Small APRA fund solutions for blended families

When clients remarry they are often keen to ensure that their new spouse is looked after in the event of their death but often they desire to leave assets to children from previous marriages. This can be particularly important if clients remarry later in life, do not have any subsequent children and have accumulated significant assets in their superannuation fund.

The blended family strategy

Using the blended family strategy, a member can arrange for their super death benefit to be paid as a pension to their subsequent spouse (the pension beneficiary) throughout that spouse's life. Then, when that spouse dies, any remaining capital is generally returned to the member's estate and the capital is distributed to the member's children or other superannuation death benefit dependants (the remainder beneficiaries).

From 1 July 2017, the maximum amount that can be used to commence a death benefit pension is $1.6 million.

The member determines how the pension benefit will be calculated and the subsequent spouse cannot commute the pension or rollover to another fund. If the subsequent spouse dies before the client, the arrangement is voided.

Fund types

Self-managed superannuation funds (SMSFs) provide a multitude of opportunities for clients, particularly around estate planning and intergenerational wealth transfers. The other type of self-managed super, a small APRA fund (SAF) is essentially an SMSF with a professional trustee. When it comes to the blended family solution, SAFs provide all of the legislative advantages that are available to SMSFs, but SAFs offer a distinct advantage – the professional trustee holds the cheque book, not the subsequent spouse. While the blended family strategy outlined in this technical fact sheet is available in an SMSF, the concern for clients is that if there was friction between the subsequent spouse and the children from previous marriages, then things may not go to plan. With cheque book in hand, the subsequent spouse could disappear with the money. And, although the children would have recourse for breach of the trust deed provisions, locating the spouse and commencing legal proceedings could be a lengthy and expensive process.

Documentation

The strategy requires a special purpose superannuation trust deed that supports the death benefit design to be included as part of the SAF. A deed of acknowledgement between the three parties (the member, subsequent spouse and the member's children) outlining the arrangement, and acknowledging that they understand it, is also highly recommended.

Members make a written binding determination to the trustee directing them as to the identity of the pension beneficiary and the remainder beneficiaries. The binding determination also includes the calculation method of the pension beneficiary's maximum pension benefit. The trustee will also formally acknowledge and agree to the binding determination.

Calculating the pension

The pension is calculated as a multiple of average weekly ordinary time earnings (AWOTE). AWOTE is currently $1,533.40[1] or $79,736 per annum. The use of AWOTE provides a strong indicator of purchasing power and provides clients with a sound basis for determining the future income needs of their spouse. AWOTE figures are issued by the Australian Bureau of Statistics (ABS) biannually as at May and November.

If a client wanted their spouse to receive an annual pension of $100,000 they would currently select an annual pension of 66 times AWOTE ($101,204 per annum).

The annual pension payment will be adjusted as at 1 July each year to reflect the updated AWOTE figure. The multiple of AWOTE will not change. The only other determination in calculating the annual pension amount is that the minimum pension required by superannuation law must always be paid. If the multiple of AWOTE chosen by the member was less than the minimum annual pension required by superannuation law, the higher minimum would be paid.

1 As at December 2016

Variation to pension calculation

The pension beneficiary can vary the annual pension payment between the superannuation minimum annual pension amount and the amount previously determined by the member. However, the pension beneficiary cannot elect an annual pension payment above the multiple of AWOTE pre-determined by the member.

The pension beneficiary cannot commute or rollover the pension payment however they can forfeit their benefit and have it passed to the remainder beneficiaries at any time.

On the death of the pension beneficiary

Following the death of the pension beneficiary, any remaining balance is paid to the original member's estate. Alternatively, any remaining balance is paid to the remainder beneficiaries as lump sums with PAYG tax deducted.

Blended family case study – Paul and Dianne

Paul and Dianne have been married for two years and they both have adult children from previous marriages. They have a comfortable lifestyle on an income of $300,000 per annum; Paul earns $250,000 per annum, Dianne does not work outside the home and they average $50,000 per annum in income from their investments.

If one of them was to die they want the survivor to be able to maintain a comfortable lifestyle and remain in the family home. Upon the death of the surviving spouse, they want all four children to benefit.

Ten years ago, Dianne's sister Sue married Bill following the death of her first husband several years earlier. Sue and Bill bought a house together and they also each had two children from their previous marriages.

When Sue died a few years ago, all her assets passed to Bill. Bill died just recently. It was the family's understanding that, when Bill died, the estate would be divided between all four children. However, sadly for Sue's children, this wasn't the case and Bill's children received all of the estate assets. Paul and Dianne are keen to ensure that they have secure plans in place to ensure that this can't happen to their children.

Paul and Dianne have the following assets:

Ownership	Asset	Value
Tenants-in-common	Family home	$1,500,000
Joint	Cash	$50,000
Paul	Shares	$1,400,000
Paul	Superannuation	$1,200,000
Dianne	Superannuation	$300,000
Total		**$4,450,000**

After meeting with their financial adviser and estate planning specialist, Paul and Dianne make a number of changes to their financial arrangements. They have Wills prepared which include a lifetime right to reside in the family home. Upon the death of the surviving spouse, all four children will share the proceeds of the sale of the family home. Upon Paul's death, his shares will be used to create a life interest trust, with the trust income paid to Dianne for the remainder of her life and the trust capital to be distributed to Paul's children on Dianne's death. The cash will pass to the surviving spouse on the death of one of them.

Paul and Dianne convert their SMSF to a SAF and make binding determinations specifying each other as the pension beneficiary and their own children as remainder beneficiaries. They set the annual reversionary pension as a multiple of AWOTE, acknowledging that they can change the multiple any time prior to death if their lifestyle needs change.

Five years later, Paul dies and their estate plans are activated. Dianne continues to live in the family home, she has access to cash and income from the life interest trust. Paul's superannuation death benefit is paid to Dianne as a pension at the pre-determined multiple of AWOTE.

Upon Dianne's death, her share of the house will pass to her two children and Paul's share of the house will pass to his two children. It is likely that the children will sell the house and receive a quarter of the proceeds each. The remainder of Paul's superannuation account is paid to his two children and Dianne's superannuation is paid to her two children. The assets of the life interest trust are divided between Paul's children.

Summary

A SAF can provide a powerful estate planning tool for blended families who wish to provide for a subsequent spouse during their lifetime whilst maximising the opportunity to leave a residual estate to children from previous relationships.

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