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Superannuation death benefit limitations

As a trusted adviser to an SMSF trustee, you need to take special care when paying death benefits as you are responsible for ensuring that the payment rules are met.

Strict rules apply, affecting who can receive a death benefit, the form in which the death benefit can be paid and the timing of such a payment.

Firstly, death benefits can only be paid either to dependants of the deceased member or the estate of the deceased.

Second, the law limits the group of dependants who are eligible to receive a pension on the death of the deceased member.

Finally, trustees must pay a death benefit as soon as possible after the death of the member.

Each death benefit interest can only be paid to each dependant as either:

- a maximum of two lump sums (an interim and final lump sum), or
- a pension or pensions in retirement phase, or
- a combination of both.

Limit of a maximum of two death benefit lump sums per dependant

It is the limit of a maximum of two death benefit lump sums per dependant that trustees need to keep track of to ensure that the cashing rules are not inadvertently breached, especially where the death benefit is being paid as a pension.

Given the account-based nature of death benefit pensions that can be paid by an SMSF trustee, an SMSF member is generally afforded the flexibility to nominate to convert a death benefit pension into a lump sum payment. This process is generally referred to as the commutation of a pension although may be subject to specific restrictions found in a trust deed.

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A partial commutation

A partial commutation is where the beneficiary requests to withdraw a lump sum amount less than their total pension entitlement, allowing their death benefit pension to continue. This is common where members withdraw their required minimum drawdown as a pension with any additional income needs met by accessing multiple lump sums from their pension account.

This strategy allows the death benefit pension to continue without breaching the superannuation death benefit rules, despite payments in excess of the maximum two lump sum limit.

A full commutation

A full commutation will result in the death benefit pension ceasing at the time the member decides to withdraw their entire pension entitlement as a lump sum. Despite the number of lump sum death benefits previously received, the law allows the beneficiary to roll over the lump sum resulting from a full commutation to another superannuation fund for immediate cashing as a new death benefit pension.

However, where a lump sum resulting from the full commutation of a death benefit pension is paid out of the superannuation system, further clarity is being sought from the ATO to ascertain whether or not this will be treated as an additional lump sum death benefit that would count towards the maximum two lump sum cashing limit. Until further clarity is provided by the ATO, caution needs to be exercised before a death benefit pension is fully commuted and paid to the dependant, especially where the dependant has previously received a lump sum death benefit.

Payment of death benefits to eligible dependants

As an SMSF trustee you need to be aware of the restrictions placed on the payment of death benefits to eligible dependants of a deceased member. Trustees who ignore these limitations risk breaching superannuation standards and potentially being liable to be fined by the Regulator.

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How can we help?

If you are concerned that the SMSF clients of your practice will be effected by the ever changing myriad of regulation and reporting obligations and do not think that you may have the administration processes covered to meet these obligations for any reason, then please call us to make an appointment to meet and discuss in confidence your particular requirements in more detail and see how we can partner with you to help you with your client's needs.

WE HAVE ADMINISTRATION PACKAGES TAILORED TO WORK WITH YOU

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