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29.45% death tax is a possibility

"In a worst case scenario, adult children could be short changed by almost a third of a parent's estate in taxes – a situation that can be worked around by seeking help from a competent financial adviser" says Adelaide based financial strategist Theo Marinis.

"The complexity of the superannuation, taxation and Centrelink interface has reached a point where most people have very little if any chance of navigating the system. People 'don't know what they don't know'.

The incongruously named 'Death Benefits Tax' is an example of this complexity", Theo said.

"Take for instance, a stereotypical situation where a 'Mum & Dad' couple with a Self-Managed Super Fund are drawing a pension from say, rent on a warehouse. Their adult children are independent. When one predeceases the other, the SMSF pension will continue to be paid to the surviving member.

What many of us may not realise is that in addition to a Death Benefits Tax, there is the potential for Capital Gains Tax to be payable by the pension fund when the last member dies.

On the death of the final SMSF member, the fund will revert from pension to accumulation phase in anticipation of paying a death benefit, as the fund no longer has any members who are eligible to receive a pension.

In order to then pay the Death Benefit Tax, the trustee must then sell down the assets (in this case the warehouse) in the accumulation phase – which in turn, triggers a potential Capital Gains Tax liability. Assuming a capital gain is incurred, CGT payable by the super fund will be at a rate of 10% (if the assets have been held by the fund for over 12 months) or 15% (if held for less than 12 months).

What is left of the proceeds of Mum and Dad's SMSF (net of CGT) when paid to beneficiaries, will then attract Death Benefits Tax at the rate of 17% on the taxable component of the benefit.

Thus in an extremely unlikely BUT absolute, worst case scenario, total tax paid by the fund on a death benefit could be as much as 29.45% as per the example below:

Asset	Tax	Rate	Net benefit
1) $100,000 (held for < 12 months)	$15,000	15% (CGT)	$85,000
2) $85,000 (net of CGT)	$14,450	*17% (DBT)	$70,550
Final net benefit			**$70,550**
Total tax paid			**$29,450**
Maximum tax rate			**29.45%**

*on taxed component of super

NOTE – example based on the following assumptions:

a) **Capital Gains in the fund of 100% (this is EXTREMELY unlikely and therefore a worst-case scenario – although inevitably there will be some CGT liability in most pension funds, therefore total death tax has potential to be > 17%)**
b) **A taxable super component of 100%**

To work around the CGT sting, the only solution is to regularly review and rebalance the portfolio periodically as part of a regular pension review (as should occur as prudent matter of course anyway!) and thus reset the CGT cost base.

NOTE this portfolio rebalance strategy may not, however be suitable for all portfolios, particularly those with illiquid direct investments (eg properties in SMSF's!).

Death Benefits Tax Liability can, however, be removed or reduced by a cash out and re-contribution strategy.

Both solutions are complex and require professional, qualified supervision and support.

The unfortunate reality is that most people are not equipped to deal with the level of complexity embedded within our superannuation system, or the time to deal directly with taxation, legal and social security experts. Such complexity forces people to hire financial planners, whether they want to or not.

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