest in one authorised investment instead of another.

There are other discretions that trustees of superannuation funds are sometimes called on to make that a are not discretionary in the sense described in the previous paragraph. They are decisions where entitlement to a benefit depend upon the trustee forming an opinion concerning a matter of fact. Analogy can be drawn here to situations where the power of a decision-maker to make a decision is dependent upon the decision-makers opinion about the existence of a jurisdictional fact (a reference to administrative law principles).

An obvious discretion the exercise of which is likely to be later scrutinised by the persons affected is the discretion trustees have to choose which of the dependants of the member will receive the benefit, and the definition of "dependant" is along the lines of "any child of the member and any other person who, *in the opinion of the trustees*, was at the relevant date wholly or partially depend upon him".[5] The formation of the trustee's opinion about whether a particular person was wholly or partially dependent upon the member at the relevant date is a precursor to the discretionary decision about which of the dependants will get the benefit.

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[4] In *Dundee General Hospital Board of Management v Walker* [1952] 1 All ER 896 the House of Lords took into account, in construing a gift dependent upon the trustees forming a certain opinion, that the trustees were people well known to the settler and were well placed to have personal knowledge about the subject matter – this must also be the case where the members of the fund are also the trustees or directors of the corporate trustee.

[5] Emphasis added. See generally *Attorney-General (Cth) v Breckler* (1999) 197 CLR 83 at [5]; *McFadden v Public Trustee (Vic)* [1981] 1 NSWLR 15 at 24; *HEST Australia Ltd v Skyley* (2005) 147 FCR 248 at [13].

7.2 Can the trustee's decision be reviewed?

The often quoted passage of McGarviie J in *Karger v Paul* [1984] VR 161 at 163-164 has resulted, in practice, in many trustees, especially of what are called "family discretionary trusts" not giving reasons for many decisions. His Honour there said:

> The discretionary power given to the trustees by cl 3, was a power, upon the request of Mr Smith, in their absolute and unfettered discretion to pay or transfer the whole or part of the capital of the estate to him. In my opinion the effect of the authorities is that, with one exception, the exercise of a discretion in these terms will not be examined or reviewed by the courts so long as the essential component parts of the exercise of the particular discretion are present. Those essential component parts are present if the discretion is exercised by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. The exception is that the validity of the trustees' reasons will be examined and reviewed if the trustees choose to state their reasons for their exercise of discretion.

There are two points to note about this passage. First, it relates to a discretion "in these terms" – that is, it is dealing with a particular trust instrument. A peculiarity of the terms of the relevant clause was that the trustees had power to transfer to one of them; at least in relation to that one any fiduciary duty not to derive a personal advantage from exercise of the power must have been impliedly negatived by the terms of the gift. Further, the power was described in these terms "absolute and unfettered discretion". Secondly, the allegation in the case was that the breaches consisted of not acting in good faith and not acting upon a fair and proper consideration. Thus, any statements of McGarvie J that, some different allegation that was not actually made in the case would be *obiter dictum*.

These points of note, themselves, show the broadness (if taken out of context) of the above statement may not be appropriate. There are also other decisions that establish a trustee's exercise of discretion is in no way immune to review or alteration.

In *Parkes Management Ltd v Perpetual Trustee Co Ltd* (1977) 3 ACLR 303 at 311 Hope JA (with whom Moffit P agreed) held:

> In equity, where a trustee has a discretionary power, that power "must be exercised with an absence of indirect motive, with honesty of intention and with a fair consideration of the issues": Jacobs Law of Trusts, 4th ed p 301. In Lewin on Trusts 15th ed p 32, the requirement is expressed to be that the trustee's conduct be bona fide and the determination not influenced by improper motives. There is ample authority for these propositions.

Chief Justice Barwick, in *Lutheran Church of Australia South Australian District Inc v Farmers' Co-operative Executor & Trustees Ltd* (1970) 121 CLR 628 at 639, said of a mere power conferred on a trustee:

> ... whilst the power is not in the nature of a trust so that the trustee must exercise it, equity would ensure that the trustee bona fide considers whether or not the power should be exercised, and that in doing so, proper considerations are in mind, and improper considerations excluded. The discretionary nature of the power does not mean that the

> discretion is absolute, in the sense that it can be exercised irresponsibly, capriciously or wantonly.

Another formulation of when an exercise of a discretionary power can be held ineffective is if the trustees act for reasons that are "irrational, perverse, or irrelevant to any sensible expectation of the settlor.": *Re Manisty's Settlement* [1974] Ch 17 at 26. Other cases have also highlighted what constitutes a valid exercise of a discretionary power – for instance, there being a duty for the donee of the power to exercise it in person and not under the dictation of someone else, and a duty not to fetter the exercise of a discretion.

In the context of a superannuation fund, Heerey J, in the Full Court of the Federal Court, in *Wilkinson v Clerical Administrative & Related Employees Superannuation Pty Ltd* (1998) 79 FCR 469 at 480 quoted a statement of Northrop J in the court below concerning the grounds on which an exercise of a trustee's power could be challenged in a court:[6]

> Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelevantly to any sensible expectation of the settler, or without giving a real or genuine consideration to the exercise of the discretion. The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable or unwise. Where a discretion is expressed to be absolute it may be that bad faith needs to be shown. The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness.

The joint decision of Gleeson CJ, McHugh, Gummow, Hayne and Callinan JJ in *Attorney-General (Cth) v Breckler* (1999) 197 CLR 83 suggests their Honours approved of the above quote.

These cases show that the exercise of a trustee will be subject of review and how they will be reviewed.

7.3 Test to apply to a superannuation trustee

Even though the formation by a trustee can be one of two kinds, the exercise of a discretion proper or the forming of an opinion on a matter of fact, the courts have held the same tests will apply in certain circumstances. In relation to the specific topic of a superannuation trustee forming an opinion on a matter of fact that is a precondition for payment of a benefit, McLelland J (as his Honour then was) in *Rapa v Patience* (unreported, Supreme Court, NSW, McLelland J, 4 April 1985) held that the principles of *Karger* apply to such decisions. That aspect of *Rapa v Patience* has been frequently followed.[7]

It seems that the basis for applying the same test for the exercise of a discretionary power to the formation of an opinion by the trustee is that forming the opinion in question is a task that has

[6] Citations in the quote itself are removed.

[7] See for example *Vidovic v Email superannuation Pty Ltd* (unreported, Supreme Court, NSW, Bryson J, 3 March 1995) at 15; *Baker v Local Government Superannuation Scheme Pty Ltd* [2007] NSWSC 1173 at [2]-[3] (McDougall J); and implicitly approved in *Hannover Life Re of Australasia Ltd v Sayseng* [2005] NSWCA 214 at [32] (Santow JA; with whom Spigelman CJ and Tobias JA agreed).

been conferred upon the trustee, and equity requires a trustee to carry out his or her task faithfully. Precisely the same sorts of circumstances as would lead to the exercise of a discretionary power not being carried out faithfully can also lead to a task of forming an opinion on a matter of fact not being carried out faithfully.

7.4 The *Karger v Paul* Test

The first task of a the court in deciding whether a trustee has exercised a discretion or formed an opinion appropriately is to turn to the trust documents, in this case the superannuation fund documents. Careful attention must be paid to the exact discretion that is under review. If the trustee has not considered the correct question, the decision is not the type of decision that the trust deed empowers the trustee to make, and so it is not an effective exercise of power. If the correct question(s) was asked by the trustee the court then reviews the way the trustee answered the question.

The court can be assisted in deciding whether a trustee has complied with the *Karger v Paul* requirements for the exercise of a discretion or formation of opinion by examining the material on the basis of which the trustees have made their decision. If on that material trustees acting honestly and reasonably could not have come the conclusion to which the trustee actually came, the decision is invalid. Justice Bryson said it thus in *Sayseng v Kellogg Superannuation Pty Ltd* [2003] NSWSC 945 at [63]:

> ... if the Trustee came to a conclusion which no reasonable person could have come to one of the first three grounds of challenge referred to in Rapa v Patience must be available; an unreasonable conclusion cannot be reached without either a failure to exercise power in good faith, or a failure to exercise the power upon real and genuine consideration, or a failure to exercise the power in accordance with the purposes for which it was conferred.

In finding that the decision is invalid the court need not identify precisely which of the first three grounds of challenge has been breached; it is sufficient to decide that one or other of them must have been breached. Such a process of reasoning is one that had been used by the High Court. In *Elders Trustee & Executor Co Ltd v Higgins* (1965) 113 CLR 426 at 451-452 Dixon CJ, McTiernan and Windeyer JJ said:

> the appellant has asked us to infer that, since mala fides or neglect is not to be imputed to a trustee from his silence alone, the various possibilities must have all been considered and a decision made to reject them. If that were so, the decision would seem to have been one that a prudent man, duly considering the relevant facts, could not reasonably reach.

The message to take from these cases would appear to be a trustee's exercise of a discretion is not immune to challenge – the usual principles of a fiduciary nature will impose restricting constraints and require the trustee to properly conduct the superannuation fund.

8 Enduring Powers of Attorney & SMSF

An enduring power of attorney is an essential document in the suite of documents that comprise a properly packaged and administered self-managed superannuation fund. With fund members increasingly travelling internationally, whether it be for work or pleasure, a risk arises that the fund of which they are trustees may breach s 17A of the SIS Act.

8.1 Enduring Powers of Attorney & Non-Enduring Powers of Attorney

Broadly speaking, powers of attorney come in two forms – general and enduring. Both are instruments by which the principal appoints one or more other persons to be their attorneys. They do so to enable the agent to do things which the principal would otherwise only be able to do under his or her own hand. These include, for example:

- withdrawing money from the principal's bank account;
- signing a transfer to sell real property registered in the principal's name.

In broad terms the difference between the two types of power of attorney is that an enduring power of attorney will continue after the principal loses capacity. A general power of attorney does not so operate.

Both a general power of attorney and an enduring power of attorney are simple documents to have prepared. Online providers will merely ask details of the relevant parties and produce a document for a small fee.

Importantly, however, because the enduring power of attorney continues once the principal has lost capacity there are additional requirements for the witnessing of the execution of that document by the principal.

Each Australian State and Territory has its own legislation when it comes to powers of attorney, and a power of attorney must be properly made under the relevant legislation. In New South Wales it is the *Powers of Attorney Act* 2003 (NSW). Other important facts to bear in mind when it comes to the power of attorney include:

- to sell real property under the strength of a power of attorney, that document needs to be registered at the land registry in the State or Territory where the property is situated;
- an enduring power of attorney can only be revoked by the principal while the principal has capacity with respect to the particular power being revoked;
- the power of attorney comes to an end when the principal dies; and
- legislation sets out a number of matters which can result in a power of attorney being revoked, either in full or in part.

When a principal appoints an attorney under an enduring power of attorney, the attorney needs to accept that appointment. The acceptance should be made after the principal signs the appointment document (although the same date is permitted). For caution the times could be entered next to the signatures or the principal can sign on an earlier day.

8.2 Relevance for Self-Managed Superannuation Funds

To qualify as an self-managed superannuation fund each member of the fund must either be a trustee of the fund or a director of the fund's corporate trustee. This threshold requirement for the very existence as an self-managed superannuation fund makes the use of an enduring power of attorney very important.

Subsection 17A(3) the SIS Act provides that an fund will continue to be an self-managed superannuation fund where, amongst other things:

> (b) the legal personal representative of a member of the fund is a trustee of the fund or a director of a body corporate that is the trustee of the fund, in place of the member, during any period when:
>
> (i) the member of the fund is under a legal disability; or
>
> (ii) the legal personal representative has an enduring power of attorney in respect of the member of the fund;

The term 'legal personal representative' is defined at s 10(1) of the SISA as follows (emphasis added):

> … the executor of the will or administrator of the estate of a deceased person, the trustee of the estate of a person under a legal disability **or a person who holds an enduring power of attorney granted by a person**.

The effect of these provisions is that:

- the enduring power of attorney is the key to allowing a fund to continue to qualify as an SMSF notwithstanding that the member may not be acting as trustee of the fund; and
- the enduring power of attorney "relief" can be invoked to assist not only when the member is under a legal disability.

It is also clear that leaving the enduring power of attorney, once executed, in a drawer is insufficient.

Where the attorney is to act for the principal in the context of an self-managed superannuation fund, subject to the following, the principal must resign as a trustee of the fund (or director of its corporate trustee) and the attorney be appointed in the principal's place. That is, the attorney is in lieu of, rather than in addition to, the principal.

Relevantly the Commissioner of Taxation states, in *Self-Managed Superannuation Fund Ruling* SMSF 2012/2 at [8] and [9]:

> [t]he appointment of the legal personal representative as a trustee and the removal of the

> member must be in accordance with the [fund's] trust deed, the SISA and any other relevant legislation…
>
> …where a corporate trustee is involved, any removal and appointment must also be properly made under any constitution for the corporate trustee and the *Corporations Act 2001*.

So the fund deed and the *Corporations Act* 2001 (Cth) are also relevant.

If the SMSF has a corporate trustee and the member does not want to step down as a director of that company, provided that the enduring power of attorney is correctly drafted for that purpose the attorney can be appointed as an alternate director on the board of the trustee company. Where the attorney is an alternate director only, the member can stay on as a director of the fund trustee, although, without limitation, the alternate director will only be able to perform the duties of a director while those duties are not being performed by the member director.

8.3 Further Points to Consider

There are several points to consider and, where necessary, address in using an enduring power of attorney in a self-managed superannuation fund environment. These include, but are not limited to, the following:

- The appointment of the legal personal representative will only be valid while the underlying instrument for the appointment is valid.
- The mere fact of the appointment may not be enough in all circumstances to save the fund for the purposes of it qualifying as a self-managed superannuation fund. Any other breaches of the SIS Act or SIS Regulations will not be avoided by the existence of an enduring power of attorney.
- Where any change is made to the officeholders of a company (including a company acting as trustee of a self-managed superannuation fund), the Australian Securities & Investments Commission must be notified of that change on the prescribed form within the requisite timeframe (presently the ASIC lodgement period is 28 days from the date of the change). Failure to notify ASIC of the change within the requisite time will result in the imposition of a late lodgement fee.
- A person will only be eligible to act as the trustee of a fund or a director of its corporate trustee if that person first consents in writing to that appointment: s118 of the SIS Act.
- A company will have contravened s201D of the *Corporations Act* 2001 (Cth) if it appoints a person as director of the company prior to that person giving the company the person's signed consent to act as one of its directors.
- Where a person is ineligible to act as either the trustee of an self-managed superannuation fund or a director of its corporate trustee, that person will not be able to assume the office from which the person is barred on the basis that he or she is the attorney for a fund

member under an enduring power of attorney.

8.4 Agent's Level of Responsibility

When a person is acting as trustee of a fund, or the director of a corporate trustee, that person is not relieved of any of the obligations otherwise applying to people administering the self-managed superannuation fund. The legal personal representative will, that is, bear all the burdens of a fund trustee. In *Managed Superannuation Fund Ruling* SMSF 2012/2 at [12] the Commissioner of Taxation

> ... as the legal personal representative is acting in a personal capacity as a trustee of the SMSF, the legal personal representative is subject to civil and criminal penalties for any breaches of their duties under the SISA or other legislation. Likewise, a legal personal representative who is a director of the corporate trustee is also subject to civil and criminal penalties for breaches of the SISA and the Corporations Act.

In these circumstances, it is vital that the proposed agent, who is to become the trustee or director of the corporate trustee, must understand the extent of the obligations they assume.

8.5 Multiple Appointments

In *Managed Superannuation Fund Ruling* SMSF 2012/2 at [65] the Commissioner of Taxation set out his view in relation to multiple appointments. There he said:

> … where one member has granted an enduring power of attorney to more than one person, one or more of those people can be appointed as trustee or director in place of the member.

This does not address the issues of multiple appointment being 'joint' or 'several', but it does confirm that a multiple appointment instrument can still operate for the purposes of the SIS Act and SIS Regulations.

9 Superannuation proceeds trusts

Division 6AA of Part III of the *Income Tax Assessment Act* 1936 (Cth) (the '**1936 Act**') discourages 'income splitting' by means of diversion of income to children to take advantage of the tax-free threshold and progressive tax rates. Broadly speaking, the provisions apply a 45% tax rate on unearned income of minors. Such income includes certain distributions from trusts.

However, Division 6AA of the 1936 Act does not apply to certain 'excepted trust income'. Such trust income includes that from a 'superannuation proceeds trust'. That is, superannuation proceeds trusts may be established by the transfer of property from a superannuation fund, as a result of the death of a person, to a trustee of a trust which will hold the property for the benefit of a child.

Subparagraph 102AG(2)(c)(v) of the 1936 Act provides that:

'(2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:

…

(c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary:

...

(v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;'

The terms of the trust must provide for the beneficial acquisition of trust property by the beneficiary upon the termination of the trust.

Although death benefits do not generally form part of an estate, generally speaking, superannuation proceeds trusts are established under the terms of a will. Such a transfer may be ensured via a binding death benefit nomination.

The Commissioner of Taxation, in *Interpretative Decision* ID 2001/751, accepts that even where a superannuation death benefit is paid to a trustee, apart from the estate (e.g. so as to satisfy the superannuation cashing rules, to an adult child of the deceased), in order to assess whether the superannuation death benefit tax concessions apply, one should look through the trust to the underlying beneficial ownership of the trust.

This would be the situation if the beneficiaries of such a trust were minor children of the deceased.