TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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A death benefit is any payment your super fund makes after you die.

Death Benefit

If you still got some super left by the time you die, there are three questions that need an answer. Who gets your super? In what form? And how is this taxed? Gordon Mackenzie of UNSW will try and give you an answer in this episode of Tax Talks. Here is what we learned from talking to Gordon.

Who Gets Your Super

You can give your super to whoever you like. Your super is yours. You decide who gets it when you are gone.

But not everybody can get your super directly from your fund. Only SIS dependants can. The others need to get your super via your estate. So if you want your super to go to a non-SIS dependant, you need to make it clear that your super is to go to your estate and then make a will accordingly.

Your SIS dependants are your spouse and de-facto spouse but not a former spouse and all of your children as well as anybody living in an interdependency relationship with you – think of your elderly parents living with you – or being financially dependent on you – think of your orphaned nephew who you put through college. Only these can get a payment directly from your fund.

How

If somebody gets your super through your estate, then your super has left the super environment by the time it hits your estate. So from there on the SIS Act has no say in what happens to your super next. Your executor runs the show.

But if somebody gets your super directly from your fund, then the SIS Act got plenty to say. The SIS Act wants to get your super out of the super environment as soon as possible. And so there are only a selected few SIS dependants who can receive your super as a death benefit pension.

Your spouse is eligible to receive a death benefit pension. Your children under 18 as as well as any child financially dependent on you and under 25 are as well. And anybody in an interdependency relationship with you, too. But that’s it. Anybody else can only receive your super as a lump sum payment that transfers the assets out of super and back into the general tax pool.

Legal Framwork

Imagine the legal framework around your super like an onion. The outside layer is the SIS Act with the SIS Regulations as its side-kick. The next layer is the trust deed including any clause about a reversionary pension. The next one is any binding death benefit nominations and then non-binding nominations. Then the trustee’s

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discretion. And ultimately your will if your super goes into your estate.

How Is This Taxed

Tax law determines how much tax beneficiaries pay upon receiving a death benefit from you. It stipulates who pays how much tax on what component of the death benefit.

It all depends on two factors. The first one is whether a beneficiary is your death benefit dependant aka tax dependant. Death benefit dependant is the official term ITAA97 uses for a tax dependant.

Your spouse and any former spouse as well as your children under 18 as well as anybody financially dependant on you or living in an interdependency relationship with you is your tax dependant. Sounds like the definition of a SIS dependant? Well, it almost is the same with two differences. Adult children not financially dependant on you are your SIS dependant but not your tax dependant. And a former spouse is your tax dependant but not your SIS dependant.

If somebody is your tax dependant, they receive any death benefit tax-free. If they aren't, they will pay 15% or 30% tax on any taxable component they receive.

And so this leads to the second factor. The amount of tax your non-tax dependants pay depends on the amount of your tax-free and taxable components in your super account. And also on the amount of taxed and untaxed element within your taxable component. Your super statement will tell you how much money you have in each component and element.

The tax-free component consists of any contributions you made out of after-tax income, mainly your non-concessional contributions. Since you already paid tax on these, your beneficiaries won't have to pay tax again. So the tax-free component goes to your beneficiaries without any further tax to pay. It doesn't matter whether they are tax dependants or not. Nobody will pay tax on your tax-free components.

The taxable component consists of any contributions that didn't go into the tax-free component. If you paid 15% contribution tax on these contributions when they came in, they go into the taxed element. Meaning you paid tax on these within the fund. But if you didn't pay tax on these when they came in, notably any life insurance payments, then they go into the untaxed element.

When your super is paid to your non-tax dependants, the legislator wants to claw back any tax concessions you received within super. They see the average tax rate at 30% so this is the tax rate they want to see applied to your super as it goes to non-dependants.

The taxed element was already taxed on 15%, so that element just gets another 15% to get to the target tax rate of 30%. But the untaxed element hadn't been taxed yet at all, so that element is subject to the full top up to 30%.

So the result of all this is that your non-tax dependants will pay 15% tax on any taxed element and 30% tax on any untaxed element.

You can't pick and choose who gets what element or component though. The proportioning rule prevents this from happening. Whatever the proportion between the components and elements within your super account is that is the proportion of any death benefits paid out of your super account.

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