THE GUIDE TO SUCCESSION, ASSET PROTECTION AND ESTATE PLANNING

By Grant Abbott

1. The Art of Tax Strategising – the Power and Passion of it all

I did a Masters of Law in the 1980's and was lucky enough to be tutored by the "best of the best" when it comes to tax strategies. Professor Ross Parsons, Professor Richard Vann, Professor Graeme Cooper and Professor Robert Deutsch – these guys really knew their stuff. As a very young man I used to sit in the tutorials and watch them pull apart the newly introduced capital gains tax and imputation systems and come up with, let's face it, schemes to use the laws to the best advantage of the taxpayer. I remember very well the first look over the imputation system with them, back in 1985, where they created in the tutorial the idea of an exempt tax paying shareholder(such as a super fund or charity) lending their shares into a trust which was held by a resident taxpayer. The exempt shareholder would get interest equivalent to their dividend with a premium and the resident beneficiary a small amount of cash dividend distribution but a stream of franking credits. The laws in the early days of imputation simply required $1 of assessable income under section 97 of the ITAA 36 and all the franking credits would fountain out. And it was a great win all around as franking credits were not refundable in these days.

Now you can imagine as a young student this was overwhelming as I was doing my Master of Laws full time while acting as the Research Officer at the Tax Institute of Australia and while an academic, I admit I had no real practical experience in terms of entities. But some of the other students in my class fermented these ideas and created huge investment products in the leading investment banks at the time, making many $millions for the bank from that one strategy. Of course tax revenue suffered and the laws were changed but the strategy lasted a good decade or more.

They showed me, and hundreds of students that went to their classes how to strategise – look at the law, apply it to a range of case studies, see the result, tweak it and then run the documentation (evidence) to mark it work. As I said, I was very naïve in those days but over time I was lucky to fall into one of the greatest tax strategies of all time – superannuation. In 1988 I was working for KPMG in their tax consulting division and was given a new client of the firm, Citicorp Life, a life insurance subsidiary of Citibank. Some of the investment banking team at Citibank had worked out that if the life company offered generous short term annuities – one to five year terms with underpinning interest rates better than the banks could offer then the Australian cash investors would love it, particularly being guaranteed by Citicorp Life's parent – Citibank.

Now here is the strategy and it was smart.

Under tax law a life insurance company had three statutory funds (much like an accumulation and pension fund in a super fund). One fund held premiums and investments for ordinary life business such as endowment and life bonds and was taxed at 39% - another had monies invested by superannuation funds and taxed at 15% and the final one, monies held for annuities and taxed at 0%. So there was the strategy kicker – being able to offer better rates because the product which was in all essence a term deposit – pay $100,000 – receive monthly annuity payments and at the end of the period receive the final annuity payment and the $100,000 back – called the residual capital value. But it got better because the underlying investments in the annuity fund were motor leases so the cash flows from the leases which were tax free to Citicorp were paid to the annuity holder. In comparison if the bank had the motor leases on its books any profit was taxed at 39% - so there was a great tax arbitrage which they could pass onto the consumer. It was so successful that within the space of 2 years more than $1 billion had been taken in by way of annuities and Citicorp Life held more than 90% of all motor vehicle leases in Australia. For those in the know it was one of the first ever securitisation projects undertaken in Australia and there I was in the middle of it.

The big turn in my life came when the COO of Citicorp Life had received a lot of interest from superannuants who could roll their super, once retired into an annuity, leave it five years then do it again. And of course I had to learn all about superannuation, rollovers, ETPs and everything there was to know about life insurance products, pensions and annuities – hence why I can cite annuity cases back to 1780 and even earlier. This led to me being the super guru and knowing about different investment strategies, switching assets between statutory funds for tax benefits, imputation credits, the Occupational Superannuation Standards Act 1986, SGC and ultimately being there at the birth of SMSFs on 1 July 1994.

And to think I spend every day of my life strategizing with cases and client circumstances that come to me from our LightYear Docs advisers. No wonder I get early in the morning with passion – it is what I was built for as are most accountants and financial planners. Compliance – blah; but strategies – game on.

2. The AHA moment – the second level of Mastery which leads to ...

There came a time, when I was doing my four day SMSF adviser course that accountants who had worked for many years doing SMSFs would suddenly become overwhelmed with what was going on. The dive into sections in the Superannuation Industry Supervision Act 1993 upended many of the preconceived beliefs. Remember the SMSF running a business example we have looked at and the claims it breached the sole purpose test. This was a fiction promulgated by many, quite famous industry lawyers for many years, only to be shot down by the Commissioner of Taxation. Let's face it if CBUS super fund with all of its building construction in every capital city in Australia is not running a business then what is?

That moment when your beliefs are shattered is a true "AHA" moment and also an indicator of the second level of mastery – *conscious incompetence.* It is that point in time when you accept you don't know what you don't know and either give up or learn and become consciously competent. I remember going down the track of building a Registered Training Organisation a decade ago and had spent more than $40,000 to build manuals, set up systems but then my "AHA" moment came when a good friend asked me why did I want to be in the business of being an RTO. And I couldn't come up with one single answer and that was the day my RTO idea was shelved and I partnered with Terra Cordis, who were highly skilled at being an RTO. So I lost $40,000 but if I had continued down that path of my own conscious incompetence it would have taken time and resources which could have been better invested elsewhere.

From the depths of unconscious incompetence we can move forward, listen and learn and aspire to become consciously competent. In the early days of SMSFs there was a lot of unconscious incompetence going around but over the past 25 years, practitioners operating in the SMSF industry are generally consciously competent – the third stage of mastery. Some more than others of course, but with all the training, the ATO rulings and plenty of daily emails to read, the industry knowledge is the best I have ever seen. With one exception – planning for the death of a member. With 90% of super benefits directed to a member's estate there are real family provision problems. And that excites me as it is new learning for everyone including the old die hard lawyers. There must be a better way!

Here's one to leave you with – can the Trustee of a SMSF establish a SMSF Death Benefits Trust on the death of a member, a trust that bypasses the estate and any family provision claim? If you know the answer to that you are consciously competent – if you would like to find out and admit you don't know the answer you are consciously competent and if you say that it can't be done, it's impossible, you may just be unconsciously incompetent.

3. It's about Family not compliance or tax savings

For most couples the family is one of the most important things in their life. Travel, good health and wealth are up there but family is ever so important. Ask yourself the question: What would your life be like without your family? Sometimes we wish that for a minute or two but our most important moments are with our family. The time my daughter Sophia was born and I got to bathe her the first time I turned into a blubbering mess and I can still feel that warm emotion. Then there are the tough times. Having to tell my father (who was a CEO of a large insurance company prior to retirement) that we had to put him into a nursing home because his constant falling was overloading mum and causing her serious health problems – that was heartbreaking. Seeing him now with dementia – it is tough. Then there are times I have been in a hole and Mum and Dad have always been there for me, I appreciate and love them so much. A billionaire who shunned the trappings of his wealth to go home to live with his mum and dad in their basement once told me that FAMILY means Father And Mother I Love You.

Now don't get me wrong there are a lot of times I have had to get my daughters out of a financial mess and helped brothers and parents – but that is the deal we made at birth and I am guessing that there are a lot of us out there like that. In fact 98% of the population put family as one of the top three most important things in their lives. So I am with the majority. But let's have some fun here where do you think compliance with the SISA or ITAA sits in terms of importance – is it in most people's top three? Would you clients drop everything and rush in to see you if there was a compliance issue with their SMSF? In fact are they even interested in learning about compliance or do they just tell you to do it all because there are more important things in their life.

So instead of compliance if you could show them a way to protect their family and family's wealth, would they be interested in that? Absolutely! We are not in the old days anymore where couples live together for all of their lives – blended families are a reality, same sex unions are not uncommon, warring children and their spouses are also a common theme and the problem of elder financial abuse is rearing an ugly head. Plus there are lawyers who will get in there and stir the pot – which we shouldn't be surprised about as it is their job. This stuff keeps people up at night, causing worry and anxiety, it creates health and wealth problems.

In December 2019 at LightYear Docs we introduced a whole range of family and family wealth protection measures and videos to go with them from state based Enduring Powers of Attorney for SMSF trustee purposes, Leading Member SMSFs and Discretionary trusts to ensure benefits and distributions only go to lineage or bloodline plus provide veto control for the Leading Member, succession planning, SMSF Wills, Wills with in-built testamentary trusts and they are hitting their mark (and we have a lot more exciting developments coming). I know that they are spot on because we have had more than half a dozen adult family members take it upon themselves to build their own Moat around their family – not just themselves but their parents and their children. It has been so exciting to watch them absorb the videos and come up with plans to protect their family. All my professional career I have been talking compliance and tax to professionals – who love it, but when I get in front of mums and dads, the excitement is not there. Tell them about putting a Moat around their family and you have not only got their interest but a real, palpable motivation.

For us tax and compliance is important but put yourselves in your client's shoes – Family – Tax or Compliance – what really motivates them the most? If you can answer that for each client a whole new world of advising awaits you, filled with challenge and passion, helping Australian families and being their most important adviser. Now that means something.

4. **Expect the Unexpected and move Fast**

Life throws things at you and you either sink or swim. I call them life examinations - you are either n it, remain focused and move through things quickly with a planned process or freeze and run away. I know because I am in deep at the moment with my mother who has a blood pressure over 200, can hardly walk and me having to deal with everything. I was lucky enough to be here in Adelaide for a quick visit find out how bad things were. She had put up a good fight for the last six months despite four trips to hospital but at some time, it's time. It was no surprise when she told me on Australia day that she wanted to go into residential care where my father has been for the past three years. So where to start?

Check the legals!

First step was to find her EPOA and when did it apply. Mum had an EPOA where I was the attorney so that was a good start. BUT it did not commence until she was diagnosed with a lack of mental capacity – which does not help her now. So I went to LightYear Docs and completed an EPOA that started immediately upon signature which will happen asap letting me make decisions for her. She is completely overwhelmed and that's a fast track to hospital with that blood pressure.

The next step was any Advance Health Care Directive)"AHCD") which provides her directions as to resuscitation, being fed intravenously, put on life support and what is to happen at her funeral. Surprisingly she did not have an AHCD despite for years telling me she did not want to be fed through a tube or kept on life support. So I immediately went upstairs to my dad's old office and created an AHCD using the LightYear Docs Hub, a document due for release when we launch our SMSF Living Will in the second quarter of 2020. While I was there I had a look at my father's AHCD which had been completed by a local legal firm for $800 and it was very minimal with most sections not completed. We can't change it as Dad is no longer mentally competent. It is what it is, even though limited in operation.

Then I had a look at her Will and it was okay with all of her assets to be split equally between her three boys. Still open to challenge – nothing can save that unless we transfer her monies to a Leading Member Discretionary Trust but with the house having to be sold to fund the nursing home for both Mum and Dad, well we can all do the math and all her boys are pretty tight. Personally I want them to enjoy the final years of their life without concern for their welfare or funding as do my brothers.

The next step is an Aged Care Assessment Test, then see if we can get her into the nursing home where my dad is, sell the property, pay off the reverse mortgage, work out social security and anything else to take the stress and worry from my mother.

Now I know what I am doing as do many of you, but there are thousands of Australian families who don't so they run away, procrastinate and hide until it becomes too late. For me this is what we are here for, to make the difference, to cut through the red tape and look after the families needs, particularly the senior members during but also when their lives come to an end, when their plans and our advice give new life to their death.

So expect the unexpected and move fast for them. It really makes a difference.

5. Protect your Client's and Your Family Wealth – the Greatest Gift of All

It takes a long time, good management, great ideas and insights plus careful budgeting, good advisers and skills to build family wealth. Yet family wealth is so vulnerable and open to attack by bad actors, lawyers, agencies, regulators and the government. Look no further than the WA Supreme Court case of **MILLER -v- TAYLOR [2018] WASC 75** where a second spouse of the deceased contested a will providing the entire estate – valued at $600,000 to his children from his first marriage. The presiding judge Justice Jeremy Curthoys ripped into the team of six lawyers, who by the time it came before him in the Supreme Court, more than $500,000 in legal fees had been racked up leaving any proper provision for the deceased's de facto spouse Angela Miller as well as ensuring his two children missed out.

The only winners were the lawyers. A lawyer made a will for the deceased ten years prior to his death and then other lawyers attacked it under the Family Provision Act (WA) 1972 ravaging the estate according to Justice Curthoys.

I ask is there no justice for the poor family left behind? And how often do lawyers overcharge or create and foster fights to boost legal fees? More importantly could things have been done differently to deliver a result and protect the estate?

Now this is not an idle case - look at *Katz v Grossman* [2005] NSWSC 934, a fight for SMSF death benefits between a brother and sister or *Donovan v Donovan* [2009] QSC 26 where the de-facto spouses SMSF death benefit payment was taken on by a child from the deceased's first marriage. And I could list another 100 cases easily and many relating to discretionary trusts as well as unpaid present entitlements.

So here is some wisdom. The first motto of family wealth protection is: "If there is a family estate, the greater the estate the more likely the challenge". This leads us to the second motto: "If there is a challenge legal fees are expected to be at least 20% of the estate and more if you come across some bad actors as in Miller v Taylor".

So we are left with a predicament. If an estate, SMSF and discretionary trust are all open for challenge by the Family Court, Family Provisions Act, regulators, creditors and just plain bad actors seeking to rile up a legal challenge to get legal fees, what can the client do and I ask you this one question – *would you want to be the adviser that can deliver a real solution to protect the client's family wealth?*

With SMSFs now holding $750Bn and more than $350Bn of that becoming a death benefit in the next 20 years, the protection strategies are vital for your clients and your own family wealth protection.

6. It's all about Protection

In the case of Andrea Miller, who challenged her spouse's will, was successful and to be awarded $220,000 out of a $600,000 estate, except by the time it had got to the WA Supreme Court, more than $500,000 of legal fees had been incurred. Sorry Andrea! If this could happen with a $600,000 estate can you imagine what would arise with a $2m contested estate. Apart from $150,000+ in legal fees, expect the time to judgement or settlement to be at least two to three years with all the family fighting and hating for that period of time. Want to know what hate looks like – read the Andrea Miller case.

So we are faced with a choice as a professional – we put our head in the sand and let the chips fall where they lie or we facilitate the building of a protective barrier around our clients structures and affairs. And what better protection than a MOAT. Now if you don't know what a MOAT is it is a fortified protection used in Medieval times to keep the angry hordes and the enemy away. Some were known to be filled with angry water creatures and a variety of booby traps and if the enemy were dumb enough to enter the MOAT they became sitting ducks for the archers. No MOAT and the first line of defence was the town or castle's walls - the families, women and children were exposed and we have seen enough movies to see how that plays out. Worse still the villages that had no walls or MOAT were easily overrun by bad actors dong what bad actors do.

So it is MOAT time where we build a fortified protection from the lawyers, litigators, bad actors and scammers seeking to rob and steal from our clients family wealth. Now if the Family Provisions Act enables unlimited challenges to an estate, the collapse of many binding death benefit nominations creating havoc for SMSFs and the tying up of discretionary trusts with hacks and attacks by the legal profession – we have to make sure all components of the MOAT are strong, effective and impassable. We want the lawyers and the bad actors to take one look and know that it is too hard for them to expend their energy on this family. Let them put their nose in the air and run to the next family – there are plenty of aggrieved ones out there. And that is the aim of the MOAT, making it too hard and too costly to mount a challenge risking legal fees, resources and coming up empty. No lawyer in their right mind would sign up for that – particularly the "No win – no fee" kind.

Let's start on the most successful MOAT of all, the structures and strategies built around the Windsor Royal Family and how a bad actor such as Prince Andrew can find himself on the other side of the MOAT with his tail between his legs and no opportunity of a challenge. Once we learn how the best of the best do it, we can copy and tailor how it is done, applying it to our own and our client's circumstances.

7. Lineage or Bloodline and Line of Succession

I know a lot of lawyers talk about bloodline when dealing with Wills and Testamentary Trusts. I on the other hand prefer lineage and if we look at the British Royal Family and its current travails it is easy to see the difference between the two. But first let's look at some definitions:

"Bloodline" is any person who share the same root DNA as the member of a super fund, beneficiary, appointor of a trust or the testator in their Will.

Whilst

"Lineage" is the direct descendant of the member of a super fund, beneficiary, appointor of a trust or the testator in their Will.

So for the Queen of England, all that come under her are both bloodline and lineage. However her bloodline included Queen Victoria and her father King George IV, her children Charles, Andrew, Anne and Edward plus her long list of grandchildren are also bloodline. They are also lineage as they are direct descendants of Her Majesty. On the other hand her sister Princess Margaret and her cousins including Prince Edward, Princess Alexandra, Prince Michael of Kent and Prince Richard to name a few are bloodline not lineage.

In a family it is easy to assess who is lineage and in most cases, through a DNA test who is bloodline. However if a Will leaves an estate to be shared between the Testator's bloodline then it could result in a long process for the Executor to put advertisements in papers, on-line or completing research to determine who are bloodline as second, third, fourth cousins and who knows where the DNA is to be found as it goes up the tree and out. Whereas a bequest for the Testators lineage is simple to determine.

Line of Succession and the Leading Member

Now we get to the important point – the line of succession. From Wikipedia in terms of the English Monarchy's line of succession:

> The line of succession to the British throne is the order in which members of the royal family would come to the throne if the reigning king or queen died.
> At present the first in line is Charles, Prince of Wales, followed by his eldest son, Prince William, Duke of Cambridge and then Prince William's son, Prince George of Cambridge.
> Traditionally, males came before females in the line of succession. However, the law changed on 26 March 2015, so at present, for people born after 28 October 2011 the succession is decided only by age: older children come before younger children. When someone who is in line to the throne has a child, that child comes after them and their older children, but before anyone else in the line of succession. Interestingly excluded from the line of succession are Catholics (as the King or Queen are the head of the Church of England) and illegitimate children.

Practical Application: When we create a Leading Member Discretionary Trust or SMSF, or upgrade an existing SMSF or discretionary trust to a Leading Member variation, the line of succession is all important. The purpose of a line of succession is so the next in line controls the Family Trust as the Leading Member appointor and the SMSF as the Leading Member. The line of succession needs to be drawn out at the time of creating the Leading Member entities and may simply follow the definitional criteria for the English Monarchy. Alternatively, with the LightYear Leading Member suite a line of succession can be named in the constituent documents. The only drawback in naming the line of succession versus a formula is where one of the line is not alive, does not want the role or is incapacitated then there needs to be a "next in line" or the Leading Membership ceases. However in the LightYear Docs Leading Member suite there is a safety clause which provides that in "the event that there is no Leading Member appointor the Trustee is to offer the role to a Beneficiary of the Trust who is a descendant of the original Leading Member appointor. That offered person may accept and become the next Leading Member appointor."

At the end of the day whether it is estate planning, succession planning via Leading Membership, SMSF Wills or beneficiaries of a testamentary or discretionary trust – all options should be presented to clients and then the build starts for a strong, secure and certain Moat around the family's wealth.

8. The Royal Protector for your Clients

Ah to be a king or queen in a Royal family. Everyone listening to you, doing what you want, having power of veto – being the titular head of a family. But personally I don't know how Queen Elizabeth does it – all those events and chicken dinners! Plus the on-going scandals and dramas that were once hidden but with the voracious media and public – nothing is kept secret anymore. Look at the fall of Prince Andrew – shunned and exiled, his children now cast out of the Royal family as the next possible King – Prince Charles, trims who is on the inside and who rests outside.

And here's the interesting part – *do you see Prince Andrew suing the Queen for wrongful dismissal or loss of revenue?*

In fact can anyone remember when any family member has sued the house of Windsor? <u>It is impregnable – impassable – secure – and not just now but for centuries past and centuries to come.</u>

How many of us would love to have such security in our personal and family affairs knowing that our well earned wealth and position is not taken down by a frivolous or aggressive law suit or that on our death our bequests and gifts to our family are laid bare for the legal vultures to pick at the carcasses – *remember the Angela Miller case?*

And it is not big estates we have to worry about. A few years ago my mother wanted to make sure that in the event of anything happening to her and dad that their estate was only ever to be for the benefit of her and my father's bloodline. They were her words and it really hit home the enormity of blended families, changing societal mores and norms and how monies can be dissipated outside the family lineage - despite the best efforts by many lawyers to protect the estates, only to have other lawyers challenge them under the Family Provisions Act.

Anyway this got my head thinking and delving into the Windsor Royal Family and the position of the Queen – she has and asserts complete authority because she is the Leading Member – what she says goes. Charles and Philip might have a view but at the end she has the power of veto. There is no democracy there and in the same vein we can build Leading Member Trusts, Companies and SMSFs to protect and preserve a client's and our own family wealth. Tomorrow I am going to have a deeper look at a <u>**Leading Member SMSF**</u> v *a normal or average SMSF* and show you why they are a must for family wealth protection. They are not for everyone but I would encourage you to listen to John Grocke, a financial planner/accountant and partner of Adelaide accounting and business advisory firm – Johnson Grocke who took the idea up with gusto, building his own to start with and now is finding great success with his clients. To hear the podcast, which is also available on Spotify under I Love SMSF or go here: [Grant's Leading Member Interview with John Grocke]

A revolution is happening and with $3,200 Billion to be passed between generations by 2040, it is game on!

9. The MOAT and Leading Member

We have seen the devastation that can be wreaked with a $600,000 estate, can you imagine what would arise with a $2m contested estate. Apart from $150,000+ in legal fees, expect the time to judgement or settlement to be at least two to three years with all the family fighting and hating for that period of time. Want to know what hate looks like – read the Andrea Miller case.

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10. The Top Three Differences between a Leading Member SMSF v Standard SMSF

Remember earlier we looked at the Royal Family and how the Queen was the Leading Member of the Windsor Royal family and how she controls and has ultimate power over the Royal family. No legal suits against her by disaffected family members – ask Prince Andrew that one. Of course the Queen may abdicate or die and in that event succession is built in and Leading Membership passes to Prince Charles. But what if Prince Charles is not alive at the time of the Queen's death? Built in succession planning sees Prince William step into Leading Membership and if he is not alive – then Prince George becomes the Leading Member and King. Safe – Certain and Secure.

Like the Royal family, a Leading Member SMSF starts with built-in succession and proceeds from there. The desire is to provide safety – certainty and security and prevent legal challenges – building a Moat around the SMSF. Here are my three top differences between a Leading Member SMSF and a standard SMSF:

i) Built in Control

A standard SMSF has little control. I have seen a fund locked up for years in a divorce, as lawyers to both parties freeze up the trustee and membership. If there is a property in the Fund with an LRBA and neither party wants to contribute into a fighting SMSF, disaster awaits. And upon death it is worse if the shares in the corporate trustee are locked into the estate which is subject to a Family Provisions Act challenge – that's a two year legal feast.

The Leading Member under the deed and constitution, if there is a trustee company, has the power to hire and fire the Trustee or trustees as well as appoint and remove the members of the Fund. If an adult child of the Leading Member is appointed as member of the fund, that appointment is at the discretion of the Leading Member. If that child gets divorced then they can be removed from the fund and transferred to an industry super fund. The Leading Member has power of veto over trustee decisions. With all trustees getting one vote, but the Leading Member with the Chairpersons and veto vote, the fund is tightly controlled for **safety – certainty and security.**

ii) Built in Succession

There is no succession in a standard SMSF. With 90% of SMSFs one or two members, if one of the trustees is incapacitated or dies, what happens to the Fund. If the last remaining member and trustee of the Fund dies, what happens? Particularly when the deed only allows members to choose a trustee or that only the trustees can choose a trustee. Oops – sorry the fund has no trustee or power to appoint one and thus it is not a regulated super fund under section 19 of SISA . So what is it? I would advise it is now a non-distributing trust with horrendous estate planning tax consequences..

In setting up a Leading Member SMSF we need to know the first, the successor, the second successor and if possible the third successor Leading Member. The fund will last for generations to come with extensions to Leading Membership to carry on for as long as the fund. And with the Leading Member asserting control over the fund, the Moat is built.

iii) Protecting the Fund from Family Provisions Litigation

The key to the Royal Family's success is that everything is kept in the family. In a standard SMSF, there is no such choice. With BDBNs easily challenged, reversionary pensions not effective in many deeds and the desire by estate planning lawyers to shift superannuation to a deceased member's legal estate then there is built in Family Provisions litigation which may see dissipation outside the deceased's bloodline – even in cases of the best lawyers who promote Bloodline Trusts – that can be broken down under estate litigation.

Not so in a Leading Member SMSF where the members must be direct lineage of the Leading Member (unless the Leading Member uses their discretion to appoint a non-bloodline member). Any benefits on death are to go to the deceased member's bloodline as protected by the Leading Member. This sees the benefits held up in the Leading Member fund and if need be paid out to a Leading Member Discretionary Trust rather than pass through the estate. This provides protection from the Family Provisions Act.

Now I can give you at least another five or more reasons why a Leading Member SMSF is better than a standard SMSF. But here's the thing, they are not for every SMSF but if your client had a choice on having greater safety , certainty and security what would they want?

11. Building a Leading Member SMSF for Succession Success

We have looked at how a Leading Member SMSF differs from a standard SMSF. For me the big differences are control, succession and protecting a family's wealth from the cancer of litigation. With the average SMSF now topping $1.2M a lot of Australian families wealth and assets are exposed. But it is never too late to build a Moat around a family and one of the most important steps is to upgrade a SMSF to a Leading Member SMSF.

For our LightYear Docs users I have built a long form interview to coach existing trustees of new SMSF trustees through the Leading Member set up. This can be accessed by contacting us at support@lightyeardocs.com.au But to get you into the zone I suggest that you may way to complete the short form interview below and see how you could build a Leading Member SMSF.

Leading Member Client Interview

Let's look at how a Leading Member can be created for your SMSF to provide *safety – security and certainty*. We can move to Family and Discretionary Trusts, companies and a Will at a later date but right now let's work on your SMSF.

Question One: The Leading Member

There can be two Leading Members in a SMSF, shared Leading Membership, however this dilutes control. For ultimate control it is best to choose one Leading Member.

i) Who is going to be the Leading Member of your Fund?

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ii) **If that person dies, abdicates or loses their mental capacity who is going to be the next Leading Member of your Fund?** *This person is the Successor Leading Member.*

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iii) If the Successor Leading Member is not alive, does not want the role or does not have mental capacity who will be the next Leading Member of your Fund? *The Second Successor Leading Member*

____

iv) Do you want to have a further Successor just in case and one to cater for longevity? If Yes – who will that be?

____

Question Two: Choose how you want the Rules to be tailored

i) Do you want the Leading Member to have veto power over the decisions of the Trustees and Members? **Yes/No**

ii) Do you want the membership of the Fund to be bloodline lineage of the Leading Member only, subject to a discretion to include a non-bloodline member and the spouse automatically included? **Yes/No**

iii) *If the Fund has a Company as Trustee, it is a great idea for the only shareholder to be the Leading Member with those shares transferred to the Successor Leading Member upon the death, disability or abdication of the Leading Member. Would you like this special strategy to ensure control?* **Yes/No**

How did you fare? It is not that sophisticated but very powerful and sets up the building of Leading Member discretionary trusts, companies and Wills, plus a lot more. As an important heads up I will be conducting a special Succession, Leading Member and Estate Planning workshop at the Novotel on the Sunshine Coast on 23 and 24 March. So for those of you looking for something more – beyond compliance, red tape, tax and SMSFs then this workshop – an opportunity of providing safety – certainty and security for your or your client's family's wealth. Save the date and watch for the release next week and super early bird pricing.

12. Make your choice: $3,200bn or $300bn?

As the old saying goes *"there is nothing certain in life but death and taxes"*. And when there is a confluence of the two plus a lot of hungry little mouths waiting to divide up estates for their own personal gain, the game suddenly gets serious. If you have never seen an estate planning war staged – it is very much like a divorce only uglier and without children, so compassion often goes out the window.

Which is why there is a real need for advisers who can plan and protect a family's wealth for the lineage or bloodline of a client. In my last few emails I have been looking at SMSFs and the use of a Leading Member SMSF along with SMSF death benefits trusts (outside of the estate and Family Provisions Act) to protect and preserve a family's wealth. Now that does not mean dependants or others won't challenge but if we act speedily on the death of a member and get the death benefits paid out within a couple of weeks then it makes it difficult to reformat an SMSF estate.

Now all of you know I love SMSFs but it is such a tight little corner of the Australian estate planning market. Over the next 20 years it is estimated that up to $300Bn in wealth will pass through BDBNs, reversionary pensions and through the estate. The major issue that will be faced death taxes wise is in relation to a deceased member's accumulation accounts in a SMSF that exists beyond the member's pension TBAR. If the accumulation benefits are paid out to adult children, tax can be as high as 27% - a real death benefits tax that is easy to get rid of with some smart planning.

But I am getting away from the focus of this discussion. SMSFs only carry $300Bn in superannuation benefits that are expected to pass in the next 20 years. While non-superannuation wealth to pass via trusts and estates will be more than $3Tn or $3,000Bn. Now I don't know about you, and you know how much I love SMSFs, but when I see $3,000Bn stack up against $300Bn – I know where my attention is going to be focused.

Now coming from a trust, tax and superannuation legal background, smart succession planning across all forms of structures (even bucket companies, LRBAs and Div 7A loans) is in my wheelhouse. And for many accountants and financial planners it is something I can teach you far easier than SMSFs plus the upside is that much of it sits well outside the Corporations Act. So as we move into a new year, I would just like you to think of where you want to spend your time – front facing strategy advice for a client in a $3Tn market or a $300Bn market?

13. Why SMSFs are one of the Best Estate Planning Vehicles

SMSFs have the tax benefits of a superannuation Fund as well as the flexibility of the family and testamentary trust (subject to income stream limitations). Each SMSF is different, as each must be tailored to the specific and changing needs of the family through the use of a strong and flexible set of governing rules particularly when it comes to estate planning. The limitations of income stream estate planning for adult children is fare better achieved by a SMSF Death Benefits Trust than a Testamentary Trust which is subject to a state based Family Provisions claim.

Advantages of SMSFs

- SMSFs are family Funds built for lifetimes and thus can provide long term estate planning solutions, including laying down income streams for future generations in the hands of the right adviser or destroyed by poor legal advice in forcing superannuation benefits into a deceased member's estate;
- If a SMSF Will is used, specific actions and requests by a member of a Fund may be put in place in respect of their superannuation benefits in the event of their death.
- Control — like the family trust, the Trustees of the Fund have control of the Fund. Under the SISA, there is a requirement that all members of the Fund, generally the family, must also be Trustees of the Fund or directors of the Fund's corporate Trustee. This means shared control among members of the Fund. On the other hand the Leading Member SMSF guarantees control between generations.
- A wide range of investment choices. Where the member is using a SMSF Will, the member may designate specific assets to pass to dependants and non-dependants upon their death. If an income stream option is used, then the Trustee will invest the assets of the Fund for the benefit of the dependant income stream recipient.
- Assets remaining in the Fund are protected from creditors.
- SMSFs have a significant advantage over entities in terms of taxation — although a SMSF Death Benefits Trust (which protects the SMSF estate from a Family Provision claim) is not afforded with adult marginal tax rates on distributions to minors.
- SMSFs are favourably treated under the social security laws. Until age-pension age, they are treated as exempt from the assets test.
- SMSFs are simple in terms of administration, with a professional administrator recording all transactions that the Trustee has made, although compliance with SISA does add to the cost of delivering a Fund that complies with all the laws.
- The penalty tax rates that apply for investment income paid to a minor do not apply to income paid from a superannuation Fund or SMSF unless via a SMSF Death Benefits Trust which should limit minor distributions.
- Income streams can only be paid to dependants for taxation purposes. If the dependant is a child of the deceased, they must be less than 18 years of age unless financially dependant upon the member when a child pension can be commenced

for a child dependant no later than age 25. In addition the pension must cease by age 25.

Disadvantages

- If a SMSF Will or valid binding death benefit nomination is not used, the passing of superannuation benefits of the deceased member is at the mercy of the remaining Trustee of the Fund — *see Katz v Grossman [2005] NSWSC 934*.
- SISA weighs heavily on the Trustee of the Fund and, as a result, the Trustee and member must consult a specialist SMSF adviser or lawyer to ensure that the SMSF estate plan not only delivers what is required but also complies with the laws. There are significant financial penalties for breaching the laws and the Commissioner of Taxation may replace and disqualify a person as Trustee.
- The cost of establishing a SMSF estate plan will depend on the size of a SMSF estate.
- SMSFs cannot be viewed in isolation but are part of an entire estate and succession plan.
- Benefits in a superannuation Fund are part of spousal property and may be split in the event of divorce. This may be of a concern where superannuation benefits are paid as a lump sum to children.
- Income streams can only be paid to dependants — as that term is defined under s 302-195 of ITAA 1997. If the dependant is a child of the deceased, they must be less than 18 years of age unless financially dependant upon the member when a child pension can be commenced for a child dependant no later than age 25. In addition, the pension must cease by age 25.

P.S. There are extensive rules and concessions provided in terms of SMSF estate planning under SISA 93 so to automatically transfer a deceased's superannuation benefits from a Commonwealth legal system to the deceased's estate to be subject to the vagaries of the Family Provisions Act – remember the Angela Taylor case is ill advised professionally and legally and as we are dealing with the Corporations Act may not be in the best interests of the superannuation member,

14. SMSF Death Benefits Trust v Testamentary Trust – which is best?

A key part of building a Moat around a family's affairs is to ensure asset protection, *not only through life but also on death*. So let's start at how an estate planning lawyer would look at things. For a SMSF member seeking advice the lawyer would generally suggest that superannuation benefits would pass into the deceased member's estate where it would form part of their Will. The superannuation may form part of the general estate or be specifically bequested to a spouse, child , charity or any other person. Now the big sell is to set up a testamentary trust which generally costs an additional $1,000+ for inclusion in the Will. The Testamentary Trust provides asset protection for the beneficiaries (generally) and all beneficiaries are taxed at ordinary marginal tax rates including minors. For older family members this means distributions through an adult child testamentary trust (where the adult child or children act as trustee and possibly appointor) can be paid to minor grandchildren of the deceased or children of the adult child – including step-children and the tax will not be at penalty under 18 tax rates but ordinary tax rates.

The main limitation of this strategy is that any super benefits passing to a deceased's estate, irrespective of whether there are testamentary trusts or not, are subject to a challenge under the Family Provisions Act. Remember the Angela Miller case – where the deceased's two children were to share the $600,000 estate equally – which could have been put into a testamentary trust if the Will and executors chose to do so. However the Court awarded Angela Miller, the de-facto spouse $220,000 which applies before the implementation of the testamentary trust. And of course if you remember there were $500,000+ in legal fees that ate up all the estate so any testamentary trust would be a worthless strategy.

NOTE: *The rule of thumb is that there is NO ASSET PROTECTION for any superannuation benefits passing through an estate and as the large majority of estate planning lawyers have no experience in SMSFs – reversionary pensions, lump sum payments and the like,99% of advice is for super benefits to go to the estate – ready for a challenge.*

In contrast, a LightYear Docs SMSF Will (not a BDBN which generally deal with percentages of superannuation benefits) provides the option of paying pensions to grandchildren who are financially dependant on the deceased member at the time of death – which means the pension is taxed at ordinary adult marginal rates but with a 15% tax offset. Far better than a testamentary trust as it is better tax wise, does not breach the rule of perpetuities and does not cost administration and accounting fees to fund. For adult children, pensions cannot be paid however a lump sum can. This lump sum under a SMSF Will can be paid to a SMSF Death Benefits Trust, a discretionary trust where the adult child is the trustee and appointor. Importantly the trust is established from the SMSF Will and does not go through the estate and is thus not subject to the Family Provisions Act or corresponding dependant challenge Acts in various states.

So there is a lot of asset protection upside however, like any discretionary trust, distributions to beneficiaries are taxed at ordinary marginal tax rates excluding minor penalty rates. There is a trade off but at the end of the day, the Angela Miller case hangs like the sword of Damocles above our client's heads and it is up to them to make the choice – Safety – Security and Certainty or see litigation eat into the estate and take years off the lives of all involved (except the lawyers).

15. The Ins and Outs of the New SMSF Death Benefits Trust

A SMSF Death Benefits Trust ("SDBT") is new type of trust used by SMSF Estate Planning advisers to protect the assets of a family from creditors, family provision actions and, at the same time, provide flexibility in relation to the distribution of a SMSF estate. In essence, a SDBT is a trust that arises from the SMSF estate of a deceased member and is contained in the deceased's SMSF Will . As such, the terms and conditions of the SDBT, including the appointer, income and capital beneficiaries, Trustee and so on, are to be designated in the SMSF Will of not a binding death benefit nomination and never a Will!

Warning: The SDBT cannot be built or provided for under a person's Will as it is the trustee of a SMSF that creates a SDBT not an executor.

The benefits and limitations of SDBT are discussed below.

1. The Benefits

- Control is held by the Trustee of the SDBT and obviously the person who has the power to appoint and remove the Trustee — the appointor of the trust. This person may be the Leading Member Appointor of the SDBT with built in succession.
- It is built for the purpose of looking after the family of one or more dependants of a deceased member of a SMSF. Numerous SDBT may be built for dependants and beneficiaries can be limited to lineage or bloodline.
- It is protected from any family provisions claim although the "notional estate" in NSW may have some limited impact.
- It is possible to create income streams from the testamentary trust — although with difficulty and certainly not the tax certainty of a pension in a SMSF however if an adult child dependant is precluded from taking a pension, the SDBT may be crafted as the "go to " safe alternative.
- The Trustee is able to look after capital and income beneficiaries differently. The Trustee may distribute a capital gain to one beneficiary, a dividend to another, while a third may receive property income, depending on the terms of the SDBT trust deed.
- A capital gains tax discount of 50% applies to any assets disposed of by the Trustee, provided the Trustee has held them for more than 12 months. Although the Trustee claims the discount, they distribute the pre-tax capital gain to the beneficiary. This enables the beneficiary to claim the discount in their own hands and, more importantly, offset the capital gain with any capital loss that they may have from the disposal of assets in the current or prior years.
- Assets are protected from creditors. In terms of divorce and family break-ups, a SDBT if properly established may be useful in sheltering assets from the Family Court and courts in general, although this is becoming more difficult.

2. **The Disadvantages**

- SDBTs are trusts which need to be administered which can be an expensive process but so is a testamentary trust.
- The SDBT deed can be general and akin to a Leading Member Discretionary Trust or tailored to the needs of a family. However a Leading Member style is sufficient for most SDBTs.
- The capital injected into the SDBT is on behalf of a dependant so that any taxable component may be subject to a maximum tax rate of 17%. However a SMSF Living Benefits Trust may not suffer this problem and is a great solution for accumulation benefits where a member's rpension TBAR has been reached.
- All income and capital gains must be distributed annually or the Trustee pays tax on the income at the top marginal tax rate of 47%. In the case of a trust with different income and capital beneficiaries, this means that, in terms of capital gains made by the trust, it must choose one of the following options and still balance between both types of beneficiaries:
  - distribute capital gains to capital beneficiaries whenever made which reduces the asset base for the income beneficiary;
  - distribute capital gains as part of the income of the trust to the income beneficiary if the income of the trust includes assessable capital gains;
  - keep it in the trust with the Trustee paying tax at 47%, and
  - keep it in the trust with the capital beneficiary paying tax with distributions recapitalised.

- Income distributed from the trust is subject to tax at the beneficiaries' marginal tax rate, although imputation credits on dividends received and passed through to a beneficiary will shelter some of the tax payable. Minors do not receive the advantage of ordinary marginal tax rates and will be subject to penalty taxes.
- SDBTs are subject to the "rule against perpetuities" and must be wound up no later than 80 years from the date of establishment. This may impact estates seeking to pay long term income benefits to a family line including children and grandchildren. Alternatively if the trust is subject to the jurisdiction of South Australia, the SDBT can live on until wound up and vested.

16. Discretionary Trusts and SMSFs – working together in death

Discretionary Trusts are the best thing since sliced bread. They are not as tax effective as SMSFs but by streaming income to a wide range of trust beneficiaries taxation can be minimised. Importantly they do not suffer the dire preservation problems of SMSFs and like a SMSF they are great for asset protection purposes. They serve their place and their time and are often overlooked when it comes to retirees, particularly "well to do" retirees. With pension caps set at $1.6M, once that limit is reached then any excess or further contributions are locked into the accumulation side of a SMSF member's superannuation account. And with the draconian imposition of a $1.6M TBAR for existing SMSF pension accounts in 2017, a lot of pension monies switched to the member's accumulation account prior to that date. The is problematical in the event of the death of the member for two reasons:

1. The assets switched from pension to accumulation come with accrued capital gains which if needed to pay out death benefits will be taxed at 10%. This could be significant if the capital gain has accrued over time;
2. If the spouse is already hitting their TBAR or not alive then the superannuation benefits generally go to adult children, non-dependants or the legal estate where the taxable component is taxed at 17%.
3.

Ideally if a client was struck with terminal cancer and had a sizable accumulation account my advice would be to withdraw the money and place it into a Leading Member Discretionary Trust for the family and the terminally ill member's lineage or bloodline. The withdrawal is tax free and I would have a good look at those assets with relatively minor capital gains or losses so the fund does not have to pay exit taxes.

The end result is we have a SMSF with pension benefits only that revert to the spouse, adult children (either directly or via a SMSF Death Benefits Trust) or dependant grandchildren or dependant bloodline who can take a reversionary accounts based pension and in addition, we have a Leading Member Discretionary Trust with built-in succession – a nice capital settlement and bloodline beneficiaries. Importantly neither the SMSF or the Leading Member Discretionary Trust will, if structured properly, form part of the deceased member's estate. We have effectively built a Moat around these structures leaving the lawyers seeking to argue a Family Provisions Act challenge empty handed.

So if this the strategy we would do for a terminally ill member, why not do it for other members who are advanced in years with sizable accumulation accounts? Just in case .... And with limits on the amount that can be contributed to superannuation once a member hits their general transfer balance, Leading Member Discretionary Trusts are now just as and in some cases more important than a SMSF for estate planning purposes. However there is a big caveat – they need to be Moated, protected from a deceased's estate which many aren't. In fact of the 800,000+ discretionary trusts in Australia, many of them are exposed on the death of the primary beneficiary and appointor as we will see.

Note: NSW lawyers may try to claim that the superannuation forms part of the deceased's "notional estate" however that generally refers to those parts of the deceased's estate which has been given away or transferred for inadequate consideration up to three years prior to a deceased's death. For example if our terminally ill client transferred an investment property to one family member with the purpose of defeating any claims in a Will, this may form part of the notional estate.

17. **A Short Dive into Trusts**

The old saying goes is that if something ain't broke don't change it. And that seems to be the case with the legal profession stuck in centuries old traditions and guilds. Funnily enough I was reading an article by an Australian lawyer recently suggesting that trust deeds should be written on parchment, vellum or paper really taking us back to the dark ages. Although some legal firms still have processes from the dark ages, we have to thank that period for the invention of the trust.

Trusts came about in the 12th century when crusading soldiers, who had transferred their properties under common law to friends and family to look after during their crusade and if they did not come back, found when they came home to England from fighting the enemy that the person entreated with looking after the property did not want to transfer the property back. A wee bit unfair and so the Law of Equity (fairness) began, running alongside the common law, such that the Chancellor and Chancery (Treasury)could hold the legal owner as holding the property on trust for the ultimate beneficiary, the crusading soldier.

Now to commence a trust, as with the crusading soldier, there needs to be property over which the trust comes about. For a discretionary trust this is normally a $10 note or cheque (almost extinct) which is provided by the person who settles the trust. As an aside the settlor should be a person who merely settles the trust and no longer has any involvement if it is an Australian trust otherwise it may create tax issues for the settlor. For a unit trust settlement generally arises from the contribution of the unit holders to acquire the units. A trust is not limited to property but can be settled by anything tangible and if the deed allows hold anything tangible and intangible.

For a discretionary trust, at the time of creating the trust there needs to be an appointor, a trustee and beneficiaries. Let's look at each in turn and cover some ideas around them:

The Appointor is the person, depending on the trust deed, who can appoint and remove the trustee of the trust. For a discretionary trust, the majority of decision making including the payment of distributions is made by the trustee so the power to hire and fire the trustee allows the appointor to rule the roost. The question is if the appointor dies who is the next appointor and if none named who can appoint the appointor. And if an appointor retires what happens? If they are divorced? What if the succeeding appointor is not alive at the time of the death of the appointor? How many lines of succeeding appointor should you go? Should succeeding appointors be lineage or bloodline?

The Trustee is the person, persons or company which acts to carry out its duties and responsibilities as determined under the trust deed and also the relevant State Trustee Acts. If the deed does not allow the trustee to carry on business then the trustee is so prohibited. A good deed will provide broad powers to the trustee in line with the Trustee Acts and a wide range of discretion.

The Beneficiaries are those persons or entities such as bucket companies that the trustee can make distributions too. They can be identified as primary beneficiaries with any child, spouse, entity connected with them being deemed to also be a beneficiary. Alternatively the deed may limit beneficiaries to being the lineage or bloodline of an appointor to the deed as in the LightYear Docs Leading Member Discretionary Trust.

Warning: A sole trustee and beneficiary cannot be one and the same as you cannot create a trust over yourself.

- **Rule Against Perpetuities**

Another important feature of a trust is the rule against perpetuities as this can have stamp duty and tax consequences. Trusts were popular death tax minimisation vehicles in the England from as early as 1285 with property vested in a trust that was perpetual so that the property was never turned over as a consequence of death. But in 1681, in the Duke of Norfolk's Case 3 Ch. Cas. 1, 22 E.R. 930 Lord Nottingham propounded a new principle, which was to become the modern rule against perpetuities, and which was binding on both Chancery and common law courts. And so it started with the rule being the time for the lives in being (the youngest beneficiary) plus 21 years. Modern statutes in Australian state legislature has the period as 80 years to ensure a vesting of the trust and potential stamp duties. The one exception is South Australia where there is no rule against perpetuities seeing trustees submitting to the jurisdiction of South Australia under their deed. If a jurisdiction is not chosen it will be a matter of fact as to where the best jurisdiction for the trust is – where the trustee resides or where the property is.

18. Building a Moat around a Discretionary Trust

We should all know by now what a Moat is and how it fortifies a family's structure making it impregnable to the devil hordes. For Discretionary Trusts the best way to set up an impregnable discretionary trust is to use a LightYear Docs Leading Member Discretionary Trust from scratch. As with the Leading Member SMSF this idea comes from the Windsor Royal Family where the Queen is the titular head of the royal family with auto-succession passing to her son Charles, his son William and then to William's son George. *Is that fair or not?* Well fairness is not an issue, it is the way it has to be to protect the monarchy and any legal challenge is doomed to failure.

So what is a Leading Member Discretionary Trust ("LMDT")?

Let's start at the start – ***the settlor**.* Like any discretionary trust the settlor should be a person who is not a potential beneficiary of the LMDT. The settlor is often the accountant or lawyer setting up the LMDT but it could just as easily be a work colleague or neighbour.

Next up is – ***the Appointor***. Remember the appointor is the all powerful cog in the discretionary trust wheel – they have the power to hire and fire the trustee of the trust. So if I was building a LMDT for the Windsor Royal Family – it is obvious that the Queen would be the Leading Member/Appointor – then if she dies, becomes incapacitated or abdicates then the Leading Member/Appointor status automatically passes to Charles and if he is dead, incapacitated or abdicates it goes to William and so on. This provides control of the trust for the duration of the trust – 80 years if the jurisdictional state for the LMDT invokes the rule against perpetuities. If the trust has chosen South Australia, where this is no rule against perpetuities then we can go a long way down in terms of succession planning. The deeper and longer we go - the more control. We will look at what can happen if we hit a roadblock where there is no appointor soon but at this stage let's set up a LMDT properly.

Strategy Tip: The benefit of building in succession planning via the Leading Member/Appointor is that it should follow the Leading Member SMSF with the result that the Leading Appointor is also the SMSF Leading Member.

The next step is ***the Trustee*** and as the LMDT is gong to be around a long time a company, which has no rule against perpetuities and remains intact unless wound up, is the perfect trustee for a LMDT. Unlike a SMSF where every member must be a director of the corporate trustee, with a LMDT corporate trustee we could simply have the Leading Appointor as director or you can include the Successor Appointor as a director. Importantly it is not just any company that fits the criteria, we need a special purpose LMDT constitution that designates the Leading Member/Appointor as the Chairman and who holds veto power over any decision making. In addition the only shareholder will be the Leading Member/Appointor and on their death their shares are cancelled and new shares issued to the next Leading Member/Appointor. We will see why we put this hack into the trusteeship rules a little later when we compare some discretionary trust estate planning disasters.

The final piece of the puzzle and most important financially is ***the Beneficiaries***. This is where we nominate the Leading Member/Appointor as the principal beneficiary and then we can include all their bloodline – essentially brothers, sisters, cousins, parents or limit it to lineage which is only direct descendants of the Leading Member/Appointor. The Leading Member/Appointor can nominate any person to be a beneficiary and include any entity connected with them such as a bucket company, SMSF or another trust. On the death or abdication of the Leading Member/Appointor, the new principal beneficiary is the successor Leading Member/Appointor. The Trustee of the LMDT can distribute to any beneficiary and also the type of income such as interest, property income, capital gains, franked dividends, foreign income and much more.

Warning: An important tax strategy for any discretionary trust and also the LMDT is the distribution of income to LMDT beneficiaries who have lower marginal tax rates such as children at university or even parents/grandparents (depending on social security). Now if that money is to be left in the LMDT and used for other purposes then the beneficiary has a loan account which is called an unpaid present entitlement(UPE) – this loan can be called upon at any time. I have seen this happen on many occasions! To protect the LMDT from a malicious claim by a UPE beneficiary at a later stage we should put in place a LightYear Docs Deed of Gift which operates to gift all past, present and future present entitlements to the LMDT.

Now that is how to build a LMDT and we will soon see how the in-built strategies provide us with protection for estate challenges, bankruptcy, creditors and potentially divorce.

19. Most Lawyers and Accountants think Discretionary Trusts have Asset Protection – Think Again!

The two reasons there are more than 800,000 discretionary trusts in Australia is firstly for tax minimisation purposes – the ability of the Trustee of the trust to distribute identifiable streams of income to various beneficiaries and spread the tax risk (watch out for the reclamation of unpaid present entitlements). Secondly with the assets of the trust whether business, cash or investments held by the trustee for the benefit of undisclosed beneficiaries, the argument is that a discretionary trust provides asset protection. And for much of the time, if properly structured this is true ,but unfortunately the way most discretionary trusts are established asset protection is very weak particularly on death and divorce. Let me give you a real life case study that will shock you.

A discretionary trust had been established many years ago by an accountant on behalf of their client – the Smith Family Trust. Inside the trust were two investment properties, both mortgaged to the bank which had grown significantly. The client, who we will call John Smith for privacy reasons, was on his second marriage with one son Mathew aged 25. However John also had an estranged ex-wife and two children from that marriage waiting in the wings. There was a corporate trustee of the trust and John with his second wife Sarah were the directors of that company. They were considering Mathew as a a director but had not got around to it. John was the only appointor to the trust. Does this sound familiar and in reality pretty stock standard? *However nothing like the LightYear Docs Leading Member Discretionary Trust.*

Anyway John died and you would expect that the Smith Family Trust would carry on without interruption, wouldn't you? Well no. John's accountant had done the right thing and had his super and the Smith Family trust hold the majority of the family assets leaving little in John's estate with the family home jointly held by Sarah who became the outright owner when John died. Naturally the children from the first marriage had standing to challenge the estate under the Succession Act 1981 (Qld). As an aside, unlike the Family Provisions Acts in many other states the former spouse has no standing in Queensland under that state's Succession Act.

Now the big problem in this case was the fact that the shares of the corporate trustee were solely owned by John Smith. The lawyers representing the aggrieved children from the first marriage made a claim over the shares and if successful they would control the trust. With John the only appointor and no mechanism under the deed of trust to appoint a new appointor or trustee at that time – the Smith Family Trust was frozen with the Executor frightened to act under threats of litigation and personal ruin. In addition and for me a very smart move, the lawyers for the children sought records from the trustee for all unpaid present entitlements of the children from the first marriage – which added up to more than $300,000. With the Executor scared and under threat, mortgage repayments for the two properties fell into arrears with threats of foreclosure however the capricious lawyer for the claimant children would not let the Executor pay anything unless the UPEs were paid first and the shares of the corporate trustee were transferred to the children. The case is still live today and John died two years ago so the legal bills on behalf of all parties are significant and the Executor has been through untold stress.

If only there had been a Leading Member Discretionary Trust in place then the Leading Member/Appointor could have been transferred to Sarah (or perhaps Mathew?). In addition, John's shares in the corporate trustee would have been cancelled on his death and transferred to the next Leading Member/Appointor Sarah ensuring security and continuity of the Smith Family Trust. The UPE argument would still have to be addressed but at least it would keep the trust out of the hands of the Executor and any family provisions challenge.

This case is a lesson to be learned by all trustees of family trusts and their accountants that with the right set up asset protection is guaranteed but with one small slip up and all hell can break loose. Look at how many Australian discretionary trusts have corporate trustees with shares held by the primary beneficiary and a sole appointor. Expect this type of case to rear its head time and time again with two years to resolve at a cost of $300,000 in legal fees and the life of the Executor ruined for that period.

For existing discretionary trusts let's look when we convene next time on how to address the current structural problems and maybe dive into divorce and discretionary trusts.

20. Upgrading Discretionary Trusts and Resettlement – an ATO Gift

SMSFs are great for upgrading the deed in its entirety, simply get the old rules and turf them out in favour of a new set of rules – easy as pie. To convert an existing SMSF with a corporate trustee to a Leading Member SMSF with a Leading Member corporate trustee under the Strategy Automation section on LightYear Docs takes five minutes – provided you have worked out the chain of succession, all automated and done for you for only $199 for both (see full details here: Leading Member Upgrade Automation). Out with the old rules and constitution and in with the new. The only real thing needed to be done is for any shareholding in the trustee company that resides in a member or person who is not the Leading Member, the shares should be cancelled leaving the only shareholder as the Leading Member. This enables the passing on and succession of the control of the trustee company to the Successor Leading Member in the event of death, incapacity or abdication by the existing Leading Member. Remember the drama of John Smith, the "deer in the headlights" Executor, the capricious lawyer and the shares in the estate – *don't let that happen to you and if you are an adviser, definitely do not let it happen to your clients!* Having corporate trustee shares run through the estate of a member is tantamount to gross negligence.

Now a SMSF is a trust and under general trust law, where a significant change is made to the rules of the trust a resettlement may arise. In essence a resettlement arises when one trust is terminated and a new trust arises. This results in the underlying assets of the trust being transferred to the new trust with potential stamp duty and capital gains tax consequences. It is the greatest fear of any accountant working with an old discretionary trust deed – the deed is rubbish but there is concern that any upgrade of the rules would result in a new trust being formed. When *Commissioner of Taxation v Bamford [2010] HCA 10* was decided in the High Court enabling the streaming of different forms of income such as capital gains and dividends with imputation credits to different beneficiaries, there was a great rush to upgrade existing discretionary trust deeds. But there was great concern there may be a resettlement until that issue was put to bed when the *ATO Commissioner released TD2012/21*. In that determination the question that the Commissioner was looking at was:

Does CGT event E1 or E2 in sections 104-55 or 104-60 of the Income Tax Assessment Act 1997 happen if the terms of a trust are changed pursuant to a valid exercise of a power contained within the trust's constituent document, or varied with the approval of a relevant court?

No. *In these circumstances neither CGT event E1 nor CGT event E2 in sections 104-55 or 104-60 of the Income Tax Assessment Act 1997 (ITAA 1997) happens unless the change causes the existing trust to terminate and a new trust to arise for trust law purposes.*

In his examples the Commissioner states quite clearly that the following will NOT see a resettlement:

Example 1: Addition of new entities to, and exclusion of existing entities from, class of objects
Example 2: Expansion of power to invest
Example 3: Addition of definition of income, power to stream, and extension of vesting date
Example 3A: Extension of vesting date

The only resettlement example was where under the rules of the Trust, the Trustee takes trust property from and settles it into a new trust as can be seen in the following example:

Example 4: settling of trust asset on new trust

The Hedgerow Trust is a discretionary trust the class of objects of which consists of a large number of entities associated with the Buttercup family. Under its terms, the trustee has a wide range of powers including the power to declare that particular assets of the trust are to be held exclusively for one or more of the trust objects to the exclusion of the other objects of the trust. In exercise of this power, the trustee declares that one of several assets forming part of the corpus of the trust – asset 1 – was henceforth held exclusively in trust for one of the objects, Mr Badger (subject to the trustee's other powers, such as its power of sale). One month later the trustee makes a second declaration to similar effect in favour of Mr Badger in respect of one of the remaining assets of the Hedgerow Trust (asset 2). While the respective declarations do not terminate the Hedgerow Trust, the effect of the declarations is that assets 1 and 2 are no longer held on that trust. Rather, the trust obligations attaching to those assets have changed in a manner consistent with a conclusion that the assets have commenced to be held on the terms of a separate trust for the benefit of Mr Badger as sole beneficiary. As a result, CGT event E1 happens when the separate trust for the benefit of Mr Badger is created over asset 1. CGT Event E2 happens when asset 2 is also transferred to that separate trust.

So it seems resettlement is not as big a concern as many expected and it is a good time to upgrade any current discretionary trust deed. And tomorrow we will look at the traps and issues that need to be addressed in upgrading a current discretionary trust to a Leading Member discretionary trust.

21. Making a Silk Purse out of a Sow's Ear – Protecting a Discretionary Trusts

I remember reviewing my first discretionary trust deed while completing my Master of Laws at Sydney University in the 1980's. It was a pretty simple thing in those days and only 12 pages long on yellowed paper. Its vesting date was 21 years after the death of the last living descendant of King George V alive at the time the trust was established - the 1960's. There was no streaming, a wide open field of beneficiaries and a line of appointors and individual trustees. If you saw it today you would laugh but it did have good bones – it's just that time has not treated it well. And out of the 800,000 discretionary trusts how many are a 8 or 9 out of 10? My guess less than 5% when we look at succession planning of appointors and the transmission of corporate trustee control on death.

So it is time to fix things up and get Moated or at least get modern!

You know my preferred option to get things right is the Leading Member Discretionary Trust ("LMDT") but I am often asked how is that different to a standard Discretionary Trust. My response it that it all comes down to duration, succession and targeted beneficiaries. On the beneficiary front is it all family members - bloodline of the Leading Member which goes wide to cousins and also upstream (not preferred) or lineage which are direct descendants of the Leading Member.

But first things first. The Leading Member in a LMDT is the current appointor of the Trust and Chairman of Trustees with a veto vote. Now you can have joint or multiple Leading Members but I would take you back to the British Monarchy and many other monarchies around the world, there is always only one King or Queen and absolute power provides control and protection. It builds a Moat around the LMDT and to be truthful I often call a LMDT a Royal Discretionary Trust. So our first question is who is going to the First Leading Member? If you have a Discretionary Trust - try this simple but powerful succession exercise yourself:

1. **First Leading Member:**

Name: Current Age:

2. **Successor Leading Member/Appointor**

If something happens to the first Leading member who takes over as Second Leading Member?

Name: Current Age:

3. **Second Successor Leading Member/Appointor**

If the Successor Leading Member is not around or incapacitated who is the second Successor Leading Member?

Name: Current Age:

Remember one of the keys of the LMDT is duration and if we choose South Australia as the jurisdiction then there is no rule against perpetuities so we could adopt a rule similar to the British Monarchy in terms of succession such as the first child or list down all our Leading Member/Appointors – even beyond the three levels above.

BIG TIP: If you are going down the Leading Member route and you or if you are an adviser the client has both a SMSF and a Discretionary Trust then the Leading Member in the SMSF will also be the Leading Member/Appointor in the trust. The Successor Leading Members will be the same across both structures and so on down the line. We are building a system to protect from legal attack, so the more condensed power the better. Of course as Trustee of both the SMSF and Discretionary Trust they must act in the best interests of the beneficiaries and members, so there is protection from abuse by the Leading Member but at the end of the day, if you don't like the Leading Member – leave.

You may remember we discussed resettlement earlier and my legal partner Tony Anamourlis from Abbott & Mourly Lawyers had a good look through the ATO determination on the matter (TD2012/21) and like me he was surprised at how generous the Commissioner was in terms of changing powers, beneficiaries, vesting dates and much more without there being a resettlement. We discussed a number of resettlement cases but if the Commissioner says there is no resettlement that is good enough for me.

Basic Discretionary Trust Fix Up: Getting Succession Right

If you are just looking to do a succession of appointors and not a LMDT then you can just insert a chain of appointors – this can be found here on the LightYear Docs site: Deed of Appointor Succession. It's a quick fix, costs $99 and works to provide some stability but it is never the Royal LMDT.

22. Accountants/Financial Planners = Succession and Estate Planning Advisers

If you have been following my discussions on all things succession, estate planning, trusts, SMSFs and Wills you will know my passion to protect families across Australia from fights, disintegration, enmity and litigation from no or poorly laid plans to secure family wealth. I have seen families decimated over estates as low as $50,000 and even go to war with lawyers knowing that the legal fees will blow up the estate. I don't need to go over the Angela Miller case again*, MILLER -v- TAYLOR [2018] WASC 75*, to see how many Australians, with a home of $600,000 on death can find that home and some personal assets be subject to Family Provisions litigation.

For any accountant or financial planner out there, it is our job to protect these families. And we are not talking about the only 1% of wealthy Australians but a large majority of our parents and our generation. So my challenge to you is to take the leap of faith and move into this field, not wholly – keep on doing what you are doing, but start slowly read, listen and learn about what is happening to the $3 trillion in Australian family wealth that is to pass in the next 20 years. As I have shown you and will continue to show you there are simple effective measures that we can put in place to protect our clients, and for that matter ourselves, with EPOAs, succession planning in trusts, Leading Member SMSFs and Trusts, death benefit trusts, Wills and testamentary trusts. Over time there will be much more to bring to the table but not just knowledge, insights and skills but real documentation (the concrete of the foundation) to make things happen easily and effectively. Plus with the added advantage of legal sign off, if you desire, there are no licensing or legal issues!

But let me tell you why it is important to hop onto this new advising movement. In the year

2001 I created Australia's first ever SMSF Adviser Course on the knowing that I could teach accountants and financial planners how to read, understand and apply the law. Many of the 1,000 or so advisers that went through this course have done extremely well as specialist SMSF advisers and being at the forefront of the industry. In 2001 at a course I conducted at Manly more than 20 of us agreed to set up an Association to provide visibility and pre-eminence to the new breed of SMSF Professionals and the SMSF Professionals Association was created (now the SMSF Association). And look at that organisation now helping their members navigate SMSF and also looking after Trustees through education and advice. Now I am the biggest advocate for SMSFs and have written five books on the subject but with continuing changes to pension limits and contribution limits, licensing, ASIC and industry funds against them SMSFs have had their day. They will never see the growth path like we saw until 2016 (except for SMSF Succession and Estate Planning).

In exactly the same vein, the attendees of Australia's first ever Succession and Estate Planning course at the Novotel on 23 and 24 March will have the opportunity to frame a new Association for Succession and Estate Planning Advisers. With $300 billion passing from SMSFs as death benefits in the next 20 year and more than $3,000 billion of non-SMSF assets like properties, shares and investment properties the time is ripe and right for this new breed of adviser who will have 10X more to work with than the traditional SMSF adviser, greater challenges in dealing with families and finding their real needs and a keep Australian family wealth to families not to enrich lawyers.

23. Not all SMSF Trustee Companies are the Same – Dangers, Strategies and Pitfalls

I recently did a webinar on SMSF Wills and the starting point was of course the legislation and specifically SIS Regulation 6. 17A and section 59(1A) of SISA 93. Following review of the laws I looked at the Commissioner's determination on death benefit nominations SMSFD 2008/3 which led to the governing rules of the Fund. In short, whatever the trust deed says in terms of making a death benefit determination – *is the law*. I have reviewed more than 100 SMSF trust deeds and corporate trustee constitutions over the years and it's strange, notwithstanding the open possibilities as to what can be done (such as a SMSF Will) the large majority of deeds fall back on the redundant SISR 6.17A. This is a real danger as binding death benefit nominations under this regulation are really for industry and retail super funds and strictly limit any nomination to a percentage of benefits only.

The pitfalls of this poor SMSF drafting in a deed can be seen in a case study where a doctor with a $1.4M SMSF accumulation account backed in part by medical rooms wanted to transfer this property to his eldest son, a doctor like his father BUT to the exclusion of his doctor daughter. Now if the deed only allows a SISR 6.17A death benefit determination the desired transfer could not happen as it goes beyond percentages. With the LightYear Docs SMSF Deed and SMSF Will our lawyers have ensured that the transfer could happen either directly as an in-specie lump sum payment to the son or the preferred option – payment into a discretionary trust, preferably a Leading Member Discretionary Trust for the son (LM appointor and trustee). Importantly any payment to the son directly or into discretionary trust would NOT go through the estate into a testamentary trust as the daughter could challenge the transfer. The SMSF Will is strong – secure – certain – safe – compliant. If you would like to watch the video - SMSF Wills Training - why BDBNs do not work

As part of the discussion, I advised of the need to upgrade the family's SMSF trust deed and corporate trustee constitution. If you watch the video I completed the task in less than five minutes and for a cost of only $129 versus $700+ at most on-line legal firms which also require the purchase of the deed of variation and company variation separately. However, the LightYear Docs SMSF Trustee constitution is different – smarter and strategic. In terms of estate planning the crucial difference and remember this is a SMSF Trustee company only and not suitable for ordinary business use or for Discretionary Trusts is Rule 7.9:

DIRECTORS MEETINGS – RULE 7.9

If a Member of the Fund dies the Member's Legal Personal Representative is to be appointed as a Replacement Director of the Company. Failure to do so within a reasonable time requires the Company to cease acting as trustee of a superannuation fund. At any meeting where the disposition of a deceased Member's superannuation benefits distribution is to be discussed and resolved only that person appointed as the deceased Member's Replacement Director may vote on any resolution.

The key takeaways from Rule 7.9 are:

1. On the death of a member, their Executor, if they have a Will or the Administrator of their estate if there is no Will, can be appointed as a Replacement Director. A Replacement Director is empowered under section 17A(3) of SISA where the normal member/trustee/trustee director rules are extended to legal personal representatives on the death of a member from the time of death until death benefits begin to be paid out. However the procedure to appoint a director is not included in Section 17A(3) so it is up to the constitution. The auto-appointment of the legal personal representative, with their consent of course, prevents cases like **Katz v Grossman** [2005] NSWSC 934 and [2009] QSC 26 - **Donovan v Donovan** where the remaining directors or trustees don't let the legal personal representative into the fund's trustee or directorship – *effectively freezing them out*. This does not happen under Rule 7.9 thanks to the auto-appointment and for me is a must.
2. The more important part I believe is the absolute control of the distribution of the deceased member's death benefits in the hands of the Replacement Director. With this rule the Member does not need a SMSF Will or BDBN as the Replacement Director, the Executor, has full and free reign as to what to do with the deceased's superannuation benefits. Although it is preferred to have a SMSF Will so the benefits do not go through the estate, unless absolutely necessary. This part of rule 7.9 ensures that the Replacement Director cannot be outvoted when it comes to distributing the deceased member's superannuation benefits.

If your current SMSF trustee company does not have these two rules – auto-appointment and Replacement Director control of deceased member benefits distribution then the existing directors can refuse any request by the legal personal representative of the deceased member to become a director – which is the case for all the trustee companies I have seen. Check out the Appointment of Directors and Directors Meeting rules in your own SMSF Trustee company constitution.

Which is better – Control and Security v No Control and legal challenge? Which would you prefer?

24. Don’t use the wrong company for a SMSF Trustee company or it will cost you?

I answered a call the other day from an SMSF administrator who was complaining that when ordering a trustee company from LightYear Docs the only shares that were showing up as part of the ordering system were Non-Dividend paying shares. In her words, she had been ordering SMSF Trustee companies from a range of providers for years (they had over 500 SMSFs) and never seen anything but ordinary shares on offer.

That got me thinking – is this going on all over the place and is it a bad thing? Well like I normally do I turned to the law and also the corporate Regulator – ASIC. That seems to me to be a good starting place rather than chatting with other lawyers or colleagues – the truth is in the law not those who interpret it, or sometimes guess at it.

So starting with the law – the Corporations Act 2001 and more specifically the Corporations (Review Fees) Regulation 2003 (“CARR”). Schedule 1 of CARR provides the annual ASiC fees for special purpose companies, which includes charitable institutions and superannuation trustee companies. The current fees for a special purpose company are:

1.	Ordinary company	\$267
2.	Special purpose company	\$54
3.	Upfront payment for ten years for special purpose company	\$375

Note: I am continually surprised that directors don’t choose the ten year payment up front option – it is cheap, efficient and protects against continuous ASIC fee increases. Of course for accountants it means no regularly review fees or chasing up clients about late payments, after all one late payment penalty is equal to a ten year upfront payment.

Anyway what is a special purpose company? Regulation 3 of CARR defines it to include as follows:

(f) a company, if:
(i) the constitution of the company *prohibits distribution of the company’s income or property to its members*; and
(ii) the sole purpose of the company is to act as the trustee of a regulated superannuation fund within the meaning of section 19 of the *Superannuation Industry (Supervision) Act 1993*.

This is further shown in the ASIC guidelines:

Superannuation Trustee Company
A superannuation trustee company acts solely as a trustee of a regulated superannuation fund. Refer to s19 of the *Superannuation Industry Supervision Act 1993* for more information. The company's constitution must prohibit the company from distributing income or property to its members.

Summary

Quite clearly the only shares that can be issued to shareholders are non-dividend paying shares. If a company issues ordinary shares to shareholders and claims that it is a special purpose company thereby breaching the regulations ASIC can levy significant fines on the directors and if done dishonestly, it can lead to criminal referrals and director disqualifications.

So what advice would I give to our SMSF administrator? Essentially they can either own up to ASIC or update the company constitution immediately and change the class of shares. For the ultra cautious I would suggest a Deed of Rectification and Ratification by the Directors of the Trustee Company.

Again it makes me wonder how many of the 300,000 or more SMSFs with company trustees are exposed under CARR?

25. The Dangers of Not Knowing what you are doing – Compensation and Criminal Referral

By now we should be getting a good grasp of the importance of succession planning in a SMSF. With 150,000 SMSFs with only one member and 400,000 SMSFs with two members, the dangers of death, divorce and dementia loom large. What happens if a fund has a corporate trustee with only one member and that member dies and the company constitution, like most only allows the shareholders or the directors of the corporate trustee to appoint a director? *And don't laugh more than 90% of Australian corporate trustees follow this path.*

In early 2019 I came across exactly this case and blow me down the Executors of the estate which included the deceased's family lawyer, their accountant and daughter all appointed themselves as directors of the corporate trustee, purportedly under section 17A(3) of SISA 93 and then paid out $1M of the deceased's $1.6M in superannuation benefits to the daughter. The other daughter of the deceased got wind of what was happening and lawyered up.

From what we have learned so far what is the problem here?

Well the Executors were illegally appointed as directors as so any payment of superannuation benefits from the fund was illegal and the outside daughter could take action against all the Executors for a breach of the governing rules of the Fund under section 54C and section 55(3) of SISA 93 and recover the monies and damages from the three parties jointly and severally. Alternatively an action could be taken under section 218 which states:

218 Recovery of profits, and compensation for loss, resulting from contravention

(1) If a civil penalty provision in relation to a superannuation entity is contravened by a person *other than a trustee of the entity*, a trustee of the entity may, by proceedings in a court of competent jurisdiction, recover from the person, as a debt due to the trustee:

(a) if that or another person has made a profit because of the act or omission constituting the contravention—an amount equal to the amount of that profit; and
(b) if the entity has suffered loss or damage as a result of that act or omission—an amount equal to the amount of that loss or damage;whether or not:
(c) the first-mentioned person has been convicted of an offence in relation to the contravention; or
(d) a civil penalty order has been made against the first-mentioned person in relation to the contravention.

(2) Proceedings under this section may only be begun within 6 years after the contravention.

The key to section 218 is there needs to be a trustee to claim the loss or damages. Let this be a warning to ALL advisers and lawyers to a SMSF to be extra careful of section 218 as a breach of the Fund's rules which includes any BDBN, SMSF Will, investment strategy and a whole lot more can result in some disastrous litigation. Also note in this section it is not a test of negligence, merely showing that a person other than the trustee has breached a civil penalty provision which is the lesser proof of "on the balance of probabilities." And if it has been done wilfully as is the case here, section 202 may come into play with the Regulator making a criminal referral which if held, may lead to a maximum term of imprisonment for five years.

Funnily enough the solution was in front of the Executors as the shares of the Corporate Trustee were held by the deceased and could have been transferred to the daughter who could have held a shareholders meeting and made herself director of the corporate trustee and also a member. But if the outside daughter's lawyer was half smart they could have challenged the transfer of shares however under the Family Provisions Act – tying up the SMSF for a couple of years and at least $200,000+ in legal fees.

When dealing or advising on SMSFs there are minefields everywhere but if you know the path ahead not only will you be protected but you will bring to the fore strong protection for your clients – building a fortified Moat around the fund with the strength of section 54C, section 218 and section 202 to ward off any incalcitrant or poorly advised lawyers and litigants.

26. Protection Hacks and Strategies built into the Leading Member Trustee Company

This Thursday, we will release Australia's first ever special purpose Leading Member Trustee company to act as trustee of a Leading Member Discretionary Trust. The difference between our standard discretionary trust and the LightYear Docs Leading Member Discretionary Trust is that it has in-built protection with the Leading Member Appointor("LMA") able to appoint and remove the Trustee of the Trust and also choose either lineage beneficiaries – direct descendants of the LMA or the bloodline of the LMA which includes brothers, sisters, parent and grandparents, aunts and uncles, plus of course a whole host of other discretions and income streaming.

As we have seen problematically the shareholding of a large number of discretionary trust corporate trustees are held by trustees or appointors. The danger is that the shares will get wrapped up in the deceased's legal estate and potentially the ordinary business of the trustee company frozen by litigation. This is more so the case where the sole appointor of the trust, with no successor appointor has died and the Trustee takes full control of the Trust including the power to appoint a new appointor or a new trustee.

The LightYear Docs Leading Member Discretionary Trust provides for the first LMA, a succeeding LMA plus a second succeeding LMA to provide protection over three generations. This is a great start to a Moat and an existing discretionary trust can be updated to a Leading Member Discretionary Trust without resettlement issues if required. This can be done on the LightYear Docs site for $99 or if you would like to get it completed by Abbott & Mourly lawyers with a letter of advice dealing with resettlement and Leading Member Discretionary Trusts the cost is $495 and can be ordered from Tony Anamourlis – tanamourlis@abbottmourly.com.au.

For most cases I advise that a corporate trustee be used for a Leading Member Discretionary Trust as an extra layer of protection but not just any company – it is best to use a *special purpose Leading Member Corporate Trustee*. This is built for Leading Member discretionary trusts only and cannot be used for SMSFs. Some of the key clauses in the company are:

1. **PURPOSE AND MISSION**

Rule 3.3 The Company, apart from acting as the trustee of a Trust is to also ensure that as trustee, *it operates for the benefit of lineage of the Leading Member Appointor or such other persons in accordance with the Leading Member Appointor's wishes*.

2. **CONTROL AND VETO POWER**

Rule 6.5 The Leading Member Appointor who is a Director of the Company should act as the Chairman of the Company and *has an absolute right of veto over all Director's decisions prior to a resolution being finalised*.

3. **LIMITED SHAREHOLDING**

Rule 12. Only a Leading Member Appointor of the Trust may be a Shareholder in the Company.

4. **SHAREHOLDING CANCELLATION ON DEATH**

Rule 15.1 If the Leading Member Appointor dies the Company is to immediately cancel the former Leading Member Appointor's shares.

Rule 15.2 At the same time the Company is to issue 100 shares or all of the Company's newly issued share capital to the successor Leading Member of the Fund and should there be no immediate successor Leading Member, that member the Trustee of the Trust or under such powers of the Trust's trust deed so chooses as the new Leading Member Appointor of the Trust.

There are a range of other important issues to be looked at however the key to effective succession planning and protection is the cancellation of the LMA's shares and issue of shares to the next LMA. It is thus impossible for the shares and the Trust assets to form part of the estate. Simple, clean, effective and a saver of a whole lot of litigation.

27. How a Corporate Trustee turns a SMSF into a vulture fund on Death

Section 17A(3) of SISA 93 provides an out to the member/trustee director rules where an Executor is appointed by the corporate trustee as a replacement director for the deceased director/member from the time of death until first benefits are paid out. The relevant section is as follows:

(3) A superannuation fund does not fail to satisfy the conditions specified in subsection (1) or (2) (member – trustee/director of corporate trustee rule) by reason only that:

> (a) a member of the fund has died and the legal personal representative of the member 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 the period:
>
> (i) beginning when the member of the fund died; and
>
> (ii) ending when death benefits commence to be payable in respect of the member of the fund

As can be seen section 17A(3) is an exception only and does not provide for auto-trusteeship or auto-directorship for an Executor. The Executor can stomp their feet, hire QCs but without auto-appointment their path to controlling what happens with a deceased's superannuation benefits is muddied. For a corporate trustee our first port of call is the company constitution and the Corporations Act 2001. This is where we a SMSF estate can become seriously unstuck if the corporate trustee constitution is deficient. And as is the case with any estate planning case that is contested, any small crack found by a lawyer can be opened wide to years long litigation and significant legal fees.

Let's consider some of the potential issues for existing SMSFs around Australia.

- **Sole director and shareholder dies**

If you remember our earlier live case study where the Executors of the estate which included the deceased's family lawyer, their accountant and daughter all appointed themselves as directors of the corporate trustee, purportedly under section 17A(3) of SISA 93 and then paid out $1M of the deceased's $1.6M in superannuation benefits to the daughter. There was no binding death benefit nomination so the Trustee had discretion where to make the death benefits payment. The deceased's other daughter sought to challenge the estate under the Family Provisions Act (NSW).

The big problem was the sole director of the company had died. Without a director or instant replacement to conduct the business of the company this may result in the Fund being a non-regulated super fund under section 19 of SISA. That section requires a trustee of the Fund in order to obtain tax concessions. This would be a disaster tax wise because if the fund is not a regulated super fund then it would be a non-distributing trust and taxed on income in the fund at top marginal tax rates.

So we need to turn our attention to the SMSF Trustee company constitution to see how a director may be appointed. If other directors can appoint, this is great for multi-director companies but of no use where the sole director has died. We may strike it lucky and find that the constitution enables the shareholders to appoint directors. The question now becomes on the death of the sole shareholder who has the power to call a general meeting? For that we turn to the rules of Executorship which provide that upon a Grant of Probate of a Will (or Grant of letters of administration in the case of an intestacy), the shareholding is to pass to and vest in the Executor. So once the property vests then the Executor can hold a shareholders meeting to appoint themselves as Director of the SMSF corporate trustee. However if there is a Family Provisions challenge to the estate then a good lawyer will ensure that the Executor does not deal with the shares in favour of themselves. The SMSF will be locked away in the closet for years.

Note: As an aside in the live case study the appointments as Executors was illegal and thus the payment of $1M to one of the Executors, the daughter of the deceased was also illegal and recoverable from the lawyer, accountant and daughter with damages.

- **Surviving Director and shareholder**

If you thought the single director and shareholder was bad, look at the cases where a surviving corporate trustee director does not see eye to eye with the Executor. This can happen in blended families or in families with the same blood. It is a litigation minefield. In Katz v Grossman [2005] NSWSC 934 the son and Executor Daniel Katz challenged his sister Linda Grossman who was the surviving trustee to pay their fathers superannuation benefits, which exceeded $1M to the estate as expressed in a binding death benefit nomination. Under the deceased's will it was to be split equally between the two children. However Trustee Linda Grossman refused to make the payment to the estate and won the case on the grounds that the BDBN was not valid and as surviving Trustee she had discretion where to make the payment – which was paid to her in the end result. With no-auto-trusteeship the executor Daniel Katz had no power as he was not in the Fund as Trustee and the Court let the payment to Linda stand as the BDBN did not meet the requirements in the governing rules. The same goes for a whole raft of cases over the years so if there is no auto-appointment then all eyes turn to any BDBN as was the case in Katz and also in Donovan v Donovan [2009] QSC 26 which dealt with a second spouse trustee and children from the first marriage as Executor.

- **Auto-Appointment but no Control**

Even where there is auto-appointment of the Executor and the Executor becomes a director if they are one of two or more directors and able to cast only one vote then they can be outvoted when it comes to paying out the deceased member's death benefits if there is no BDBN or the BDBN is weak and open to challenge. It is crucial that in the event of a Replacement Trustee/Director that they have the sole voting power when it comes to dealing with the deceased member's superannuation benefits.

The Upshot

If a member of a super fund dies and there is no Moat around their superannuation estate then there is good cause for it to be challenged – this is perhaps one of the fastest growing litigation areas around and very expensive to the SMSF estate and legal challengers. This is why at Abbott & Mourly we have taken great pains with the Lightyear Docs Leading Member SMSF Corporate Trustee, the special purpose SMSF corporate trustee, the two

SMSF deeds and the SMSF Will to ensure it provides protection as well as auto-appointments plus control particularly where there is a SMSF Will. This is a crucial time for all SMSF members to address the issue and build a Moat – once death arises then all bets are off and the SMSF may end up being a vulture fund.

28. This is a scary Family Provision Case hitting a SMSF Death Benefit

I am all about building a Moat around our family finances to protect it from challenges and the ravages of Family Provision claims. A properly structured Discretionary Trust as I have built in the Leading Member Appointor discretionary trust is as good as it gets – a testamentary trust is at the other end of the spectrum as it flows from an estate So where does superannuation fit in?

First Rule: if a deceased's superannuation benefits are passed to the deceased's estate it will be open to challenge and that means a lot of costs, resources and time spent fighting. Now the criteria for a person to make a Family Provision claim is that the claim is made within 12 months of the death of the deceased and the person making the claim:

- *Is an 'eligible person', and*
- *has been left out of a will, or*
- *did not receive what they believed they were entitled to receive.*

An "eligible person" includes a wide range of claimantss including:

- *the wife or husband of the deceased*
- *a person who was living in a de facto relationship with the deceased (including same sex couples)*
- *a child of the deceased (including an adopted child)*
- *a former wife or husband of the deceased*
- *a person who was, at any particular time, wholly (entirely) or partly dependent on the deceased, and who is **a grandchild** of the deceased or was at that particular time a member of the same household as the deceased*
- *a person with whom the deceased was living in a close personal relationship at the time of the deceased person's death.*

But what if we deal with superannuation directly so it is paid as a lump sum payment to a spouse or as a reversionary pension, rather than going through the estate. Is there the possibility of a challenge? Can the aggrieved parties, such as a former spouse from 25 years ago, make a family provision against the trustee of the super fund and even recover costs?

Surprisingly this is where the concept of a notional estate – for NSW estates anyway, may come in to spoil the party. With more than $80Bn sitting in NSW superannuation funds including industry and retail super funds as well as SMSFs, the notional estate provisions in Part 3.3 of the Succession Act (NSW) 2006 are scary – if they apply.

In short a notional estate brings in monies and property outside of the estate into the estate for a family provision claim. Each notional estate claim is to be determined by the Supreme Court so expect a lot of legal fees, however if you can get your hands on super, and costs are paid from super then most lawyers would say it is worth it. The first step pursuant to section 75 is for the Supreme Court to find a "relevant property transaction" which generally is property divested prior to the deceased's death for the purpose of beating a family provision claim. *But, and this is a big but*, it can include monies held on trust which are dealt with at the time of death and for which no adequate compensation has been paid.

In *Kelly v Deluchi* [2012] NSWSC 841, Justice Hallen looked at whether the payment of a death benefit from a SMSF to the deceased's spouse was a relevant property transaction. In that regard Hallen J stated:

> "I am satisfied that the basis of a relevant property transaction for the purposes of s 75 has been established and that it is taken to have been entered into immediately before, and to take effect on, the occurrence of the resolution of the Trustee, in February 2010, that is to say, after the deceased's death …. *In all the circumstances of this case, I propose to make an order designating part of the property held by the Trustee as notional estate."*

The end result was that children of the deceased had the bequests their father left them in the will doubled and more than $150,000 in costs awarded against the trustee of the SMSF. We need to look at this case further as the list of claimants was as long as your arm and there are some really troubling signs on the application of the legal to superannuation. At least at this stage, only the Succession Act (NSW) 2006 has the concept of a notional estate – other states have not followed this precedent but those in NSW this is no help.

29. **Is any Super Safe from Estate Litigation? Advisers and Lawyers beware!!**

Having sat on a Board of Trustees at Rothschild Australia many years ago, I know full well that superannuation death benefits are generally not released until a full investigation of the relevant parties who may be dependant is undertaken. Once that investigation is exhausted, and I mean completely exhausted the superannuation death benefits are then paid.

Once paid, and sometimes before they are paid, a person who is a dependant upon the deceased (including adult children) may make a complaint to the Superannuation Complaints Tribunal("SCT") seeking to be paid some of the deceased's death benefits. The SCT is now merged with two other tribunals into the Australian Financial Complaints Authority ("AFCA"). Under tribunal guidelines a superannuation complaint can be made by the Estate of a member of a superannuation fund or any other person who has an interest in a deceased member's superannuation death benefit. Generally the time limit on making the complaint is two years if the trustee of the fund has notified the relevant persons otherwise it can be extended longer. There is no limit on the size of the complaint and in 2018 – 2019 the Superannuation Complaints Tribunal received 2,255 complaints with a third of those dealing with death benefits. It is clear that the SCT and now AFCA are the pre-eminent bodies dealing with superannuation death benefit complaints. As to the process by the tribunal in determining who is entitled to any death benefits you can review the SCT death benefit process report here: Death Benefit Report

But how does AFCA super complaints relate to a family provisions claim under State based laws? First and foremost if superannuation is passed by the Trustee of a superannuation fund to the estate, it can be challenged by any eligible person under a family provisions claim – who may not necessarily be a dependant under the SIS Act 93. Funnily enough while AFCA is hearing an action as against the trustee, the relevant Supreme Court may be hearing a family provisions claim. How do these interact?. It is vital to understand that the family provisions claim is against the legal estate whilst the AFCA super claim is against the Trustee. If AFCA makes an award against a trustee and the trustee has already paid that death benefit to the deceased member's estate then any adjustment payments are to be paid by the trustee not from the member's super as it is long gone. *The lawyers would love that- two bites at the cherry.*

But we recently looked at the case of In *Kelly v Deluchi* [2012] NSWSC 841, where Justice Hallen of the NSW Supreme Court looked at whether the direct payment of a death benefit from a SMSF (not via the estate) was caught up in a family provisions claim under the notional estate concept found in the Succession Act (NSW) 2006. Hallen J stated:

> "I am satisfied that the basis of a relevant property transaction for the purposes of s 75 has been established and that it is taken to have been entered into immediately before, and to take effect on, the occurrence of the resolution of the Trustee, in February 2010, that is to say, after the deceased's death …. *In all the circumstances of this case, I propose to make an order designating part of the property held by the Trustee as notional estate."*

So we have an instance of where a state based Supreme Court can infiltrate a proposed death benefit payment to be made under the SISA 93 directly to the spouse. In my mind that encroachment by the State on Federal laws is revolutionary and to be intensely watched. I recently completed a long scholarly article for the self managed superannuation magazine produced by Benchmark Media for release in February 2020 on whether States could tax superannuation. In that article I reviewed the constitutional side of the equation – where States sought to impose laws that are authorised under the Constitution of the Commonwealth of Australia 1900.

The seminal constitution case on State v Commonwealth government powers was *Commonwealth v Tasmania* ("Tasmanian Dam case") [1983] HCA 21; (1983) 158 CLR 1 (1 July 1983). In short the Tasmanian government sought to build a Hydro Electric dam in Tasmania and the Commonwealth government, following Bob Hawke's Labor Party win, passed the World Heritage Properties Conservation Act 1983 (Cth), which, in conjunction with the National Parks and Wildlife Conservation Act 1975 (Cth) enabled them to prohibit clearing, excavation and other activities within the Tasmanian Wilderness World Heritage Area.

In a split decision – 4:3 the High Court held that – *"Section 9(1)(h) of the World Heritage Properties Conservation Act 1983 is valid. In consequence, except with the consent in writing of the Commonwealth Minister, it is unlawful for any person to do the following acts in relation to particular specified property adjacent to the Franklin River, including Kutikina Cave and Deena Reena Cave: (a) carrying out works in the course of constructing or continuing to construct a dam that, when constructed, will be capable of causing the inundation of that property or any part of it; (b) carrying out works preparatory to the construction of such a dam; (c) carrying out works associated with the construction or continued construction of such a dam."*

So where the Commonwealth is authorised under the Constitution to make laws in a specific area, these are to override any State based laws. Interestingly the constitution was not argued in *Kelly's* case. In fact Hallen J noted in terms of the spouse, Mary who was to receive the death benefit and also in regard to the trustee of the superfund paying the death benefit:

"Senior counsel for Mary and the Trustee made no submissions, in writing, or orally, that the Court, for any reason other than that the claim of each of the Plaintiffs should be dismissed, should not make an order designating property as notional estate. To the contrary, it seemed to be accepted by him that such an order could be made to satisfy any family provision order in favour of one, or both, of the Plaintiffs and any costs ordered to be paid."

And that's that – I am stunned and shocked. What was the Senior Counsel thinking? Obviously not the SISA 93.

30. **Kelly's Case, Notional Estate and SMSFs**

We have been through my vies on the constitutionality of any State based laws seeking to usurp Commonwealth law and in particular SISA 93. But as the Tasmanian Dams case was only a 4:3 majority who knows what the High Court would decide in relation to superannuation, which is not a specific head of legislative power under section 51 of the Constitution of the Commonwealth of Australia 1900. And that could mean everything.

1. **Background and Will of Roy Edward Kelly**

I want to delve into *Kelly v Deluchi* [2012] NSWSC 841 (26 July 2012) to show what can happen when States draft laws interfering with SISA 93. Let's start at the background and it is important to read and absorb this, as it is not an uncommon style of directions and client background:

- The deceased died on 11 December 2009. He was then aged 69 years, having been born in March 1940.
- The deceased was married to Denise Eileen Wallace in May 1962. She predeceased him, having died in June 1981. Mark, Peter and Michele is each a child of the deceased and Denise.
- The deceased married Loretto Pasion in January 1982. There were no children of their union, although Loretto had two daughters who lived in the same household with the deceased and Michele. About a year after they moved in, Loretto and her children left, and were not seen again. *The marriage was annulled in February 1984, as Loretto had remained married to her husband in the Philippines.*
- Mary was born in August 1947. She and the deceased were married in September 1985 and remained married until the deceased's death, nearly 24 years later. In all, their relationship spanned more than 25 years.
- Mary was previously married to Alan James Smith. There were three children of their marriage, namely Michael Alan Smith, who was born in November 1971, Kaylene Jean Smith, who was born in May 1973 and Jennifer May Smith, who was born in July 1974. Mary's marriage to Alan was dissolved in April 1983.
- *At the time of the deceased's marriage to Mary, he still had the care of Michele, whilst Mary had the care of her three children*. They all seem to have lived together for some time although the detail of the family arrangements during this period is scant. (Michele says that only Mary and Michael moved in to the deceased's home.)

-

The deceased left a Will that he made on 16 July 2009, Probate of which was granted, on 16 August 2010, by this Court, to Alexander and Robyn.
The deceased's Will, relevantly, provided for:

(a) a pecuniary legacy of $50,000 to Mark:
(b) a pecuniary legacy of $75,000 to Peter:
(c) a pecuniary legacy of $75,000 to Michele :
(d) a pecuniary legacy of $10,000 to the deceased's friend, Errol Larbalestier.

It went on to leave:

(iv) Forty percent (40%) of my Life Insurance policy proceeds to be divided equally amongst my six (6) grandchildren being the children of my son Peter and my daughter Michele;
(v) Sixty percent (60%) of my Life Insurance policy proceeds to be divided equally amongst my two (2) grandchildren, being the daughters of my son Mark; ..
(vii) My Rollex (sic) watch (known as 'oyster perpetual - just date) to my son Peter Roy Kelly;
(viii) My Toyota Landcruiser and my Golf Caravan to my stepson Michael Smith; and
(ix) The balance of my Residuary Estate to my Wife, Mary. ..."

The deceased then made a bequest of $2,000 to Alexander and Robyn for their time and effort required to distribute the estate. Finally, in the Will, the deceased explained that he had left Mark less than he had left to Peter and Michele because his relationship with Mark "has not been constant".

2. **The Estate and the SMSF**

Roy Kelly died with an estate of $281,000, reduced to $262,000 by the time of the hearing due to probate, funeral and other expenses. In addition Roy held a joint tenancy in a property in Belrose with Mary. There was a superfund with a corporate trustee in which Roy and Mary were directors and at the time of death Roy had a member's benefit of $1,234,702 which had shrunk to $1,043,009 by the time of the hearing. Costs of the case to date were $190,000 which included legal expenses plus airfares and accommodation for Peter and Michele, Roy's youngest children who resided in Canada.

The estate was not enough to pay out all of Roy's bequests and as a result the Executors needed to cut back on all bequests and in reality, cost of the proceeding, unless super was taken into account, would have eaten into the majority of the estate with beneficiaries getting cents in the $$.

Looking at the SMSF it held shares and business real property at Willoughby which was used by Roy in his engineering business. The latest trust deed provided as follows in relation to death benefits:

> "Subject to the Relevant Law, upon the death of a Member or Beneficiary who had Dependants, the Trustee shall:
>
> > (i) if required by a Death Benefit Notice given by the Member or Beneficiary to the Trustee, pay or apply the Benefit in accordance with that Death Benefit Notice;
> > *(ii) otherwise, pay or apply the Benefit to or for the benefit of one or more of the Member's or Beneficiary's Dependants (including any Nominated*

Dependants) and legal personal representative in such proportions, form, manner and at such times as the Trustee shall from time to time in its discretion determine provided that the payment of the Benefit shall comply with the Relevant Law." [This is a shocker!]

Hallen J noted in the case that *"At an Extraordinary General Meeting, held at the Belrose property on 18 February 2010, it was noted that an application of Death Notice Benefit in respect of the deceased had been received from Mary and a resolution was passed "[T]o allocate death benefit of former member and reversionary pension to the widow. No other person is known to be financially dependant at the time of death on the former member ...". The resolution was signed by Mary as "Chairperson for and on behalf of [the Trustee] ATF [the Fund]."*

Note: The clause of the deed in relation to the distribution of death benefits where no Death Benefit Notice was received by the Trustee was woeful but the fact that Mary tried to put in place a Death Benefit Notice for him post the death of Roy was even worse.

3. **The Result**

Hallen J looked at whether the deceased's superannuation benefits could form part of Roy's notional estate and be used for distribution to eligible persons which he noted included:

- His children
- His step children
- His grandchildren
- His ex- wives including the Filipino from25 years ago in the annulled marriage

In terms of whether Roy's super and the SMSF monies could form part of the notional estate, Hallen J noted:

> *"Senior counsel for Mary and the Trustee made no submissions, in writing, or orally, that the Court, for any reason other than that the claim of each of the Plaintiffs should be dismissed, should not make an order designating property as notional estate. To the contrary, it seemed to be accepted by him that such an order could be made to satisfy any family provision order in favour of one, or both, of the Plaintiffs and any costs ordered to be paid. In any event, having considered the evidence, I am satisfied that a notional estate order may be made in the circumstances of this case. There is no evidence relied upon which would prevent such an order being made."*

So Hallen J took into account Mary's SMSF monies and determined he appropriate distribution under the estate, topped up by super monies should be:

1. Peter should receive a legacy of $150,000
2. Michele should receive a legacy of $100,000
3. The $190,000 in legal and other costs

It could have been a lot worse and a lot of mistakes were made, particularly with the SMSF Deed. I wonder if there is a better way? What do you think???

31. **In Super Death gives new Life – if you're fast**

The average size member's benefit in a SMSF is $600,000. But taking into account the lower balances of younger members, we are probably closer to $1M which seems to play out in the various cases dealing with binding death benefit nominations and *Kelly's case* that we reviewed in terms of bringing in a deceased's superannuation benefits into a notional estate.

It goes without saying that death brings grief for all those let behind, *but death is a part of life*. The bushfires that burned Australia, killing vast amounts of animals, insects, our fellow Australians and crushing many people's homes and livelihoods was destructive and a death on earth. We all felt grief at what was happening and left us looking for answers on why it happened and what could be done to prevent it next time. Let's hope that a Royal Commission into the bushfire crisis can review the vast array of evidence to come up with some real solutions. But while we reflect on the past, a common human condition, the bush gets on with living. This photo published recently shows the new growth, the new life emerging from the charred landscape. Life goes on.

SMSFs and Death Benefits – be the Bush

For retail and industry superannuation funds the passing of a deceased member's death benefits to dependants to create new life and vigour for the family will take a long time. The ability of any dependant and inter-dependant person to make a claim against the member's benefits in the Superannuation Complaints Tribunal ("SCT") sees trustees of retail and industry super funds being extra cautious. But for SMSFs that fall outside the legislative reach of the SCT, paying out a member's death benefits could happen within hours of the receipt of a death certificate. Take a reversionary pension for example, with a spouse as the reversionary pension member. As soon as the Trustee receives notification the member has died the deceased's pension account is closed and the remaining balance is transferred to the new reversionary pension beneficiary. The only hold up is the administrators to the Fund but a good administrator or professional advising the Trustee of the Fund would ensure that this happens within days of the death of the member.

For non-reversionary pensions on the death of a member, depending on the trust deed, they fold back to the deceased member's accumulation account and aggregate with other benefits in that account all ready for the payment of death benefits as soon as practicable per SIS Regulation 6.21. Now if there is a valid binding death benefit nomination or better still a SMSF Will, then the process of paying out the benefits should take no more than a month and hopefully a lot less courtesy of a good adviser. Yet too often I see the Trustee and their advisers sitting on their hands and sometimes taking years to pay out death benefits.

Now here is the strategy, if the death benefits are paid out to give new life to the beneficiaries and this happens before probate of the deceased's estate, or even before the Executor can find the deceased's last will and testament, then the superannuation estate is done and dusted. A Family Provisions challenge will amount to a hill of beans as the saying goes. And what lawyer would want to take on a tough case where there can be no pressure exerted on the Trustee – particularly the No Win - No Fee lawyers. In NSW, the only state with the concept of the notional estate, things may be different but you know my view on the constitutionality of the notional estate and super. But importantly if the deceased's superannuation benefits are no longer there, then any challenge is clouded. And if it is a one member fund then wind that thing up!

But how do we speed up the death benefit payment process? Let's find out .....

32. **Steps to close out a Death Benefit Quickly**

We all know that it is important to pay out superannuation death benefits quickly – *generally no longer than a month post the death of the member*. Unfortunately with a retail or industry superannuation fund that is impossible courtesy of the Superannuation Complaints Tribunal but not for SMSFs. So why does it take so long to complete superannuation death benefit payments for the majority of SMSFs when the Superannuation Complaints Tribunal does not apply to SMSFs?

It's simple – how do you do it?

To be honest accountants and administrators are great at accounting for contributions, making pension payments, ensuring compliance and doing what the modern day software systems such as BLG's simple super and Class Super but these systems do not have administrative processes for death benefits automated. Plenty of feeds to make financial administration easy but not creating basic to sophisticated estate planning strategies or how to wind up a fund or pay out a death benefit. So when writing my latest SMSF book "The Guru's Guide to SMSFs" I decided to flowchart the exact process for what happens on the death of a member. That chart is below and consists of a maximum nine steps which a trustee, administrator or accountant can follow to pay out a superannuation death benefit of a member or better still use an automation platform that deals with the pay out of death benefits. At this stage the only platform offering death benefits, estate planning, LRBA and many other SMSF strategies is LIghtYear Docs.

WHAT HAPPENS ON THE DEATH OF A MEMBER OF THE FUND

STEP 01 – Member's death sparks a course of action by the Adviser and the Trustee

A Obtain notification and note from the Trustee that the member is dead
B Advice to be sought dependant upon any formal requests in the Binding Death Benefit Nomination SMSF Will or Conditional Pension

STEP 02 – Documentation Review – linked to the Members

A Review the SMSF Trust Deed
B Check that the lineage and any Change of Trustee documents are correct
C Review the BDBN, SMSF Will and any Pension documentation

STEP 03 – Trustee/Director Appointment

A What do the Trust Deed or the Trustee Constitution require for SMSF replacements?
B What voting powers apply to the existing Trustees and Replacement Trustee/Director?
C What is the Adviser's position?
D Notify the Regulators

STEP 04 – Fund-Member Insurances

A Review any Fund/Member Insurances
B Contact Life Broker to accelerate insurance payout
C Determine Insurance distribution policy

STEP 05 – Determine Member Death Benefits

A Calculate death benefits in line with the trust deed – BDBN or SMSF Will
B Are there any reserve payments?
C Value assets used to pay death benefits

STEP 06 – Auto-reversionary Pensions

A What does the deed state regarding the transfer of the pension?
B Review of Pension documentation for compliance and transfer of Pension Account

STEP 07 – Set up Payment Schedules

A Be careful as the SIS Act requires that once the first payment is made the Replacement Trustee must step down
B Review who is to get what payment – lump sum or income steam and are there any in-specie payments?

STEP 08 – Retirement of Replacement Trustee

A The laws require the retirement of the Replacement Trustee/Director
B Ensure new Members become Trustee/Director unless incapacitated

STEP 09 – Ongoing payout of Pensions

A What are continuing Pension requirements?
B Is there a SMSF Guardian in place to protect further reversionaries down the line?

APPENDIX A

The Honeypot of Super – are the States coming to tax it?

1. Introduction

The various States of Australia are voracious when it comes to increasing revenue to build infrastructure, provide subsidised transport services, pay for their public servants and of course their politicians. Originally able to levy income taxes, this power was ceded to the newly formed Commonwealth by way of the Commonwealth of Australia Constitution Act 1900. From that time States have introduced a whole raft of taxes including payroll taxes, stamp duties, landholder duties, foreign investor surcharges, royalties, fines and GST revenue allocated from the Commonwealth Government.

Take NSW (see Chart One) for example with a Budgeted revenue of $84Bn this financial year, with a significant increase projected in Taxation and Commonwealth GST revenue until the income year ending 30 June 2023. But there is only so much they can tax and if the property market slows, great holes appear. And the Federal Government is more likely to slow GST grant revenue or reshape it with strings attached.

In this article I am going to look at the very real chance that the States will work to levy, tax or someway place a charge on their residents superannuation, not directly but indirectly. Of course there will be massive pushback and the two big factors going against are competition and the Constitution of Australia but NSW has introduced laws sneaking into super already and perhaps the next step may be a death benefits levy.

Chart One: NSW Budgeted Revenue

Table 4.2: General government sector - summary of revenue

	2017-18 Actual $m	2018-19 Revised $m	2019-20 Budget $m	2020-21 $m	2021-22 Forward Estimates $m	2022-23 $m	% Average growth p.a. 2018-19 to 2022-23
Revenue from transactions							
Taxation	31,326	31,263	31,841	33,876	35,296	36,665	4.1
Grant revenue (including GST)	31,860	31,857	33,003	34,260	35,953	37,635	4.3
Sale of goods and services	8,508	8,797	9,762	10,421	9,972	8,988	0.5
Interest income	558	531	333	322	288	272	(15.4)
Dividends and income tax equivalents from other sectors	1,578	1,921	1,877	1,359	796	779	(20.2)
Other dividends and distributions	2,114	1,796	2,001	2,002	2,203	2,351	7.0
Royalties	1,763	2,074	1,988	1,967	1,961	1,955	(1.5)
Fines, regulatory fees and other revenues	2,967	2,888	3,510	3,425	3,549	3,363	3.9
Total revenue	**80,672**	**81,128**	**84,316**	**87,632**	**90,018**	**92,009**	**3.2**

2. Competition – States fighting for Business

Each State levies much the same sort of taxes and levies relying on similar Budgetary Income items but with some *well-directed exemptions and concessions* that can make that State more attractive than others to business, families, retirees and property owners.

A classic case in point was death duties where until the 1980's Australian States levied death and probate duties. However Premier Joh Bjelke Peterson promoting Queensland as the retirement capital of Australia started the first move to abolish death duties with a total inter-spousal exemption from death duties in Queensland in 1975, followed in 1977 by total abolition of estate and gift duties in that State. Retirees flooded in from all States and soon other States around Australia followed suit so that all death and probate duties were removed with the final bastion being Tasmania in 1982.

From an SMSF perspective NSW was one of the first states in Australia to provide concessional stamp duty for the transfer of property from an individual to a SMSF either directly or via an LRBA provided it is for their retirement purposes and segregated from other assets and members of the Fund. No such exemption exists in Queensland. Or the stamp duty exemption in South Australia for transfers of industrial or commercial property. Each state government has its focus but at the end of the day the main drivers of revenue are GST grants and stamp duties on land transfers.

If one State reintroduced death duties on, say the payment of death benefits, it would cause a furore but it would a resident of a State leave that State for a death benefit tax? Some may but like the Foreign Surcharge on Property – once a new tax or surcharge takes hold it sweeps through all States.

3. Can a State tax or draft laws impacting Superannuation?

Chart Two shows the current and projected statistics for superannuation in Australia and wouldn't the States love to have even the smallest slice of it – even a 1/1,000th of a percent tax on it. It would solve so many budget issues and I am sure there would be cogent arguments put to advance the case. But could they?

Chart Two: THE BIG SUPERANNUATION HONEY POT

Projected superannuation assets

Year	Consensus private sector forecast ($billion)	Treasury 2008 asset forecasts ($billion)
2020	2,900 - 3,100	2,815
2025	3,500 - 4,500	3,830
2030	5,000 - 6,500	5,075
2035	6,100 - 8,500	6,650
2040	9,000 - 10,500	8,645

Source: Assorted forecasts, Treasury RIM Group and Cooper Review.

4. Starting Point – The Commonwealth Constitution

Section 5 of the Commonwealth of Australia Constitution Act 1900 provides:

> "This Act, and all laws made by the Parliament of the Commonwealth under the Constitution, shall be binding on the courts, judges, and people of every State and of every part of the Commonwealth, notwithstanding anything in the laws of any State; and the laws of the Commonwealth shall be in force on all British ships, the Queen's ships of war excepted, whose first port of clearance and whose port of destination are in the Commonwealth."

In effect all of the States chose to come together in 1900 to create one Commonwealth of Australia and provide rules and laws in relation to a wide range of things and matters including:

51 Legislative powers of the Parliament

The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

> (ii) taxation; but so as not to discriminate between States or parts of States;
> (xx) foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth;
> (xxiii) invalid and old-age pensions;
> (xxix) external affairs.

As could be expected in 1900 there was no superannuation power of legislation and there still isn't to this day. As such the Commonwealth Parliament does not have, prima facie, powers to make laws dealing with superannuation. This was the major concern I raised decades ago in relation to the Occupational Superannuation Standards Act 1987 enacted by the

Commonwealth government – *was it in fact constitutional?* This issue was addressed by the introduction of the Superannuation Industry Standards Act 1993 which provides at section 19 for a superannuation fund to be regulated, and thereby entitled to tax concessions under the Income Tax Assessment Act 1997 it has to be established by way of a company or for the sole or predominant purpose of old age pensions – two of the constitutional powers above. A very roundabout way to regulate superannuation, particularly as the core companies power lies in the Corporations Act 2001 and with ASIC.

5. State v Commonwealth Government Powers – the Tasmanian Dams Case

The seminal constitution case on State v Commonwealth government powers was *Commonwealth v Tasmania* ("Tasmanian Dam case") [1983] HCA 21; (1983) 158 CLR 1 (1 July 1983). In short the Tasmanian government sought to build a Hydro Electric dam in Tasmania and the Commonwealth government, following Bob Hawke's Labor Party win, passed the World Heritage Properties Conservation Act 1983 (Cth), which, in conjunction with the National Parks and Wildlife Conservation Act 1975 (Cth) enabled them to prohibit clearing, excavation and other activities within the Tasmanian Wilderness World Heritage Area.

In a split decision – 4:3 the High Court held that – *"Section 9(1)(h) of the World Heritage Properties Conservation Act 1983 is valid. In consequence, except with the consent in writing of the Commonwealth Minister, it is unlawful for any person to do the following acts in relation to particular specified property adjacent to the Franklin River, including Kutikina Cave and Deena Reena Cave: (a) carrying out works in the course of constructing or continuing to construct a dam that, when constructed, will be capable of causing the inundation of that property or any part of it; (b) carrying out works preparatory to the construction of such a dam; (c) carrying out works associated with the construction or continued construction of such a dam."*

It is clear that where the Commonwealth has a power to legislate, such a companies and taxation the States do not have such authority. But superannuation? Plus the Tasmanian Dams case was only a 4:3 majority on a specific head of power.

6. The door opens - Family Provisions Act (NSW) 1982 and updated Succession Act (NSW) 2006– can it impact Super?

There has been much argument from estate planning lawyers, although never challenged or used that the Succession Act NSW 2006 and specifically the rules in relation to a deceased's notional estate applies to superannuation. Can a State parliament make laws to direct a trustee of a federally authorised body to do something, even if it means the trustee is breaching the federal law?

Let's start by looking at the all-important idea of making a family provision claim against a deceased's estate. Law Access of NSW provides the following guidance:

i) What is a family provision claim?

A family provision claim is an application to the Supreme Court of New South Wales for a share or a larger share from *the estate of a deceased person*.

You can make a family provision claim if you:

- *are an 'eligible person', and*
- *have been left out of a will, or*
- *did not receive what you thought you were entitled to receive.*

A family provision claim must be filed with the court within 12 months of the date of death (where the deceased person died on or after 1 March 2009). It is not necessary to obtain a grant of Probate or a grant of Letters of Administration before making an application for family provision.

ii) Who is eligible to make a family provision claim?

A family provision claim can only be made by an 'eligible person'.

An 'eligible person' includes:

- *the wife or husband of the deceased*
- *a person who was living in a de facto relationship with the deceased (including same sex couples)*
- *a child of the deceased (including an adopted child)*
- *a former wife or husband of the deceased*
- *a person who was, at any particular time, wholly (entirely) or partly dependent on the deceased, and who is a grandchild of the deceased or was at that particular time a member of the same household as the deceased*
- *a person with whom the deceased was living in a close personal relationship at the time of the deceased person's death.*

iii) What will the court consider?

Before making an order, the court will consider the following:

- the relationship between the applicant and the deceased person
- any obligations or responsibilities owed by the deceased person to the applicant
- the value and location of the deceased person's estate
- the financial circumstances of the applicant, including their current and future financial needs
- whether the applicant is financially supported by another person
- whether the applicant has any physical, intellectual or mental disabilities
- the applicant's age
- any contribution made by the applicant to increase the value of the estate
- whether the deceased person has already provided for the applicant during their lifetime or from the estate
- whether the deceased person provided maintenance, support or assistance to the applicant
- whether any other person is responsible to support the applicant
- the applicant's character
- any applicable customary law if the deceased was Aboriginal or Torres Strait Islander
- any other claims on the estate
- any other matter the court may consider as relevant.

iv) The Notional Estate

A notional estate only comes into play in the Supreme Court when there is a family provision claim and there is a relevant property transaction. In Kelly v Deluchi [2012] NSWSC 841, Justice looked at whether the payment of a death benefit from a SMSF was a relevant property transaction. In that regard Hallen J stated:

> "I am satisfied that the basis of a relevant property transaction for the purposes of s 75 has been established and that it is taken to have been entered into immediately before, and to take effect on, the occurrence of the resolution of the Trustee, in February 2010, that is to say, after the deceased's death …. *In all the circumstances of this case, I propose to make an order designating part of the property held by the Trustee as notional estate."*

The end result was that children of the deceased had the bequests their father left them in the will doubled and more than $150,000 in costs awarded against the trustee of the SMSF. Interestingly there was no argument from counsel of the SMSF trustee that the SIS Act 93 has it's own laws for death benefits and that such a direction by the Courts to the Trustee of the SMSF would breach various sections of SISA 92.

There are so many questions to this case – what would have happened if there was a reversionary pension? Would it have to be commuted? Could the Trustee of the SMSF take action against the Court for breach of SISA 93.

Summary

The NSW Succession Act 2006 opens a door, that if not closed or put to bed constitutionally, may result in the States one day levying duties on superannuation death benefits, super benefits or who knows how inventive they may get. Is that what we really want?