How you can pass on your SMSF wealth effectively

DIY super

Tim Mackay

We all know Benjamin Franklin's quote: "In this world nothing can be said to be certain, except death and taxes." Neither is particularly pleasant but it's a real kick in the guts when you have tax upon death.

I've long believed that all self-managed superannuation fund (SMSF) members should adhere to the Kerry Packer school of taxation – minimise your tax and don't leave the Australian Taxation Office a tip; your family deserves it far more than the ATO. Pay what you owe and no more.

During the 2019 federal election, we saw a scare campaign on Labor's supposed plans to re-introduce a death tax (fake news in the modern lingo). But until 1979, Australia actually had a 27.9 per cent inheritance tax on estates greater than $1 million.

Fast-forward 40 years to 2019 and we still have an effective death tax. Death benefits tax can apply to your super balance when you die at a tax rate of 32 per cent, 17 per cent or 0 per cent (the first two include 2 per cent Medicare levy).

It's complicated how the tax is applied – it's dependent on the tax-free/taxable portions of your super; whether it's sourced from an insurance policy payout; whether it's paid as an income stream or a lump sum; and who receives the death benefit (for example, a spouse is not taxed while an adult child can be).

Be mindful that just because you may be in pension phase and pay no tax, or in accumulation phase paying little tax due to franking credits, this doesn't mean when you die and leave your SMSF proceeds to your family that they will pay no tax.

Everyone's situation is different, but with prior planning much of the super death tax can legally be reduced to zero.

Since the transfer balance account was introduced in 2017, death benefits you leave over the $1.6 million account not in pension phase must be transferred out of the low-taxed super environment.

If you knew the day you were going to die and knew tax would be payable, you could withdraw your accumulation and/or pension accounts the day before. Sure, life doesn't work like this, but if you start to lose capacity, I recommend granting someone you trust an enduring power of attorney (they will need to become a trustee of your SMSF in your place). They can act in your best interests.

Planning is vital to ensure your funds go where you want them to.

You can also consider a recontribution strategy and withdraw money from your super and recontribute to increase your tax-free portion, reducing any potential death tax. You cannot do this if your total superannuation balance (the sum of your accumulation and pension accounts) is more than $1.6 million. Keep within your non-concessional contribution caps and age limits.

Plan on how you want your SMSF assets to be distributed – via your will or via documents such as reversionary pension or death benefit nominations (which can be binding or non-binding).

If the death benefit is paid to beneficiaries via your estate (instead of via a death benefit nomination), it does not attract the 2 per cent Medicare levy.

If you do nothing, your assets do not automatically form part of your estate, which may not be optimal. It can be critical to put in place reversionary pensions and/or death nominations to ensure your wealth is transferred to your family in the way you want. A reversionary pension (to your remaining spouse, for example) can be the best way to keep up to $1.6 million in the zero or low-taxed super environment. However, you must create this at the time you establish each pension.

Be mindful that death benefits can be paid only to a "beneficiary" as defined by super law (for example, a spouse, a child or step-child, a financial dependant, or someone in an interdependency relationship with you or your estate).

All of the above multiplies in complexity if you have a blended family. If you have a sizeable SMSF balance with competing family interests, seek professional SMSF estate planning advice well in advance of any problem. Smart SMSF estate planning ensures your wealth is passed to your loved ones in the most tax-effective manner. It also reduces arguments and allows your grieving loved ones to be the best version of themselves.

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Clarification

The Australian Financial Review published an article on July 16 titled "Death knell of private banking in Australia." JP Morgan disputes the statement in the column that it has "retreated" from private banking in Australia. The bank says this is incorrect and that it's "business as usual".