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Technically Speaking: Understanding the Transfer Balance Cap series – Death benefits

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Overview

In the first bulletin of our *Understanding the Transfer Balance Cap* series, we laid a foundation to better understand how the TBC regime operates – in particular, the interaction between an individual's Transfer Balance Account (TBA) and their Transfer Balance Cap (TBC).

We also highlighted several common transfer balance events (which we categorised as either a credit or a debit) – one of which related to the commencement of a death benefit pension.

In this bulletin, we turn our attention to how the TBC regime applies when a death benefit is paid to a deceased member's beneficiary.

Dealing with death benefits

When considering the impact that receiving a death benefit may have on an individual's TBA, it is important to remember the context within which the TBC regime operates. That is, the TBC regime broadly operates by tracking amounts that an individual transfers into, and removes from, retirement phase pension accounts – with the overarching aim to limit the amount that can be transferred to retirement phase.

It is also important to acknowledge that where a member dies, their TBA essentially dies[1] with them. That is, a deceased member's TBA is not inherited by their dependants.

Further, when a deceased member's benefits are cashed as a lump sum, there is no impact to the TBC of either the beneficiary or the deceased member.

As such, where a death benefit is paid as a lump sum superannuation death benefit, regardless of the size of the benefit, there are no TBC implications to be considered.

Of course, where permitted by an SMSF's trust deed, a fund trustee may choose to pay a death benefit as one or more death benefit pensions to an eligible beneficiary.

The discussion that follows will therefor focus on the TBC implications that the payment of a death benefit, in the form of a superannuation death benefit pension, may have on the TBC of the recipient of that death benefit pension.

Before we begin our discussion of the TBC implications, it's worth remembering that a superannuation death benefit pension can only be paid to certain beneficiaries. That is, a death benefit pension can only be paid to a person considered to be a dependant for superannuation purposes.

[1] Section 294-45 ITAA 1997

Additional restrictions apply where the dependant in question is a child. That is, a trustee is unable to pay a death benefit pension to a child aged 18 or older, unless the child:

- Is under age 25 and financially dependant on the deceased member, or
- Has a permanent disability.

Further, unless the child has a permanent disability, the trustee must typically:

- Stop paying the income stream on or before the child turns 25[2], and
- Pay any remaining benefits to the child as a tax-free lump sum.

The payment of superannuation death benefits is discussed in detail in our Go-To Guide: Superannuation Death Benefits.

Death benefits and the TBC

As we established in Bulletin 1 of this *Understanding the TBC* series, any amount(s) used to commence a new retirement phase pension will result in a credit to an individual's TBA.

As a retirement phase pension is defined to include a pension payable as a result of someone else's death, a death benefit pension will be a retirement phase pension. This also includes a Transition to Retirement Income Stream which reverts to a deceased member's beneficiary.

Therefore, whenever a deceased member's benefits are paid to an eligible beneficiary in the form of a death benefit pension, there will be an impact on the recipient beneficiary's TBC – that is, a credit will be applied to their TBA.

As a result, members of a couple will broadly lose the benefit of having two TBCs when one of them dies. And the surviving spouse will need to manage any death benefit pension(s) within their own TBC.

The amount that is credited to a beneficiary's TBA, and the timing of when that credit arises, will depend on whether the pension was received as a reversionary pension, or whether the death benefit commenced as a new death benefit pension.

The following table summarises the TBC implications of receiving a death benefit pension:

	The amount of the credit is…	The credit arises…
Reversionary pension	The account balance on date of death	12 months from date of death
Non-reversionary pension	The account balance used to commence the death benefit pension	On the commencement date of the death benefit pension

Due to these differences in the value of the amount to be credited, and the timing of the credit arising in the beneficiaries TBA, it is important to be able to distinguish between a reversionary pension and a non-reversionary pension.

[2] This requirement does not apply to children with a permanent disability.

To assist with this, it is worth referencing the ATO's guidance provided in [Law Companion Ruling (LCR) 2017/3 – Superannuation reform: Superannuation death benefits and the transfer balance cap] which states the following ***[Emphasis added]***:

> *"A reversionary death benefit income stream is a superannuation income stream that reverts to the reversionary beneficiary* ***automatically*** *upon the member's death. That is, the superannuation income stream continues with the entitlement to it passing from one person (the member) to another (the dependant beneficiary).*
>
> *The superannuation income stream reverts in this manner because the governing rules or the agreement/standards under which the superannuation income stream is provided expressly provides for reversion, as opposed to the superannuation provider exercising a power or discretion to determine a benefit in the beneficiary's favour. That is, the preconditions necessary for a superannuation income stream to revert must exist* ***within the rules governing the superannuation income stream prior to the member's death****. If this is not the case then the superannuation income stream ceases on the member's death…*
>
> *A binding death benefit nomination, by itself, does not make a superannuation income stream reversionary. If the governing rules or the agreement/standards under which the superannuation income stream is provided does not expressly provide for reversion then a binding death benefit nomination cannot alter this. The binding death benefit nomination may have the effect of directing the superannuation provider as to whom the death benefit is to be paid and the form, but it cannot turn a non-reversionary superannuation income stream into a reversionary superannuation income stream.*
>
> *A non-reversionary death benefit income stream is* ***a new superannuation income stream*** *created and paid to the dependant beneficiary or beneficiaries.*
>
> *Death benefit income streams are non-reversionary if the superannuation provider has the* ***power or discretion to determine****:*
>
> - *to whom the death benefit is paid*
> - *the form in which the death benefit will be paid (for example as a superannuation lump sum or a superannuation income stream), or*
> - *the amount of the death benefit paid."*

The above LCR 2017/3 also provides several practical examples to further clarify the distinction between these two pension types.

Note: Typically, a reversionary beneficiary should be specifically identified at the commencement of the original pension. This is particularly relevant for non-account based pensions where the relevant life expectancy of the reversionary pensioner is factored into the pension at the start. However, for account-based pensions, while the law is silent on this particular point, it is generally accepted that a reversionary pensioner can be added to an existing pension without the pension ceasing – as long as the fund's governing rules permit.

Non-reversionary pension

From a practical perspective, non-reversionary pensions are those that are commenced using the proceeds from a deceased member's accumulation interest, or as a result of receiving a death benefit from a deceased member's non-reversionary pension.

Where an individual receives a non-reversionary death benefit pension, this will result in a credit being recorded to the beneficiary's TBA on the date the pension commences. The value of this credit will be the account balance at the time the pension is commenced.

That is, where a death benefit pension is not reversionary, the 'credit' arises on the day the beneficiary becomes entitled to the death benefit pension[3] - which is generally when the trustee determines to pay the pension and the beneficiary starts being paid the death benefit pension.

Given the passage of time between the date of death of the member and the date that such a pension is commenced, included in the value of the credit for a non-reversionary death benefit pension will be any investment earnings that accrue between the date of the member's death and the date the pension becomes payable.

Also included are any other amounts the trustee decides to pay as a death benefit pension, including insurance proceeds or allocations from reserves to the deceased member's interest.

Example

Patrick died in July 2023. At the time of his death, he had a non-reversionary account-based pension valued at $900,000. His wife Alyssa was validly nominated under a binding death benefit nomination.

Alyssa has decided that she would like to receive the proceeds from Patricks benefit in the form of a death benefit pension.

The death benefit pension does not commence until January 2024. By this time, the balance had grown to $1,000,000.

Upon commencement of the death benefit pension, i.e. in January 2024, a credit for $1,000,000 will be applied to Alyssa's TBA – reflecting the amount used to commence the death benefit pension.

Reversionary pension

As we have already established, reversionary pensions are different to other death benefit pensions because they immediately revert to the beneficiary on the death of the member. That is, the reversionary beneficiary is automatically entitled to the pension on the death of the original pensioner.

Where the death benefit pension is reversionary, the date of death of the original pensioner is when the death benefit pension becomes payable to the beneficiary. As a result, the value of the original

[3] An exception being where a member was entitled to a non-reversionary death benefit prior to 1 July 2017, as the credit arose on 1 July 2017. In this case, the value of the credit equals the value of the income stream at the end of 30 June 2017.

pension as at the date of the member's death is the amount of the credit that will be applied against the beneficiary's TBC.

However, special rules apply to reversionary pensions which result in a delay to the credit arising in the beneficiaries TBA. That is, the above credit will only be recorded against the beneficiaries TBA 12 months after the date of death.

This 12-month grace period can be a useful time to assist individuals to deal with the TBC implications of receiving a reversionary pension – more on that later.

Importantly, the value credited toward a beneficiary's TBA does not include any investment gains accrued after date of death or any other amounts added to the deceased member's pension interest such as insurance proceeds. This means that at the end of this 12-month period:

- If market conditions are strong and assets grow, the reversionary beneficiary will benefit from a pension interest that will be valued above the corresponding amount of the 'credit' in their TBA, although
- If market conditions experience a decline, the value of the 'credit' to the reversionary beneficiary's TBA will be greater than the value of the pension interest at that time.

Example

Margaret died in July 2023. At the time of her death, she had an account-based pension valued at $900,000. When she commenced this pension, her husband Jonah had been listed as a reversionary beneficiary.

As the pension is reversionary to Jonah, the payments automatically continue to be paid to him – that is, the pension does not cease on Margaret's death.

In July 2024, twelve months after Margaret's death, a credit for $900,000 will appear in Jonah's TBA – reflecting the pension's value on the date of Margaret's death.

The amount of this credit is not impacted by the amount of growth experienced to the pension balance.

Further, in these situations, the credit arose on the later of:

- 1 July 2017, or
- At the end of the period 12 months from the date of the original pensioner's death.

Example

Gaston died in January 2017. At the time of his death, he had an account-based pension valued at $900,000. When he commenced this pension, his wife Amelia had been listed as a reversionary beneficiary.

By 1 July 2017, the value of this pension had grown to $1,000,000.

The value of the credit applied to Amelia's TBA would have been $1,000,000 – that is, the value at 1 July 2017, as opposed to the value on the date of Gaston's death.

Further, the credit would have been applied to Amelia's TBA in January 2018 – that is, 12 months after Gaston's death.

Planning ahead – When death benefit pensions cause an excess

What is hopefully becoming evident from our discussion thus far, is that the receipt of a death benefit pension by an eligible beneficiary may result in that individual exceeding their TBC.

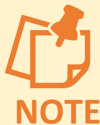
Where a death benefit pension causes (or is likely to cause) a beneficiary to exceed their TBC, any excess death benefit amount that would take them above their TBC, will typically need to be taken as a lump sum death benefit and cannot be retained within the superannuation environment.

Example

Marcus (age 53) recently died, leaving $2.5 Million in the accumulation phase of his superannuation fund. His wife Caitlin (age 50) intends to take the death benefit in the form of a death benefit pension. Neither Marcus, nor Caitlin, had previously had a TBA.

As the value of Marcus's death benefit exceeds Caitlin's TBC (i.e. $1.9 Million for the 2023-24 year), Caitlin will not be able to receive the entire death benefit as a pension.

While Caitlin can use up to $1.9 Million of Marcus' accumulated benefits to commence a death benefit pension, she will need to take the remaining $600,000 as a lump sum death benefit.



Note: While it is possible to roll over a death benefit to a new superannuation provider, the rolled over amount retains its death benefit status. In order to satisfy the cashing rules, the new trustee(s) must use the rolled over amount to commence a death benefit pension or pay the amount as a lump sum. The rolled over death benefits cannot be retained in accumulation phase, nor mixed with the beneficiary's own superannuation interest. In the context of an SMSF, an internal transfer of monies will also be treated as a rollover.

Where a beneficiary is already in receipt of a retirement phase pension and has an established TBA, careful planning is required to avoid exceeding their TBC.

While we have learnt that a retirement phase pension (including a death benefit pension) will give rise to a credit to an individual's TBA, we also learnt (through the Bulletin 1 in this series) that a commutation (in full or in part) will result in a debit to an individual's TBC.

Beneficiaries will need to ensure that the receipt of a death benefit pension will not result in them exceeding their transfer balance cap. If a death benefit income stream, in combination with the individual's own superannuation income stream, results in a beneficiary exceeding their transfer balance cap, they will need to decide which superannuation income stream to commute.

In many cases, a beneficiary should consider commuting some or all of their own retirement phase pension back to accumulation phase prior to the transfer balance credit arising in their TBA as a result of receiving a death benefit pension.

The full, or partial, commutation of a beneficiary's own pension will give rise to a 'debit' in their TBA, potentially freeing up sufficient cap space to enable them to receive the death benefit pension.

By choosing to commute some or all of their own retirement phase pension back to accumulation, a

beneficiary may be better able to maximise the amount of benefits remaining in the concessionally taxed superannuation environment, by reducing the amount of a death benefit that must be paid to them as a lump sum.

Example

Narelle (age 66) died in July 2023. At the time of her death, she had an account-based pension (non-reversionary) valued at $900,000. A binding death benefit nomination in favor of Neil (her husband) had been put in place several years earlier.

Neil (age 67) already has a retirement phase pension valued at $1.35 Million, which he commenced in July 2023 with a value of $1.3 Million at that time.

As Narelle's pension is not reversionary, the death benefit pension will only be payable to Neil from the time the trustee(s) determines to pay the death benefit. Let's assume this occurs 6 months after Narelle's death at which time the pension is valued at $1 Million.

If Neil were to receive this death benefit in the form of a pension, when combined with his existing account-based pension, this would result in him exceeding his TBC of $1.9 Million – as outlined below.

Date	Description	Debit	Credit	Transfer Balance
July 2023	Neil Commences retirement phase pension		$1,300,000	$1,300,000
December 2023	Death benefit pension commences		$1,000,000	$2,300,000

To avoid exceeding his TBC, Neil could choose to receive only $600,000 of the death benefit in the form of a pension – and take the remaining $300,000 as a lump sum death benefit, as outlined below.

Date	Description	Debit	Credit	Transfer Balance
July 2023	Neil Commences retirement phase pension		$1,300,000	$1,300,000
December 2023	Death benefit pension commences		$600,000	$1,900,000

Alternatively, before the death benefit pension commences to be paid to him, Neil could commute part of his existing account-based pension back to accumulation phase. In doing so, the resulting debit to his TBA would free up additional cap space to ensure a larger amount is retained in superannuation.

If we assume that Neil commutes $300,000 from his account-based pension, he could subsequently receive the entire death benefit in the form of a pension, as follows:

Date	Description	Debit	Credit	Transfer Balance
July 2023	Neil Commences retirement phase pension		$1,300,000	$1,300,000
October 2023	Neil partially commutes retirement phase pension	$300,000		$1,000,000
December 2023	Death benefit pension commences		$900,000	$1,900,000

By partially commuting his account-based pension prior to the commencement of the death benefit pension, Neil has remained within his TBC while at the same time maximizing the amount retained within the superannuation system.

Given that Neil will need to ensure that these transactions are completed before the death benefit pension commences, and as fund trustees are compelled to commence paying a death benefit as soon as practicable, the length of time available for Neil to make these decisions may be limited.

When dealing with a reversionary pension, greater flexibility is available given the 12-month grace period we discussed earlier, as well as the fact that a beneficiary may be able to choose to either:

- commute some (or all) of the death benefit pension, and/or
- if they have one, commute some (or all) of any existing retirement phase pension they are already receiving.

Importantly, where any death benefit pension is partially or fully commuted, in order to satisfy the cashing rules, the commuted amount must be 'cashed' and cannot be retained in the superannuation system.

This means the commutation lump sum amount must either be withdrawn from the fund, or used to fund a new death benefit pension. The cashing requirements will not be satisfied if the commuted benefits stay in the accumulation phase – as confirmed by the ATO in *Law Companion Ruling (LCR) 2017/3 – Superannuation Reform: Superannuation death benefits and the transfer balance cap,* which provides clarity on the ATO's interpretation of the cashing rules.

On the other hand, as we uncovered in Neil's example earlier, where a commutation is made from a beneficiary's existing retirement phase pension, the amount commuted can be retained as an accumulation interest.

Example

James died on 1 July 2023 with an account-based pension valued at $1.8 Million. His wife Alison was nominated as a reversionary beneficiary – and as a result, James' pension immediately continued to be payable to Alison.

Alison already has her own account-based pension which is currently valued at $700,000. This pension commenced in July 2020 with $800,000 – and her personal TBC is $1.75 Million.

The reversionary pension will not be credited to Alison's account until 12 months after James' death (i.e. on 1 July 2024). At this time, James' pension is expected to be worth $2 Million. Notwithstanding this, the credit to Alison's TBA will only be for the value of James' pension at the date of his death (i.e. $1.8 Million).

This credit of $1.8 Million to Alison's TBA will result in her exceeding her TBC by $850,000.

Date	Description	Debit	Credit	Transfer Balance
July 2020	Alison commences retirement phase pension		$800,000	$800,000
July 2024	James' death benefit pension credited to Alison's TBA		$1,800,000	$2,600,000

Before this credit is applied to her TBA (i.e. before 1 July 2024), Alison could consider fully commuting her existing account-based pension back to accumulation. This would result in a debit to her TBA – resulting in a TBA balance of $100,000.

Unfortunately, this will not create sufficient cap space to allow her to retain the total value of James' death benefit pension. As you can see below, she will exceed her TBC of $1.75 Million by $150,000.

Date	Description	Debit	Credit	Transfer Balance
July 2020	Alison commences retirement phase pension		$800,000	$800,000
June 2024	Alison fully commutes retirement phase pension	$700,000		$100,000
July 2024	James' death benefit pension credit to Alison's TBA		$1,800,000	$1,900,000

To avoid exceeding her TBC, Alison could also consider commuting $150,000 from James' death benefit pension. As illustrated below, this will ensure that in July 2024, when James' reversionary death benefit pension is credited to her TBA, she will not exceed her TBC – notwithstanding the pension will be worth around $2 Million at that time.

Date	Description	Debit	Credit	Transfer Balance
July 2020	Alison commences retirement phase pension		$800,000	$800,000
June 2024	Alison fully commutes retirement phase pension	$700,000		$100,000
June 2024	Alison partially commutes death benefit pension	$150,000		($50,000)
July 2024	James' death benefit pension credit to Alison's TBA		$1,800,000	$1,750,000

Alison has been able to make a lump sum commutation from the death benefit pension before the credit arises in her TBA, demonstrating the usefulness of the 12 month grace period applicable where a pension is automatically reversionary.

While the TBA credit that arises for a reversionary beneficiary is delayed by 12 months, the following considerations must not be overlooked:

- To ensure that the original pension continues, the fund trustee(s) must ensure that the minimum pension standards continue to be met, including the need to pay the minimum annual pension amount in the year the original pensioner dies. The minimum pension amount is not recalculated on the date of death – although the trustee(s) will need to recalculate the minimum at the start of the next financial year.
- Depending on the age of the reversionary beneficiary, there may be income tax consequences of any pension payments received by the beneficiary.
- Where the reversionary income stream is a defined benefit income stream, any pension payments received will be assessed against the beneficiary's defined benefit income cap.
- The proportions of tax-free and taxable components continue to reflect those as at the commencement of the original deceased member's pension. Any earnings or capital growth on the assets supporting the reversionary pension are allocated in those proportions.
- The trustee continues to claim exempt pension income on earnings generated by the fund's assets supporting the reversionary pension from the date of death of the original pensioner. The pension does not cease unless the reversionary pensioner commutes the pension. As

the beneficiary has up to 12 months to restructure, it is possible for the original pension to stay in 'retirement phase' and benefit from the exemption for up to 12 months before the beneficiary needs to restructure to manage their TBC.

- While the TBC credit may not arise until 12 months after date of death, the value of the death benefit pension will have an immediate impact on the beneficiary's TSB – although, as the TSB is measured on 30 June each year, this will typically only impact on strategies being contemplated for the following financial year.
- The impact that a reversionary pension may have on any Government benefits the beneficiary is entitled to.

Modified TBC for children

Where a death benefit pension becomes payable to a beneficiary who is a child, the child will effectively have a modified TBC. These modified rules apply to a child in receipt of either a reversionary or non-reversionary death benefit pension.

Note: Although financially dependent grandchildren may be eligible to receive a death benefit pension following the death of a grandparent, the modified TBC rules do not apply to them. That is, the standard TBC rules will apply in these circumstances. As such, the receipt of a death benefit pension will affect the amount of superannuation a financially dependent grandchild can transfer to the pension phase on their own retirement.

This modified TBC, referred to as a 'transfer balance cap increment' represents the amount that can be used to commence a death benefit pension for that child. Further, a transfer balance cap increment applies for each death benefit income stream the child receives.

However, any remaining death benefit amount payable to that child (i.e. above the transfer balance cap increment) must be paid out of super as a lump sum death benefit.

This transfer balance cap increment is generally extinguished when the child turns 25[4] (which is when they are typically required to cash out the death benefit income stream). This ensures that children receive their own TBC when they eventually start their own retirement pension.

Tip: While not a common occurrence, where a child is already in receipt of a retirement phase pension, e.g. a disability pension, the child will already have their own personal TBC. However, this has no impact on their transfer balance cap increment with respect to a death benefit pension.

In these situations, the child's personal TBC is disregarded when it comes to determining their eligibility to receive a death benefit pension. Equally, any death benefit pension and related transfer balance cap increment is disregarded when determining the child's proportional indexation of their general TBC.

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[4] An exception to this general rule applies for children with a permanent disability. These children are not required to cash in their death benefit pension at age 25. Their transfer balance cap increment will cease when the funds supporting the death benefit income streams are exhausted.

The amount of a child's transfer balance cap increment is, in part, determined by whether the deceased parent had a TBA at their time of death.

Note: Where both parents die, the child's transfer balance cap increment is the sum of amounts worked out in relation to each parent. This is determined by calculating their available cap increment for each parent and adding together the available cap increments.

1. Deceased did not have a TBA at time of death

Where the deceased parent ***did not*** have a transfer balance account at the time of their death (i.e. they had not previously commenced a retirement phase pension), the child's transfer balance cap increment will be:

- If the child is the sole beneficiary of the deceased parent's superannuation interest, the general TBC in the year the death benefit pension commences (i.e. $1.9 Million in 2023-24), or
- If the child is not the sole beneficiary of the deceased parent's superannuation interest, their proportionate share of the deceased parent's superannuation interests multiplied by the general TBC for the year the death benefit pension commences.

Example:

Eliza died in July 2023, aged 40.

After receiving the proceeds from a life insurance policy held through Eliza's superannuation fund, the final account balance was $2 Million (entirely in the accumulation phase). She had never previously commenced a retirement phase pension.

Under a binding death benefit nomination, her benefit was to be paid equally to her two children Jason (age 13) and Sophie (aged 10).

The maximum amount that can be used to commence a death benefit pension for Jason and Sophie is calculated as follows:

Each child's proportionate share of Eliza's superannuation interests X the general TBC

= 50% X $1.9 Million

= $950,000 each

As Eliza's total death benefit is $2 Million, the remaining $100,000 will need to be paid as a lump sum death benefit. That is, this amount cannot be used to pay a death benefit pension to either of the children.

2. Deceased had a TBA at time of death

Where the deceased parent had a TBA at the time of death, only the amount of a child's death benefit pension that is funded from the deceased parent's retirement phase pension can benefit from a cap increment.

That is, to be within their cap, the death benefit pension paid to a child must be sourced ***only*** from the retirement phase interest(s) of the deceased parent.

Where the death benefit pension is sourced from the deceased parent's accumulation account, the child's transfer balance cap increment will be nil. This is irrespective of the balance in the deceased parent's TBA. In this scenario, the entire amount received by the child as a death benefit pension will be considered to be excessive – and will need to be cashed out.

Where a death benefit pension is sourced solely from the deceased parent's retirement phase interest(s), the child's transfer balance cap increment will equal the amount of the deceased parent's pension account balance, or the portion of that interest that the child is entitled to.

As such, a child's transfer balance cap increment is calculated as the child's 'share' of their parent's pension interests and not a share of their parent's full TBC.

This applies irrespective of whether the value of the retirement phase interest(s) exceeds $1.9 Million at the time. This amount may also include any income earned on the retirement phase interest assets after the death of the parent and prior to the commencement of the child death benefit pension.

Further, where a death benefit pension is reversionary, the child will benefit from the 12-month deferral of the credit as discussed earlier in this bulletin.

Example:

Constance died in July 2023. At the time of her death, she had an account-based pension valued at $2.25 Million. She had no accumulation account.

The fund trustee(s) decide to pay the balance of Constance's superannuation benefits to her son Bart, age 15.

Even though the value of the death benefit is greater than the general TBC ($1.9 Million in the 2023-24 financial year), the entire balance can be paid to Bart as a death benefit pension as the pension will be sourced entirely from Constance's retirement phase interest.

Note: For the sake of completeness, it is worth noting that special rules apply in the unlikely scenario where a death benefit pension is sourced from the deceased parent's retirement phase interest(s), but at the time of death the deceased parent had an excess transfer balance. In these cases, the child's transfer balance cap increment will broadly be reduced by the child's share of the deceased parent's excess amount.

If a death benefit pension is not wholly sourced from the deceased parent's retirement phase interest(s), the child will generally have an excess transfer balance which must be cashed out.

Where a death benefit is to be paid partially from a retirement phase interest, with the remainder being paid from an accumulation interest, the child's transfer balance cap increment will need to be adjusted to reflect only the part funded from the retirement phase interest.

In this regard, it is important to be aware that if the deceased parent had life insurance, any proceeds received by the SMSF will be counted as part of the parent's accumulation interest for TBC purposes, even if the trustees paid all insurance premiums from the parent's pension account.

Example:

Hugh dies at the age of 65. He has nominated his 2 adopted children (both under 18) as equal beneficiaries of his superannuation benefits.

His superannuation benefits include an account-based pension worth $1.2 Million and $200,000 in an accumulation account.

As Hugh had a TBA, due to having previously commenced a retirement phase pension, only a death benefit pension funded from his pension account will give rise to a transfer balance cap increment for each child. Therefore, each child would have a transfer balance cap increment of $600,000 – and can receive a death benefit pension to this amount.

However, the benefit in Hugh's accumulation account would need to be cashed as a lump sum death benefit of $100,000 to each child.

Tip: Where a member dies with both accumulation and retirement phase pension interests, trustees may consider paying the retirement phase interest to a child as a death benefit pension while paying the accumulation benefits to an alternative dependant such as a spouse. Of course, this will depend on the level of flexibility available to the fund trustee(s) at that time and the governing rules of the fund.

CPD quiz

Please click here to access the CPD quiz.

If you have difficulties accessing the quiz via the above link, please copy and paste this URL into a new browser: https://web.smsfassociation.com/smsfassociationcom-ah3t2/pages/e0a23fe6d588ee11be3600224894af01.html?PageId=e0a23fe6d588ee11be3600224894af01

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