



THE THREE LEVELS OF SANITY (+ 1) IN HANDLING YOUR SMSF ESTATE -THE SIMPLE CASE FOR AN SMSF WILL

It is a common belief that when you die, your superannuation entitlements will automatically be dealt with by your Will.

This is simply not correct.

When you die the distribution of your superannuation entitlements is *not* governed by your will. (See McFadden –v- Public Trustee for Victoria [1981] 1 NSWLR 15,22) It is governed by the trustee of your superannuation fund. Your SMSF trustee decides how the distributions are to be made, *subject to* the terms of the superannuation trust deed and relevant legislation. Your Will only becomes relevant if the distributions are paid to your legal estate by your SMSF trustee.

Let us see what in effect can happen to your superannuation entitlements when you die. This can give you a simple understanding of why you need a SMSF Will.

Some superannuation funds allow you to make a direction, called a Non-Binding Death Benefit Nomination. The difficulty is as the name says. It is not binding on your trustee & the trustee may very well decide to ignore it.

Let’s have a look at how this impacted on a family in **Katz’s Case**.

Katz v Grossman [2005] NSWSC 934 highlighted the shortcomings of Non-Binding Death Benefit Nominations & also the importance of choosing the trustees of a SMSF carefully.

Mr. & Mrs. Katz were members and trustees of their SMSF. They had two children, Linda and Daniel. After Mrs. Katz died, Mr. Katz appointed Linda as co-trustee of the fund. Prior to his death, Mr. Katz made a Non-Binding Death Benefit Nomination in his Will stating that his two children, Linda and Daniel, were to receive his entitlements in the SMSF in equal shares on his death. Later, when Mr. Katz died, Linda appointed *her husband* as co-trustee of the fund which she was legally entitled to do. Linda and her husband (as trustees of the fund) could legally decide who received Mr. Katz’s superannuation entitlements. Linda and her husband resolved to pay all of Mr. Katz’s superannuation (approximately \$1 million!) to Linda to the exclusion of her brother Daniel. Daniel took the matter to the Supreme Court. Unfortunately for him, the Court could not change what had occurred as it was in accordance with the law, and Daniel received no part of his father’s superannuation death benefits.

Quite simply if you choose to rely on Non-Binding Death Benefit Nominations it may be said that you are very insane.

Let’s go up a level of sanity with your handling of your SMSF Estate.

Some superannuation funds allow you to make a legally enforceable direction, called a Binding Death Benefit Nomination. (BDBN) This is a written notice to the trustee of your super fund which sets out who will receive your superannuation entitlements upon your death, and what you want them to receive. The BDBN must comply with the rules of your super fund, as well as the law. It is arguable that it needs to

be updated every three years in order to be valid and binding. It would certainly be more prudent to follow this approach.

The dangers of failing to provide a *complying* BDBN can be seen in the February 2009, Queensland Supreme Court case of **Donovan v Donovan** [2009] QSC 26.

In this case, Mr. Donovan established a superannuation fund with a corporate trustee. Mr. Donovan was a member of the SMSF. Mr. and Mrs. Donovan (his wife by a second marriage) were also the respective Director and Secretary of the corporate trustee.

The revised trust deed of Mr. Donovan's super fund required a corporate trustee to be bound by a BDBN, where it satisfied 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, which Mrs. Donovan now controlled.

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 regulation 6.17A (6) of the *Superannuation Industry (Supervision) Regulations 1994* (Cmth.) to be binding on the SMSF trustees. The court held that the letter was not in the form prescribed by the act. As such Mr. Donovan's letter was not a BDBN, & the corporate trustee was accordingly not obliged to distribute Mr. Donovan's superannuation entitlements to his legal personal representative for inclusion in his legal estate.

Quite simply if you choose to rely on a Binding Death Benefit Nomination it may be said that you are *quite* insane.

Let's go up a level of sanity with your handling of your SMSF Estate.

In accordance with the provisions of the superannuation laws, specifically section 55(1) of the Superannuation Industry (Supervision) Act 1993 (Cmth) [SIS Act], neither the trustee of a superannuation fund nor any other person, can breach any of the governing rules of the fund. Such a breach may jeopardise the fund's complying status and thus its concessional tax status. Additionally it may render the trustee liable to significant monetary penalties or being replaced by a trustee appointed by the Commissioner of Taxation.

The governing rules are defined under section 10(1) of the SIS Act to include the fund's trust deed and any other rules made by the trustee of the fund including a SMSF Will made on behalf of a member. Therefore, before a SMSF estate plan can be created, a thorough review of the trust deed must be undertaken to determine if the provisions of the Deed allow a SMSF Will to be established.

The following is an extract directly from our SMSF Trust Deed and Governing Rules, which has been drafted to carefully take into consideration SMSF estate planning needs:–

11. Rule 11 – Creating a Member SMSF Estate Plan and SMSF Will SMSF Will and Non-Lapsing Binding Nomination

11.1 A Member may provide the Trustee with a request to accept any of the following:

- a) A Non Binding Death Benefit Nomination in the format as provided for in Schedule 1 of this document;
- b) A Binding Death Benefit Nomination in the format as provided for in Schedule 2 of this document;
- c) A Non-Lapsing Binding Death Benefit Nomination in the format as provided for in Schedule 2 of this document;

d) A SMSF Will incorporating a non lapsing binding death benefit nomination and non-lapsing directions to the Trustee to be drafted in accordance with the provisions of this document.

11.2 Any of the documents referred to in Clause 11.1 above may provide written direction to the Trustee requesting:

a) the manner and form in which Death Benefits will be paid in the event of the Member's death to one or more beneficiaries including as a lump sum, pension or combination of both.

b) the Beneficiaries the Death Benefits are to be paid to including the Dependants of the Member, the Member's Legal Estate or such person as are otherwise allowed to receive a Member's Death Benefits under the Superannuation Laws.

c) the amount or amounts of the Death Benefit to be paid to one or more beneficiaries in the event of a Member's death including the transfer of part or the whole of any Fund Asset in satisfaction of the payment of an amount of Death Benefit.

d) the terms and conditions upon which a beneficiary is to receive a Death Benefit from the Member's SMSF Estate including whether the Death Benefit is to revert to another person,

e) Legal Estate or entity in the event of the beneficiary's death, incapacity or the happening of a particular event.

f) the terms and conditions regarding the payment of any Reserve Benefit to the deceased Member's Dependants or Legal Estate.

g) the terms and conditions regarding the payment of any insurance proceeds payable on the life of the Member including a payment to an Anti-Detriment Reserve, the deceased Member's Dependants or Legal Estate.

11.3 The Trustee of the Fund may accept in writing or at a Trustee Meeting part of or all the Member's Non-Binding Death Benefit Nomination, Non-lapsing Binding Death Benefit Nominations and SMSF Will request, however, the Trustee is not obligated to do so.

11.4 Solely at the Trustee's discretion if the Trustee accepts part of or all of a Member's Non-Binding Death Benefit Nomination, Non-lapsing Binding Death Benefit Nominations and Member SMSF Will, the Nominations or SMSF Will shall become a Special Rule of the Fund.

11.5 The Trustee may at the request of the Member create a Special Rule to make provision for the requirements of that Member's Non-Binding Death Benefit Nomination, Non-lapsing Binding Death Benefit Nominations and Member SMSF Will.

11.6 The Trustee may determine whether any Special Rule created for a Member can be varied and under what circumstances including allowing a Member or the Trustee to be the only person that can vary the Special Rule in accordance with Rule 11.4 and 11.5

11.7 The Trustee may at the request of the Member amend the provisions of the Deed to enable the provisions of the Special Rule to establish the applicable Member's Non-Binding Death Benefit Nomination, Non-lapsing Binding Death Benefit Nominations or SMSF Will.

11.8 The Trustee and Member may first obtain expert advice from a SMSF Specialist adviser prior to making any formal request or acceptance of a Member's SMSF Will.

11.9 The Trustee is not bound by any Member's Non-Binding Death Benefit Nomination.

Smart SMSF estate planners make use of a SMSF Will to steer where they wish for their SMSF estate to go upon their death. A properly drawn SMSF Will becomes a binding rule of the SMSF, and one that cannot be varied by anyone except the Member making their SMSF Will once accepted by the Trustees of the SMSF. This provides great security for the member in relation to their Death benefits.

A death benefit binding direction allows the member to direct the trustee as to how their death benefits are to be distributed and in what form. Additionally, it can direct the trustee as to who the deceased member's replacement trustee is to be. This is achieved by writing or embedding into the Fund's governing rules the member's death benefit binding direction so that it has the force of the trust deed and the SIS Act.

The death benefit binding direction inside a SMSF Will provides a member with the most secure option in terms of their SMSF estate planning. One may say it is the sanest way for you to proceed with your SMSF estate planning!

Couple this with auto-reversionary pension documents and your SMSF death benefits are soundly protected for those that you intend to receive them.

It is advisable that a person wishing to create an SMSF Will & Auto-reversionary pension documents seek expert advice from SMSF Law Equityprotect prior to finalising any documents.

And if this information isn't yet convincing enough let's go up just one more level of sanity with your handling of your SMSF Estate.

The Final Judgement of the SUPREME COURT VICTORIA was handed down in the case of WOOSTER -V- MORRIS on the 1st NOV 2013. The facts in dot point format are>>>

- Blended Family!!!
- SMSF established by Deed – 24th AUG 2005
- Trustees & members = Mr Morris and Mrs Morris (his 2nd wife)
- Mr. Morris died 27th FEB 2010
- He had E\$900K in his pension account
- He had made a Binding Death Benefit Nomination (BDBN) in favour of his daughters from first marriage to exclusion of his 2nd wife
- OCT 2010 2nd wife brought her son in as second Trustee
- 11th MAY 2011- 2nd wife took legal advice and was advised that the Mr. Morris' BDBN was not valid as deceased had not complied with requirements in SMSF Deed
- 16th AUG 2011- 2nd wife took legal advice and was advised deceased member's death benefits could be paid to herself within the fund as a pension
- 18th AUG 2011- Corporate Trustee appointed- UPPER SWAN NOMINEES P/L . 2nd wife sole Director. 2nd wife & her son resigned as Trustees. UPPER SWAN NOMINEES P/L as Trustee accepted the legal advice that the BDBN was not binding. Death benefits were paid to 2nd wife as a pension.
- **Dispute over a BDBN**
- Plaintiffs = Deceased member's daughters from first marriage
- Defendants = 2nd wife of Deceased (a Trustee & Member of the SMSF), her son as one of the Trustees of the SMSF, and new SMSF Corporate Trustee - UPPER SWAN NOMINEES P/L

BDBN

The Special Referee held the BDBN was binding on Trustees of SMSF namely 2nd wife & her son until 18th AUG 2011, & then on the Company Trustee

WHO PAYS THE JUDGEMENT???

Justice McMillan>>> "Cl 3.4 of the [SMSF] Deed provides any member, dependant or beneficiary has an interest in the trust fund of the [SMSF] as a whole, not in any particular part of the fund. In any event the deceased's account was transferred into 2nd wife's account & it is not now appropriate to try to pry the two accounts apart." **"The orders [Judgement & Costs] made against the [SMSF] should come out of the fund as a whole not just the interests of the deceased. This outcome best reflects the terms of the [SMSF] Deed and the way the [SMSF] has been managed."**

ON THE ? OF INDEMNITY BY SMSF FOR THE TRUSTEES

Justice McMillan>>> “There is no doubt the defendants had a right of indemnity out of the [SMSF] . . . According to the general law and [SMSF] Deed.”

“There are two decisions made by [2nd wife] that given that she did not seek the advice of the court amount to her breach of her obligations to the [SMSF];

1. Deciding the BDBN was not binding, &
2. Deciding to defend these proceedings.

In making both decisions she failed to act impartially, putting her interests ahead of the other beneficiaries of the [SMSF]. She should have recognised her conflict of interest and sought the advice of the Court before making either decision.”

“If [2nd wife] and the company Trustee were permitted to claim an indemnity, the costs of the wrong headed defence will be borne by the [SMSF]. Instead, the defendants should pay the costs consequent upon the decision to defend the proceeding”.

COSTS ORDERS-

Against company Trustee **& against 2nd wife personally!!!**

Justice McMillan>>> “In my view the existence of the corporate Trustee should not protect [2nd wife]” “There is no reason why the presence of a corporate veil should preclude a costs order against a controlling Director who stands to benefit from the proceedings.”

“The paramount duty of a Trustee is to exercise its power in the best interests of the present and future beneficiaries of the trust holding the scales impartially between the different classes of beneficiaries. In my view [2nd wife’s] substantial financial interest in the outcome and the lack of concern for the other beneficiaries in making the decision to defend the proceedings mean it is unfair that if UPPER SWAN is unable to pay all the costs award made against it, it should fall upon [2nd wife] in her personal capacity to meet any shortfall.”

The 2nd wife (Mrs. Morris) died prior to the final orders being handed down by the Supreme Court. I looked after her personal estate planning before she died but not her SMSF Estate planning. She died of cancer and being embroiled in this case may well have been the catalyst that brought on her illness. After costs orders are paid it is unlikely that her family will see any money from her personal SMSF holdings. They will likely all be lost in costs.

THE MORAL TO THE STORY IS THAT THE QUALITY OF YOUR SMSF ESTATE DOCUMENTS ARE PARAMOUNT!!! ALL OF THE CASES ABOVE WERE DETERMINED ON THE CONTENT OF THE DOCUMENTS THAT WERE BEFORE THE COURT. SO PLEASE CONTACT US NOW TO ASSIST WITH YOUR CLIENT’S SMSF DOCUMENTS. A PERSON’S SMSF ESTATE IS OFTEN THEIR No.1 OR No.2 ASSETS BY SIZE IN THEIR HOUSEHOLD. IT DESERVES PROPER CARE AND PROTECTION.

**“Prevention IS better than cure in the real world,
AND PREVENTION IS OFTEN VERY
MUCH CHEAPER IN THE LEGAL WORLD”.**

**From the desk of Shane Ellis
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*Shane Ellis is the Managing Director of the Shane Ellis legal Group including SMSF Law Equityprotect. He is a Senior Consulting Lawyer specialising in **SMSF ESTATES & LAW, FAMILY ESTATE PLANNING, and Asset Protection Structuring & Business Structures**. He is one of few lawyers in Australia to hold SPAA ACCREDITED SMSF SPECIALIST ADVISOR status & ASIC RG 146 SPECIALIST SELF MANAGED SUPERANNUATION FUND ACCREDITATION. He has won Best of the Gold Coast Awards for three consecutive years for quality of legal services. He speaks regularly to business and professional groups on SMSF Estate Planning; Asset Protection & Business Structures & for the Queensland Law Society Magazine 'PROCTOR' on patterns for success in business.*

Shane is available to assist you!

Shane would love to speak to your clients on these matters and assist you with the growth of your business.

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