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Welcome to Estate Affairs – July 2013 edition

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Dealing with blended families in super

By Julie Steed, Technical Services Manager

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. In this article, we will examine a method for achieving both of these objectives within superannuation.

The blended family strategy – how it works
Using the blended family strategy, your client 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 returned to the client's estate and the capital is distributed to the client's children or other superannuation death benefit dependants (the remainder beneficiaries). This basically provides the subsequent spouse with a life interest in the deceased member's superannuation.

The client 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.

Protecting the assets of blended families
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 funds (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 article 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 client, subsequent spouse and the client's children) outlining the arrangement, and acknowledging that they understand it, is also highly recommended.

Clients 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.

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Calculating the pension
The pension is calculated as a multiple of average weekly ordinary time earnings (AWOTE). AWOTE is currently $1,396[1] or $72,592 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 in 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 72 times AWOTE ($100,512 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 client was less than the minimum annual pension required by superannuation law, the higher minimum would be paid.

[1] As at November 2012

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 client. However, the pension beneficiary cannot elect an annual pension payment above the amount pre-determined by the client.

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 remainder beneficiaries as lump sums with PAYG tax deducted.

Blended family case study – Jack and Irene
Jack and Irene have been married for -five years and they both have adult children from previous marriages. They have a comfortable lifestyle on an income of $300,000 per annum.

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, Irene's sister Sarah married David following the death of her first husband several years earlier. Sarah and David bought a house together and they also each had two children from their previous marriages.

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

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Jack and Irene have the following assets:

Ownership	Asset	Value
Tenants-in-common	Family home	$1,000,000
Jack	Superannuation	$500,000
Irene	Superannuation	$600,000
Total		**$2,100,000**

After meeting with their financial adviser and estate planning specialist, Jack and Irene 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 surviving spouse, all four children will share the proceeds of the sale of the family home.

Jack and Irene 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, Jack dies and their estate plans are activated. Irene continues to live in the family home. Jack's superannuation death benefit is paid to Irene as a pension at the pre-determined multiple of AWOTE.

Upon Irene's death, her share of the house will pass to her two children and Jack'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 Jack's superannuation account is paid to his two children and Irene's superannuation is paid to her two children.

Conclusion
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.

Estate planning issues for blended families

By Neil Page, AET Legal Counsel, Estate and Trustee Services

The estate planning issues outlined in Julie's article are important: plan early, plan correctly and seek appropriate advice. This particularly applies to the client but also applies to their adviser who, in advising today's blended families, must be aware of the relevant estate planning options that are available.

As can be seen by the article an active restructure of the client's affairs may be required to enable a solution to be found. The estate planning approach is not always about fitting the current asset structures into the estate plan.

There are a couple of matters in the article that require further discussion.

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Right of residence clauses
The right of residence clause contained in a Will can only apply if Jack and Irene owned the property as tenants-in-common. Ownership by joint tenants will see the property pass to the survivor. In my view Jack and Irene should never have owned the property as joint tenants in the first instance. As can be seen in the case of David and Sarah, this is a recipe for disaster.

Asset ownership should be discussed with your clients to avoid future estate planning issues. The need to understand how assets should be owned can, and should take place at the time of purchase.

The right of residence clause usually provides the survivor with the following options:

1. The right to reside in the residence for as long as the survivor wishes.

2. The right to sell and purchase another residence on the same terms established in the Will for the first residence. A subsequent purchase will be in the name of the executor of the estate and the survivor as tenants-in-common.

3. The survivor will usually be required to pay for all outgoings in relation to the property such as rates, taxes and insurance. In addition they will be required to maintain the property in a similar state of repair and condition during the term of their residence. There is often a legal distinction between what can and cannot be enforced in relation to maintenance requirements and this can sometimes lead to confusion and uncertainty.

4. Any discussion concerning a right to reside must also take into account the possibility that the survivor wants to downsize. This may leave surplus funds from the sale. Are those surplus funds to be paid out to the deceased's children at that time? Or are they to be held in trust for the survivor, with the survivor being entitled to receive income from the surplus funds during the remainder of his or her life? These issues need to be considered and drafted into the Will.

A common problem arises where there is a desire or need to move into retirement living accommodation and an accommodation bond has to be paid. Should the whole of the proceeds from the residence be made available for the 'purchase' of an accommodation bond or just the survivor's interest in the proceeds? What if the survivor's interest in the proceeds is insufficient to purchase an accommodation bond? These are common and real scenarios that must be considered as part of a client's estate planning strategy. There is no right or wrong way but the above issues need to be identified, discussed and resolved.

Does the blended family solution remove the possibility of a family provision claim being made?
Whilst each State jurisdiction is different in relation to family provision claims, the general thrust of the legislation is to ensure that a person who, according to the relevant legislation, should be adequately provided for, is in fact adequately provided for under the terms of the Will.

There is no doubt that in all jurisdictions a surviving spouse is a person for whom the deceased needs to make adequate provision.

Right of residence
Depending on the overall financial circumstances, a Court might determine that a right to reside in a residence does not provide adequate provision for a surviving spouse. One reason for this is that the spouse loses the ability to control their accommodation needs and requirements in later life. A carefully worded and clearly understood right of residence clause that provides the surviving spouse with the ability to relocate and adjust his or her living requirements to their relevant needs will assist a Court's determination that it is adequate provision.

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Superannuation
Apart from the 'notional estate' aspects of the law in New South Wales, other States will not treat the superannuation asset as an asset of the estate for family provision claim purposes. That is, the surviving spouse will not have a claim on the deceased partner's interest in the small APRA fund (SAF) because it does not form part of the estate assets. Ownership and control of the fund always remains with the trustee of the SAF (which in this example is AET). The fund is not paid into the estate of the deceased until after the death of the surviving spouse hence is not subject to any claims by that spouse.

As mentioned above, this scenario may be different in New South Wales. Therefore specific advice needs to be sought in that jurisdiction.

The issue of a family provision claim is mentioned in this article to alert all advisers that even the best laid plans can be challenged and altered by the Courts intervention.

Conclusion
Blended families are complex family structures which present a range of estate planning issues for both clients and advisers. Advisers should be aware of the estate planning options available, such as the blended family strategy, to ensure their client's assets are distributed according to their wishes, when they pass away.

For further information on the AET small APRA fund solution for blended families please click here.

If you have any questions, or need more information, please call us on 1800 882 218 or visit www.aetlimited.com.au