

FROM THE EDITOR, ISSUE 26. 14/9/2011

Superannuation and Death Benefits

Rivkin Super was launched in March this year, offering people a highly cost effective, streamlined self managed superannuation administration service. Rivkin Super includes an ongoing membership to the Rivkin Report.

In this From The Editor, Rivkin Super manager Charity Bru discusses taxation implications regarding a members superannuation assets when they die. The issue is potentially complex, and there are a number of issues to consider.

To be paid a superannuation death benefit at all, the beneficiary must first meet the Superannuation Industry (Supervision) Act 1993 (SISA) definition of dependency. Then, taxation treatment of the benefit paid depends on the definition of dependency according to the Income Tax Assessment Act 1936 (ITAA).

What is a superannuation death benefit?

When a member of a superannuation fund dies and the superannuation money is paid out, the payment is called a 'superannuation death benefit'. The payment can be in the form of a lump sum or income stream.

Who is eligible for a superannuation death benefit?

Superannuation death benefits can only be directly paid to a dependent as defined by the SISA. This generally means a spouse (including de facto), any of your children, and, from 1 July 2008, any person with whom you had an 'interdependency relationship'.

For the purposes of the SISA, two people are in an interdependent relationship (whether or not they are related by family) if:

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

The interdependency provisions mean that SISA dependents now include domestic carers and same sex partners.

How are superannuation death benefits taxed?

How the eligible beneficiary is taxed depends on whether the beneficiary is a dependant according to the ITAA. This differs slightly to the SISA definition of a dependent.

For the purposes of the ITAA, a dependent is a spouse (including de facto), your children under 18, and anyone who relied upon you for financial maintenance or maintained an interdependency relationship at the time of passing.

An interdependency relationship for ITAA purposes is the same for SISA purposes.

1. If the beneficiary is an ITAA dependant

If an individual falls into the definition of both a SISA dependent and a ITAA dependent, such as a spouse or child under 18, then they may receive a benefit directly from the deceased's superannuation, and this may be paid as either an income stream or a lump sum, and the income will be taxed as per table 1 below.

Table 1: Tax Treatment where the Beneficiary is an ITAA dependant

	Dependant aged 60 or over, or the deceased died aged 60 or over	Dependant aged under 60 and deceased died under age 60
Tax free component (such as non-concessional contributions)	Tax free	Tax free
Taxable component (such as employer and salary sacrificed contributions)	Tax free	Taxed at marginal rates, with a 15% tax offset

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2. If a beneficiary is not an ITAA dependant

If an individual falls into the definition of a SISA dependent but NOT an ITAA dependent, such as an adult child, then they may receive a benefit directly from the deceased's superannuation but it may only be paid as a lump sum. The benefit paid will then be taxed as per table 2 below.

The components of your superannuation benefit will be maintained in your superannuation fund and can generally be found in your annual member's statement.

The proportioning rule

In the past you could choose what component of your benefit was paid out (i.e. you could choose to pay a benefit solely from the tax free component). Now, all benefits paid from super must have the proportioning rule applied. This means that the benefits will display the same proportions of tax free and taxable components as the whole of the member's benefit upon their decease.

Case Study

To put these rules into context, let's look at an example. Mr and Mrs Fry are elderly and still living together in their old age (both over 60 years old). They have two children, both over 18 who have left the nest and have both started their own families. Both Mr and Mrs Fry have nominated each other as beneficiaries for their super, and then to their children in equal shares, then to their legal personal representative thereafter.

Scenario 1a – Firstly, Mr Fry passes away

In the event of Mr Fry's decease, Mrs Fry will receive his superannuation as she is his nominated beneficiary. She is over 60 years of age and qualifies as a dependant for SISA and ITAA purposes; therefore she will receive the income tax free. As a spouse, Mrs Fry can receive the benefits either as an income stream directly from the fund, or she can pay it out of the fund as a lump sum. The only difference is that if the benefit is paid as a lump sum it will exit the superannuation environment and therefore any income earned on that amount afterwards will be taxed at Mrs Fry's marginal tax rates. If the benefit is paid as an income stream, it remains in super and any income earned on that component will be tax free.

Note that if both Mr and Mrs Fry were under 60 years of age when Mr Fry died, Mrs Fry would have to pay tax on her benefit at her marginal income rates of tax, with a 15% offset.

Scenario 1b – Then Mrs Fry passes away

In the event of Mrs Fry's decease, she has nominated her two children to receive her benefits in equal shares. Unfortunately, though the children qualify as SISA dependants and therefore can be paid directly from the superannuation fund, they do not qualify as dependants for tax purposes.

This means that the benefit can only be paid to the children as a lump sum, and taxed according to the components of the benefit (see table for tax on lump sum payments above). Yes, this means that the adult children will have to pay tax on superannuation benefits received from parents, even though if the parents had remained alive the benefit would be paid tax free.

Table 2: Tax Treatment where the Beneficiary is not an ITAA Dependant

		Tax Treatment in hands of beneficiary
Tax free component (such as non-concessional contributions)		Tax free
Taxable component (such as employer and salary sacrificed contributions)	Element taxed in the fund	Taxed at 15% plus Medicare levy 1.5%
	Element untaxed in the fund (untaxed elements in super are generally found in certain public sector funds)	Taxed at 30% plus Medicare levy 1.5%

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Scenario 2 – Mr and Mrs Fry’s children pre-decease them

If Mr and Mrs Fry’s children pass away prior to both of their decease and they have no remaining dependants that fall into the SISA definition, the benefit would pass to the legal personal representative of the last remaining survivor upon their decease. It would then be up to the trustee of that individual’s Estate to distribute the benefit in accordance with their Will, and each beneficiary is then taxed according to the lump sum table above.

Confused? The flowchart on the next page might help with determining the eligibility of beneficiaries to receive death benefits directly from super and their tax treatment.

The Recontribution Strategy

One method that can be used to try and minimise the taxes payable upon death is the ‘Recontribution Strategy’.

This strategy involves withdrawing your superannuation benefit, then recontributing it back to the fund as a non-concessional (undeducted) contribution. This means that the component recontributed to the fund now becomes tax-free. As the tax-free component of a super fund is always tax-free to the beneficiary (see Table 2), increasing the tax-free portion lowers the overall level of tax paid after death.

When can the Recontribution Strategy be used?

The Recontribution Strategy involves the withdrawal and contribution of super, so you must be eligible to do both to take advantage. Generally, this only happens under the following circumstances:

- You are between 65 and 75 years of age and you are still meeting the ‘work test’ (working 40 hours in any 30 day period during the financial year); or
- You reach age 55 and retire fully from work; or
- You reach age 55 and commence a Transition to Retirement Pension (you can only withdraw up to 10% of your balance each year).

You must also consider the non-concessional contribution limits each year when recontributing.

Conclusion

As you can see, the payment of death benefits from superannuation can be a potentially complex situation. Therefore, it is very important to take your superannuation into account as part of your estate planning and to consider the use of death benefit nominations. To find out more about your specific personal situation, please contact your superannuation administrator or solicitor.

Please contact Charity Bru at Rivkin Super on **(02) 8302 3607** or charity.bru@rivkin.com.au to discuss any general questions you may have.

Good Investing,



Charity Bru,
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The following flowchart may help determine the tax treatment of your super benefits upon death:

