

***SMSFD 2008/D1 - Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) Act 1993 on a fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?***

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This document has been finalised by SMSFD 2008/3.

! There is a Compendium for this document: SMSFD 2008/3EC .



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# Draft Self Managed Superannuation Funds Determination

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Self Managed Superannuation Funds: is there any restriction in the *Superannuation Industry (Supervision) Act 1993* on a fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?

## Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which provisions of the *Superannuation Industry (Supervision) Act 1993*, or regulations under that Act, apply to superannuation funds that the Commissioner regulates: principally self managed superannuation funds.

Self Managed Superannuation Funds Determinations (whether draft or final) are not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than the final version of this determination indicates, the fact that you acted in accordance with the final version of this determination would be a relevant factor in your favour in the Commissioner's exercise of any discretion as to what action to take in response to a breach of that law. The Commissioner may, having regard to all the circumstances, decide that it is appropriate to take no action in response to the breach.

## Ruling

1. No. Section 59 of the *Superannuation Industry (Supervision) Act 1993* (SISA)<sup>1</sup> and Superannuation Industry (Supervision) Regulations 1994 (SISR) regulation 6.17A do not apply to self managed superannuation funds (SMSF). This means that the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A.
2. However, a death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards in the SISR. The relevant operating standards are mentioned in Appendix 1 of this draft Determination.

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<sup>1</sup> All legislative references in this determination are to the SISA unless otherwise indicated.

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## **Date of effect**

3. It is proposed that when the final Determination is issued, the Determination will apply both before and after its date of issue. However, the Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

## **Funds to which this Determination applies**

4. This Determination applies to SMSFs<sup>2</sup> and former SMSFs.<sup>3</sup> References in the Determination to SMSFs include former SMSFs unless otherwise indicated.

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**Commissioner of Taxation**

10 September 2008

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<sup>2</sup> As defined in section 17A.

<sup>3</sup> A former SMSF is a fund that has ceased being a SMSF and has not appointed a registrable superannuation entity (RSE) licensee as trustee – see subsection 10(4).

## Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached.***

### Background

5. The payment of death benefits from a superannuation fund is determined in accordance with the governing rules of the superannuation fund and not in accordance with the terms of the deceased's will.<sup>4</sup> Trustees of SMSFs cannot abrogate their responsibility in making decisions in the exercise of their fiduciary functions except as authorised under the governing rules of the trust or legislation.<sup>5</sup> When undertaking their duties, trustees must act in good faith, responsibly and reasonably.<sup>6</sup>

6. The payment of death benefits from a superannuation fund is therefore ultimately a matter for the discretion of the trustee of the fund unless legislation or the governing rules provide otherwise.

### Legislation

7. Section 55A, which applies to 2007/08 and later income years, provides that the governing rules<sup>7</sup> of a regulated superannuation fund must not permit a fund member's benefits to be cashed after the member's death otherwise than in accordance with the operating standards.<sup>8</sup> The governing rules of a fund are invalid to the extent that they are inconsistent with this SISA requirement.<sup>9</sup>

8. SISR regulation 6.22 specifies the range of persons in whose favour the death benefits of a member of a regulated superannuation fund may be cashed. Death benefits may, subject to certain limited exceptions,<sup>10</sup> only be paid to a member's legal personal representative or one or more of the member's dependants.<sup>11</sup>

9. SISR regulation 6.22 does allow death benefits to be cashed in favour of another individual if, after making reasonable enquiries, the fund trustee is not able to find either a legal personal representative or a dependant of the member.<sup>12</sup>

10. Subsection 59(1) provides a prohibition against the governing rules of a superannuation entity permitting a discretion to be exercised by a person other than the trustee, but the prohibition does not apply to SMSFs.

<sup>4</sup> *McFadden v. Public Trustee for Victoria* [1981] 1 NSWLR 15 at 22.

<sup>5</sup> *Scott v. National Trust* [1998] 2 All ER 705 at 717.

<sup>6</sup> *Scott v. National Trust* [1998] 2 All ER 705 at 717.

<sup>7</sup> As defined in section 10.

<sup>8</sup> Subsection 55A(1).

<sup>9</sup> Subsection 55A(2).

<sup>10</sup> An exception to SISR regulation 6.22 is also provided to enable member benefits to be cashed in favour of a non-member spouse under a payment splitting arrangement established under the *Family Law Act 1975*. (SISR subregulation 6.22(1) in conjunction with Part 7A of SISR. Refer also SISR subregulations 6.17(2A) and (2B)).

A further exception enabling member's benefits to be cashed in favour of a non-member can arise where the Regulator has given written approval for the purposes of subparagraph 62(1)(b)(v).

<sup>11</sup> SISR subregulation 6.22(2).

<sup>12</sup> SISR subregulation 6.22(3).

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11. Subsection 59(1A) overrides subsection 59(1) to allow for certain death benefit nominations in accordance with the regulations. Subsection 59(1A) does not expressly exclude SMSFs from its scope. On one possible reading of the provision, the restrictions it places, in the course of providing an exception to the general rule in subsection 59(1), on the creation of binding death benefit nominations also apply to SMSFs. The Commissioner does not agree with this interpretation.

## **Explanation**

12. A member can make a death benefit nomination that is a binding direction on the trustee of an SMSF if that is provided for in the governing rules of the fund.

### ***The statutory requirements in section 59(1A) and regulation 6.17A have no application to SMSFs***

13. Subsection 59(1A) is framed as an exception to subsection 59(1). The Commissioner does not consider that it separately imposes positive obligations or restrictions on entities not covered by the principal rule in subsection 59(1). The rules in subsection 59(1A), and in any regulations made for the purposes of subsection 59(1A), are simply conditions that must be satisfied to attract the exemption from subsection 59(1).

14. The content of SISR regulation 6.17A tends to confirm this view. SISR subregulation 6.17A(3) in particular requires the trustee to give the member seeking to make a nomination certain information to help the member understand the member's rights in relation to the nomination. This provision has little relevance to the administration of SMSFs, whose management and membership are essentially the same people.

15. Therefore, subsection 59(1A) has no application to SMSFs and consequently the requirements prescribed in SISR regulation 6.17A for the making of binding death benefit nominations do not apply to SMSFs.

16. Due to section 59 not applying to SMSFs it is possible, consistent with the SISA and the SISR, for the governing rules of an SMSF to permit a member to make a binding death benefit nomination in a different manner and form to that set down in SISR regulation 6.17A.

### ***Payments must be in accordance with the operating standards***

17. Pursuant to section 55A the governing rules of an SMSF must not permit a fund member's benefits to be cashed after the member's death otherwise than in accordance with the prescribed standards applying to the operation of regulated superannuation funds.

18. Governing rules, to the extent that they purport to permit benefits to be cashed otherwise than in accordance with the operating standards, are made invalid by subsection 55A(2). A death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards.

19. In this regard, an operating standard of particular relevance is SISR regulation 6.22. This operating standard limits the range of persons in favour of whom member benefits can be cashed after the death of the member. Subject to limited exceptions specified in the regulations, member death benefits must be cashed in favour of a member's legal personal representative and/or one or more of the member's dependants.

20. However if a trustee is not, after making reasonable enquiries, able to locate either a personal legal representative or a dependant of a member, the trustee may pay benefits to another individual.

21. With effect from 1 July 2007, SISR regulation 6.21 further restricts the persons to whom the trustee can pay a death benefit in the form of a pension. A death benefit in the form of a pension may be paid only to a person who is a dependant of the deceased member, and in the case of a child of the deceased member is:

- (a) less than 18 years of age, or
- (b) being 18 or more years of age is:
  - financially dependent on the member and less than 25 years of age, or
  - has a disability of a kind prescribed.<sup>13</sup>

22. Prior to the inclusion of section 55A, which became effective from 1 July 2007, a death benefit nomination that purported to direct a trustee to pay death benefits otherwise than as permitted under the operating standards that then existed would still not have been binding on the trustee even if made in accordance with the governing rules.

23. A person who intentionally or recklessly contravenes an applicable operating standard is guilty of an offence punishable on conviction by a fine not exceeding 100 penalty units.<sup>14</sup>

#### *Meaning of dependant*

24. 'Dependant' is defined in subsection 10(1). Dependant includes '*the spouse of the person, any child of the person and any person with whom the person has an interdependency relationship*'. Because the definition is inclusive a 'dependant' for the purposes of the SISA includes a person who is a dependant under the ordinary meaning of the word in the context in which it is used.

25. 'Interdependency relationship' is defined in section 10A. Under section 10A, which through subsection 10A(3) links to SISR regulation 1.04AAAA, two persons have an interdependency relationship if they have a close personal relationship and either:

- (a) they live together, and one or each of them provides the other with financial support, domestic support and personal care, or
- (b) the reason they do not satisfy the requirements in (a) is that either or both of them suffer from a physical, intellectual, psychiatric or other disability, or they are temporarily living apart (for example due to a gaol term).

26. SISR regulation 1.04AAAA prescribes that all of the circumstances of a relationship are relevant to determining if an interdependency relationship exists including several factors listed in the regulation.

<sup>13</sup> Refer to subsection 8(1) of the *Disability Services Act 1986*.

<sup>14</sup> Section 34.

## Appendix 2 – Examples

**❶** *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached.*

### Example 1

27. In 2004 Jen, a member of an SMSF, makes a valid binding death benefit nomination in the form required under the governing rules of the SMSF. The nomination made by Jen requires the SMSF trustee to provide the whole of any benefit payable in the event of her death to Seth, who she was married to at the time. Under the governing rules a member's binding death benefit nomination remains valid for five years from the date received by the trustee.

28. In 2006, Jen and Seth divorce.

29. Jen remarries in 2008 but dies later that year. At the time of death the nomination made by Jen in 2004 had neither been revoked nor amended.

30. The SMSF trustee is not required to follow the death benefit nomination which Jen made in favour of Seth. While the death benefit nomination was made in accordance with the governing rules of the SMSF, Seth, no longer being Jen's spouse, had ceased to be a dependant of Jen for the purposes of the SISA and SISR. Therefore, payment of a benefit to the nominated person would contravene the operating standards of the SISA.

31. As such, the payment of Jen's death benefits becomes subject to the discretion of the SMSF trustee.

32. In this regard, the SMSF trustee must comply with SISR regulation 6.22 and not, subject to limited exceptions, cash the death benefits in favour of a person other than the executor of Jen's deceased estate or any dependants of Jen.

### Example 2

33. Tom is a member of a SMSF and has provided the trustee with a written death benefit nomination made in accordance with the governing rules of the fund. The nomination directs the SMSF trustee to pay Tom's death benefits to his nephew Cameron.

34. Tom dies and is survived by his spouse, the other member of the SMSF. At the time of Tom's death Cameron was financially independent and living in his own flat.

35. Cameron is not Tom's dependant and falls outside the range of persons to whom Tom's death benefits can be cashed in accordance with SISR regulation 6.22. This is because SISR regulation 6.22 restricts, subject to limited exceptions, the recipients of death benefits to the dependants and personal legal representative of the deceased member.

36. As Tom's nomination is not valid due to the operation of section 55A, it is not binding on the trustee. As such the payment of death benefits is a matter for the discretion of the trustee acting in accordance with the governing rules of the SMSF and the requirements of legislation including the SISA and the SISR.

## Appendix 3 – Your comments

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37. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

38. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au).

Please advise if you do not want your comments included in the edited version of the compendium.

<b>Due date:</b>	<b>10 October 2008</b>
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## References

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*Previous draft:*

Not previously issued as a draft

*Subject references:*

- binding death benefit nominations
- death benefits
- self managed superannuation funds
- superannuation

*Legislative references:*

- SISA 1993
- SISA 1993 10(1)
- SISA 1993 10(4)
- SISA 1993 10A
- SISA 1993 17A
- SISA 1993 34
- SISA 1993 55A
- SISA 1993 59

- SISA 1993 59(1)
- SISA 1993 59(1A)
- SISA 1993 62(1)(b)(v)
- SISR 1994
- SISR 1994 1.04AAAA
- SISR 1994 6.17
- SISR 1994 6.17A
- SISR 1994 6.21
- SISR 1994 6.22
- SISR 1994 Pt 7A
- Family Law Act 1975
- Disability Services Act 1986

*Case references:*

- McFadden v. Public Trustee for Victoria [1981] 1 NSWLR 15
- Scott v. National Trust [1998] 2 All ER 705

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ATO references

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