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KEEPING SUPERANNUATION TRUSTEES ON THE STRAIGHT AND NARROW

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1. Introduction

This paper will consider the following:

1.1 Fitting superannuation into estate planning – the legislative framework governing superannuation death benefits

1.2 Binding nominations – why they are essential; tips and traps

1.3 The consequences of failing to make binding nominations – possession is nine tenths of the law

1.4 Duties of trustees and responsibilities for discretionary decision-making – the 'good faith' requirement and when decisions are reviewable

1.5 Conflicts of interest and disputes involving super funds, the estate and potential claimants

1.6 Drafting tips for minimising or limiting decision-making and risks

1.7 Strategies for managing disputes between the estate and a super fund

2. Fitting superannuation into estate planning – the legislative framework governing superannuation death benefits

2.1 On the death of a member, their superannuation 'death benefits' must be cashed out as soon as practicable, with death being a 'compulsory cashing' requirement.[1] This requires the member's death benefits to be cashed in favour of:

(a) one or more of their dependants; or

[1] See r 6.21 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**the SIS Regs**).

(b) their legal personal representative.[2]

2.2 Death benefits must be paid out under a valid binding nomination if one was made, or at the trustee's discretion in the absence of a valid binding nomination.

2.3 The definition of 'dependant' is crucial in determining both the eligibility of payment and tax treatment of superannuation death benefits. Notably, 'dependant' is defined differently under taxation law under the ITAA97 and superannuation law under the SIS Act. In particular:

(a) 'dependants' under the SIS Act (**SIS Dependants**) are able to receive death benefits directly from the fund; and

(b) 'death benefit dependants' under the ITAA97 (**Tax Dependants**) are potentially able to receive death benefits tax-free.

2.4 The different definitions of 'beneficiary' under tax and superannuation law are outlined in the table below:

Tax dependant (as defined in section 302-195 of the ITAA97)	**SIS dependant (as defined in section 10 of the SIS Act)**
Spouse or de facto partner of the deceased; Former spouse or de facto spouse of the deceased; Child of the deceased under 18 years old; Any person with whom the deceased had an interdependency relationship; and Any other person who was dependant of the deceased just before he or she died.	Spouse or de facto partner of the deceased; Child of the deceased (any age). This includes stepchildren provided that the "connecting parent", namely the stepchild's natural parent is still surviving;[3] and Any person with whom the deceased had an interdependency relationship.

2.5 The compulsory cashing requirement means that a member's superannuation death benefits must come out in one form or another and can take place as either or a combination of the following forms (subject to the relevant trust deed):

(a) a **lump sum** (either a single, or interim lump sum and final lump sum) to one or more lump sum dependants including the member's legal personal representative as trustee for their deceased estate; or

(b) one or more **pensions/income streams** to a member's income stream dependant.

2.6 Subject to the terms of the SMSF trust deed:

(a) **lump sums**[4] can generally be paid to a member's spouse, children (of any age), step-children (providing the 'connecting parent', ie the child's

[2] See r 6.22 of the SIS Regs.
[3] See ATO Interpretative Decision 2011/77, also note *Re Burt* [1988] 1 QdR 23.
[4] See in particular, r 6.22 of the SIS Regs.

parent is still surviving),[5] any person financially dependent on the deceased member prior to their death and the legal personal representative as trustee of their deceased estate; and

(b) **income streams[6]** can generally be paid to a member's spouse, children (under the age of 18 years), children (between 18-25 years old and who were financially dependent on the member prior to the member's death) and children who suffer a significant disability.[7]

2.7 Note that where income streams are paid to children under the age of 25 years, they must be commuted to lump sums upon the child attaining the age of 25 years. Further, a child is generally able to call for their entitlement to the lump sum upon attaining the age of 18 years.

2.8 The table below summaries the tax dependants and SIS dependants eligible to receive superannuation death benefit payments in the form and manner as listed:

Who	SIS dependant	Tax dependant	Form and manner of payment
Spouse / de facto partner	YES	YES	Lump sum or pension
Minor children	YES	YES	Lump sum or pension
Adult children – financial dependants	YES	YES	Lump sum or pension (up to 25 years unless child has a significant disability)
Adult children – non-financial dependants	YES	NO	Lump sum
Financial dependants and inter-dependants	YES	YES	Lump sum or pension
Estate	YES: r 6.22 SISR	Look through	Lump sum

2.9 It is common for individuals to address the payment of their superannuation death benefits by preparing binding death benefit nominations which if validly prepared, will force the superannuation fund trustee to pay the individual's superannuation death benefits in favour of their nominees.

3. Binding nominations – why they are essential; tips and traps

3.1 Binding death benefit nominations are often prepared as part of the estate plan. It cannot be stressed enough that a binding death benefit nomination is a legal document and should not be simply 'filled out' without considering the terms of the trust deed, or the individual's estate planning objectives holistically. It should not be done in isolation and specialist advice should be sought.

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[5] See further ATO ID 2011/77.
[6] See in particular, r 6.21(2A) and (2B) of the SIS Regs.
[7] As described in subsection 8(1) of the *Disability Services Act 1986* (Cth).

3.2 A binding death benefit nomination is an estate planning tool with the following uses:

(a) It binds the trustee and removes any discretion. Beneficiaries under a binding nomination have a vested and indefeasible interest on the member's death.

(b) Binding nominations may remove assets out of family provision reach, subject to the New South Wales notional estate rules under the *Succession Act 2006* (NSW).[8]

(c) Ultimately, it ensures that the fund member's intentions are met.

3.3 Notably, cases have arisen in the context where binding death benefit nominations have either lapsed (where the trust deed imposes a 3-year lapsing rule) or have otherwise failed in circumstances where they have nominated non-SIS Dependants or otherwise failed to follow specific prescribed procedural requirements in the trust deed.[9] This then leaves open the risk of a challenge to the trustee's payment of death benefits. These issues can be prevented by properly and carefully considering matters in the estate plan rather than leaving it to chance to sort out after death.

3.4 When making binding nominations as part of the estate plan, it is absolutely critical that the terms of the trust deed are examined (and if necessary updated) to ensure that the nominations made are at law binding, and that the estate planning objectives of the individual are met.

3.5 In the absence of a binding death benefit nomination, the trustee has the power to make a decision in relation to the pay out of the member's superannuation entitlements on their death. Cases below highlight that possession is nine-tenths of the law and the trustee holds the purse strings.

3.6 Even if binding nominations have been prepared, possession is nine tenths of the law. It is important in the estate plan to consider the successor controller of the fund as they will practically hold the 'purse strings' on a member's death, regardless of whether the nomination is valid.[10]

Lapsed nominations

3.7 Older trust deeds may expressly impose a 'lapsing requirement' which states that binding death benefit nominations lapse 3 years after their making. The significance of this is that should a member make such a nomination and die within 3 years of making the nomination, all things equal, the nomination would be valid and enforceable. If the member dies after 3 years of making the nomination, the trustee can disregard the nomination in making the death benefit payment on the basis that it has lapsed.

3.8 Another issue is whether the law requires binding death benefit nominations to lapse every 3 years in the context of SMSFs. In this regard, note the following:

(a) Section 55A provides that the governing rules of a regulated superannuation fund must not permit a fund member's benefits to be

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[8] See in particular, *Benz v Armstrong* [2022] NSWSC 534.

[9] See for example, *Donovan v Donovan* [2009] QSC 26; *Munro v Munro* [2015] QSC 61; *Cantor Management Services Pty Ltd v Booth* [2017] SASCFC 122; *Re Narumon Pty Ltd* [2018] QSC 185.

[10] See, for eg, *Wooster v Morris* [2013] VSC 594.

cashed after the member's death otherwise than in accordance with the operating standards. The governing rules of a fund are invalid to the extent that they are inconsistent with this requirement.

(b) As noted above, death benefits may be cashed in favour of a member's dependant or their legal personal representative (estate) as a lump sum or income stream/pension where permitted.

(c) Section 59 of the SIS Act provides that the governing rules of a superannuation fund other than an SMSF must not permit a discretion under those rules that is exercisable by a person other than the trustee to be exercised unless the rules require the consent of the trustee to the to the exercise of the discretion.

(d) Subsection 59(1A) is an exemption to the general prohibition in section 59, allowing the fund's governing rules to permit a member to give a notice to the trustee that is in accordance with the SIS Regs to require the trustee to distribute death benefits to a person under the notice, being the member's legal personal representative or dependants under the SIS Act.

(e) Regulation 6.17A of the SIS Regs sets out the rules and requirements for the giving and operation of binding nominations. The provisions state that:

(i) The trustee must give the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to pay their death benefits in accordance with a binding nomination.

(ii) The person, or each of the persons appointed in the binding nomination must be the member's legal personal representative and/or a dependant.

(iii) The proportion of the benefit that will be paid to each nominated person must be certain or readily ascertainable from the binding nomination.

(iv) The binding nomination must be in writing, signed and dated by the member in the presence of two witnesses being persons each of whom has attained the age of 18 years and neither of whom is a person mentioned in the notice, and must contain a declaration signed and dated by the witnesses stating that the notice was signed by the member in their presence.

(v) A binding nomination will cease to have effect, unless revoked sooner, 3 years after the day it was first signed or last confirmed or amended by the member (or a shorter period if required under the governing rules).

3.9 The Commissioner takes the view, as stated in SMSF Determination SMSFD 2008/3 that sections 59(1A) of the SIS Act and regulation 6.17A of the SIS Regs do not have any application in the context of SMSFs. However, this is of course, subject to the terms of the relevant trust deed, noting that older deeds may expressly incorporate the requirements and provisions of regulation 6.17A into its terms. It is common for more modern trust deeds to expressly exclude the operation of regulations 6.17A or the 3 year requirement to avoid any doubt.

3.10 Several cases have noted that the formalities in regulation 6.17A do not automatically apply to self-managed superannuation funds. In *Re Narumon Pty Ltd* [2018] QSC 185 (***Re Narumon***), it was held that regulation 6.17A of the SIS Regs applies only to the payment of benefits on or after death under the governing rules of a superannuation fund that section 59 of the SIS Act applies (ie 'a superannuation entity other than a self-managed superannuation fund').

3.11 In *Re Narumon*, the terms of the trust deed did not make specific reference to regulation 6.17A of the SIS Regs but instead made reference to 'Superannuation Law' in relation to binding death benefit nominations. There was therefore a question in *Re Narumon* as to whether the requirements of regulation 6.17A of the SIS Regs were imported into the SMSF's trust deed by the use of the terms 'Superannuation Law'. The Queensland Supreme Court in *Re Narumon* agreed with its decision in *Munro & Anor v Munro & Anor* [2015] QSC 61 that wording of the definition of terms such as 'Superannuation Law' and 'Relevant Requirements' refer to laws or regulations that the SMSF must comply with to be a regulated superannuation fund, and that regulation 6.17A is not such a law or regulation. The South Australian Supreme Court in *Cantor Management Services v Booth* [2017] SASCFC 122 also approved the judgement in *Munro v Munro*.

3.12 Notably though, not all Australian States and Territories had binding authority on the application of regulation 6.17A and the 3 year lapsing issue despite the Commissioner's views expressed in SMSFD 2008/3 and the Queensland and South Australian decisions noted above. The Western Australian Court of Appeal in *Hill v Zuda Pty Ltd* [2021] WASCA 59 cited the High Court's comments in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*[11] noting that the High Court stated:

> *Intermediate appellate courts and trial judges in Australia should not depart from decisions in intermediate appellate courts in another jurisdiction on the interpretation of Commonwealth legislation or uniform natural legislation unless they are convinced that the interpretation is plainly wrong.*

3.13 The Western Australian Supreme Court of Appeal therefore accepted the position adopted in previous causes including *Cantor Management v Booth* 'until such a time as the decision is overruled by the High Court.' The Court of Appeal's decision was subsequently appealed to the High Court. On 15 June 2022, the High Court handed down its judgement an unanimously dismissed the appeal and confirmed that regulation 6.17A of the SIS Regs (including the three year lapsing rule) **does not apply** to SMSFs and we now have confirmation on this point across all Australian States and Territories.

3.14 Although regulation 6.17A does not automatically to SMSFs, the fund's governing rules may prescribe specific procedures to be followed, so it is absolutely critical to review the terms of the trust deed when nominations are prepared to ensure that they are binding on the trustee.

Invalid appointments

3.15 Under superannuation law, only SIS Dependants and/or the member's legal personal representative (estate) can receive superannuation directly from the fund on death. This general provision is of course, subject to the terms of the

[11] (2007) 230 CLR 89.

relevant trust deed which may further narrow (intentionally or unintentionally) the class of beneficiaries eligible to receive.

3.16 Appointments of non-SIS Dependants under a binding nomination are invalid and this was seen in cases such as *Re Narumon* where the deceased member's sister was nominated to receive 5% of the member's death benefits. A relevant issue was whether the whole binding nomination failed or whether only the 5% portion failed. The Queensland Supreme Court held that the binding death benefit nomination in that case did not fail completely; only the 5% that passed to a non-SIS dependant failed which then became a portion for the exercise of trustee discretion. In my opinion, the nominated beneficiaries (the deceased's wife and his son) were 'lucky' in the circumstances. I am strongly of the view that the wording of the trust deed in question should be examined in determining whether the whole or part of the nomination ought to lapse, and whether the trustee ought to exercise its discretion over the whole death benefit or just the portion of the death benefit that failed under the nomination.

3.17 Furthermore, in *Re Marsella; Marsella v Wareham (No 2)* [2019] VSC 65 and *Wareham v Marsella* [2020] VSCA 95, the deceased member prepared a binding nomination at the time the SMSF was established which nominated her grandchildren to receive her death benefits. That nomination lapsed prior to death and in any event was not valid because the grandchildren were not the deceased's SIS Dependants.

Other procedural requirements

3.18 Trust deeds may have other "procedural requirements" which may require the binding nomination to be "given" to the trustee or "accepted" by the trustee.[12]

3.19 Furthermore, some trust deeds may require the member to make a binding death benefit nomination in a form prescribed under the terms of the trust deed.

3.20 Issues may arise in the context of multi-member funds, where the trust deed requires the nomination to be accepted by the other trustees for the nomination to be valid. If the other members/trustees have differing interests, they could potentially thwart the member's estate planning intentions by refusing acceptance. Furthermore, where nominations are made without following such procedures, there is a significant risk that those nominations could be rendered invalid on death.

3.21 It is therefore absolutely critical that any procedural requirements mandated by the trust deed be followed. In my opinion, such procedural requirements are unnecessary and should be done away with to minimise arguments of invalidity after death. Where possible, the trust deed ought to be amended to dispense with such requirements to enable the member to freely deal with their death benefits as part of their estate planning. Preparing a nomination should be a relatively simple exercise for a member, free of ambiguity or complexity, as much as possible.

[12] See for example, *Cantor Management Services Pty Ltd v Booth* [2017] SASCFC 122.

4. The consequences of failing to make binding nominations – possession is nine tenths of the law

4.1 Obviously, where a binding nomination has been validly made, the trustee ought to make payment under the nomination, as soon as practicable after the member's death.

4.2 In the absence of a binding death benefit nomination, the trustee is able to exercise the right to pay the deceased's death benefits in a manner they wish, including directly to a SIS Dependant or the member's legal personal representative (estate).

4.3 Several cases have emphasised the importance of carefully choosing successor SMSF controllers on the death or incapacity of a member. Some cases highlighting the risks and issues are outlined below.

Katz v Grossman[13]

4.4 In the fact circumstances of this early case, Ervin and Evelin Katz were the individual trustees of their SMSF. Evelin passed away in July 1998 and Ervin subsequently appointed his daughter Linda as the co-trustee of the fund to meet the requirements of section 17A of the SIS Act in May 1999. This was done by Ervin as the remaining trustee pursuant to s 6 of the *Trustee Act 1925* (NSW) on the basis that there were no persons nominated under the terms of trust for the purposes of appointing new trustees given that Evelin had passed away and the trust deed required a majority of the members to appoint a trustee. Probate was granted to Ervin as Evelin's executor under Will in March 2000.

4.5 Ervin then passed away in September 2003 and prior to his death, he made a non-binding wish which stated that his superannuation was to be distributed equally between his two children, Daniel and Linda. Probate of Ervin's Will was granted to Daniel and Linda as his executors in August 2004. In December 2003, Linda appointed her husband Peter as co-trustee of the SMSF with her and they paid out all death benefits to Linda shortly after.

4.6 Daniel challenged Ervin's appointment of Linda as co-trustee under the *Trustee Act* on the basis that Ervin and Evelin's estate (as majority members) should have appointed Linda as the new trustee under the deed and there was no power for Ervin as the continuing trustee to appoint Linda under s 6 of the *Trustee Act*. Daniel also challenged Peter's appointment as trustee after Ervin's death, on similar grounds.

4.7 The Court held that Ervin's decision was valid under s 6 of the Trustee Act as it took some time for Probate to be granted and there was therefore no person having the power to appoint a trustee and therefore s 6 of the Trustee Act could be used to appoint Linda. The Court also held that Linda's appointment of her husband as a co-trustee was also valid under s 6 of the *Trustee Act* for similar reasons.

Ioppolo v Conti[14]

4.8 In the fact circumstances of this case, Francesca Conti and her husband Augusto Conti were the trustees of their SMSF, which was established in 2002.

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[13] [2005] NSWSC 934.

[14] *Ioppolo and Hesford v Conti* [2013] WASC 389 (Trial Decision), *Ioppolo v Conti* [2015] WASCA 45 (Appeal Decision).

Francesca and Augusto were the only trustees and members of the fund. Francesca died in 2010.

4.9 Francesca left a Will dated 2005. Francesca expressed a desire in her Will that her superannuation death benefits should be paid to her four children from her previous relationship, and that she did not want any entitlement paid to Augusto. Probate of Francesca's Will was granted to two of her children, namely Grace and Rosario.

4.10 Francesca made the following binding death benefit nominations:

(a) the first BDBN was signed on the same date as the Fund's establishment, in 2002 nominating Augusto to receive all of the death benefits. The trust deed stipulated that BDBNs lapsed after 3 years from when it was signed and so this nomination expired in 2005; and

(b) a second BDBN was signed in 2006 which also nominated Augusto to receive all of her death benefits. This nomination expired in 2009 given the 3 year lapsing rule under the deed.

4.11 Following Francesca's death, Augusto in his capacity as trustee of the Fund resolved to pay all death benefits to himself. The next day, Augusto resigned as trustee of the Fund and appointed Augusto Investments Pty Ltd as trustee of the Fund, of which he was the sole director (and thus controlled by him).

4.12 The executors of Francesca's estate commenced proceedings against Augusto and the new corporate trustee but failed. Francesca's children argued that section 17A of the SIS Act required the appointment of a deceased member's legal personal representative as a trustee of the Fund upon the death of the deceased, and sought an order of the Court appointing one of them as a trustee of the Fund. They also asserted that Augusto purported to exercise the power to pay Francesca's superannuation death benefits to himself with knowledge of the provisions of Francesca's Will and thus acted in bad faith in pursuit of his own personal interests.

4.13 The Court rejected the arguments of Francesca's executors and held that:

(a) section 17A of the SIS Act, more particularly paragraph 17A(3)(a), did not require Augusto (as the sole remaining trustee after Francesca's death) to appoint Francesca's legal personal representatives to the position of trustee to represent Francesca's interests. By extension, the Court rejected the arguments of Francesca's executors that Augusto was unable to take any action with respect to the death benefits until one of them was appointed as a trustee of the fund; and

(b) there was no evidence that Augusto did not exercise the discretion conferred upon him as trustee in a bona fide manner. The terms of Francesca's Will (2005) were inconsistent with the 2006 BDBN that she executed after the Will and which lapsed, and it was open to Augusto to consider that the subsequent execution of the BDBN meant that the expression of intention in the Will had been superseded, and was no longer worthy of weight as to what should happen with her superannuation benefits. Therefore, it was impossible to infer that Augusto lacked bona fides from the failure to take into account the clear and unequivocal wishes of Francesca in her Will.

4.14 This case leaves open the question of whether the wishes of the deceased (whether contained in the terms of his or her Will or otherwise) are required to

be considered by the trustee of the SMSF, in order to be considered to have exercised their discretion as to the payment of the deceased's death benefits.

5. Duties of trustees and responsibilities for discretionary decision-making: the 'good faith' requirement and when decisions are reviewable

5.1 The previous section of this paper highlights the powerful role that the trustee or director of a corporate trustee of an SMSF assumes in respect of the payment of a deceased member's superannuation benefits. This is particularly the case as many SMSF trust deeds confer on the trustee an absolute and unfettered discretion in relation to the administration of the fund.

5.2 The decisions of *Re Marsella; Marsella v Wareham (No 2)*[15] (**the Trial Decision**) and the Court of Appeal's decision in *Wareham v Marsella*[16] (**the Appeal Decision**) (collectively referred to as ***Marsella***) highlight that the exercise of discretion by a trustee, especially so as to prefer their interests over that of others, is subject to challenge. The facts of *Marsella* are summarised below:

(a) Helen Swanson was the sole member of her SMSF established in 2003. Helen and her daughter Carol were the individual trustees.

(b) Helen made a BDBN in 2003 nominating her grandchildren to receive her death benefits and under the trust deed, the BDBN lapsed 3 years later. In any event it was invalid given that her grandchildren were not SIS Dependants. No other BDBN was made prior to death.

(c) Helen died in 2016 leaving Riccardo, her husband of 32 years as well as her two children Carol and Charles (children from her previous marriage).

(d) Helen made a Will in 2015 providing Riccardo with a right of residency in her property in Mornington. Riccardo was the sole executor of the Will and probate was granted to him in August 2016. Riccardo made a family provision claim against the estate and this matter proceeded to mediation in May 2017 (which failed) and the Court handed down its judgement on the family provision matter in June 2018.[17]

(e) Carol received advice from the SMSF's accountant that she needed to pay out the death benefits and wind up the fund as soon as possible. Carol also appointed her husband Martin as a co-trustee of the Fund in April 2017.

(f) Immediately after Martin was appointed as a co-trustee, the trustees then determined to pay all of the death benefits to Carol and wind up the Fund. Notably, the trustee resolutions recorded that they gave "due consideration" to the possible interests of all dependants, potential beneficiaries and Helen's estate.

(g) There was some exchange of correspondence between Riccardo's solicitors and Carol's solicitors. In particular:

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[15] [2019] VSC 65.
[16] [2020] VSCA 95.
[17] *Re Marsella; Masella v Wareham* [2018] VSC 312.

(i) Riccardo learned through Carol's solicitors that the SMSF assets were being sold;

(ii) Riccardo through his solicitors claimed the SMSF assets were part of the estate and sought undertakings that no further assets were to be sold or otherwise dealt with;

(iii) Carol's solicitors stated that:

(A) superannuation assets were not estate assets (which was correct); and

(B) Riccardo was '*neither a Member, Trustee or Beneficiary of the Fund, and as such [the trustee] is not required to consult with him on any matter relating to the administration of the Fund*' (which was not correct); and

(C) there was a further exchange of correspondence between the parties where Carol's solicitor repeatedly and asserted that Riccardo had no interest in the Fund and Carol was entitled to have the benefit paid to herself.

(h) Riccardo commenced proceedings seeking:

(i) the removal of Carol and Martin as trustees of the Fund;

(ii) an injunction restraining the distribution of the death benefits; and

(iii) an order requiring Carol and Martin to repay any part of the death benefits that had already been distributed.

5.3 The key questions for the Court were:

(a) whether the trustee's discretion to pay out death benefits can be impugned on the basis that they failed to act in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred; and

(b) whether the trustees should be removed.

5.4 At trial, McMillan J held that the trustees had not exercised their discretion in good faith and upon a real and genuine consideration and ought to be removed. The Court noted that the trustee's powers were not exercised for an improper purpose. In doing so, the Court noted that:

(a) The principles in *Karger v Paul*[18] which are that a trustee's decision will not be disputed by a Court provided that:

(i) the discretion is exercised in good faith;

(ii) the trustee gave real and genuine consideration to the exercise of the power; and

[18] [1984] VR 161.

(iii) the power is exercised in accordance with the purposes for which the discretion was conferred.

(b) The exercise of trustee discretion will not be examined or reviewed by the Court so long as the essential component parts of the exercise of the particular discretion are present. An exemption to this is if the trustees choose to state their reasons for their exercise of discretion, in which case, the validity of the trustees' reasons will be examined.

(c) To ascertain whether there was a failure by the trustee to exercise the discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred, it is relevant for the Court to look at evidence of:

(i) the inquiries made by the trustees; and

(ii) information that they had and the reasons for and the manner of exercising their discretion.

(d) It is not for the Court to determine how the discretion was exercised, the reasonableness of the outcome or whether discretion was exercised wisely. Unreasonableness is not in and of itself grounds for the Court to impugn a trustee's discretion, but where the outcome is "grotesquely unreasonable", it may be evidence that discretionary power was never exercised, evidence of bad faith or a 'miscarriage of duty'.

(e) A lack of good faith 'encompasses more than fraud' and 'may include the taking into account of irrelevant considerations and a refusal to take into account relevant considerations.'

(f) The power to pay out death benefits is a 'special power' (as opposed to a general power of investment) under terms of the trust deed so the trustee has a duty to properly consider its exercise of power.

(g) The trustees could not escape the Court's jurisdiction regarding an alleged breach of trust by simply winding up the Fund.

(h) The trustees had not acted in good faith in the circumstances and failed to give 'real and genuine consideration'. This was inferred mainly from the content and tone of correspondence from the trustees' solicitors. In particular:

(i) the trustees made incorrect assertions to Riccardo's solicitors that the trustees did not need to consider Riccardo as a beneficiary. This suggested the trustees did not properly understand the terms of trust and their duties owed to beneficiaries, or even who the beneficiaries were;

(ii) the trustees failed to obtain "specialist legal advice" prior to making decisions particularly given the legal complexities and substantial death benefit;

(iii) the trustees failed to properly consider Riccardo's substantial relationship with Helen as well as his financial circumstances which were all relevant; and

(iv) the failure to pay any part of the death benefits to Riccardo was 'grotesquely unreasonable' and highlighted that no real

and genuine consideration was given to Riccardo as a potential beneficiary.

(i) The trustees paying all the death benefits to Carol, acted in conflict with their own personal interests (the conflict of which commenced on Helen's death in light of the personal acrimony between Carol and Riccardo).

(j) Although Martin did not approach the exercise of trustee power with the same arbitrariness or bad faith as Carol, Martin had acted in breach of duty by being appointed (he could have avoided being in a position of conflict by avoiding the appointment).

(k) It was not clear whether the trustee's actions had been motivated by personal animosity towards Riccardo or by the fact that the death benefits needed to be distributed as soon as practicable. The Court accepted that improper purpose had not been made out here given the payments made for the latter purpose would not be an exercise of power for an improper purpose. The Court noted that a negative inference cannot be drawn from the non-disclosure of trustee reasons for their decision. However, the other factors and circumstances noted above persuaded the Court to find that trustee discretionary power had not been properly exercised.

5.5 The trustees appealed the decision mainly contending that McMillan J erred in finding that the trustee's discretionary power was not exercised in good faith and upon real and genuine consideration to the exercise of power.

5.6 The Court of Appeal upheld McMillan J's findings at trial and approved the general principle in *Karger v Paul*. The Court of Appeal discussed in further detail the extent to which such principles applied to superannuation funds (and in particular SMSFs). The Court noted that until the High Court decides otherwise, the principles in *Karger v Paul* remain relevant to SMSFs which are 'closer to the *Karger v Paul* kind of fund' than externally managed funds.

5.7 The Court of Appeal also noted that:

(a) When the occasion for the exercise of a discretionary power has arisen, trustees, while not bound to exercise the discretion, are bound to consider whether it ought in their judgment to be exercised.

(b) In the case of superannuation funds, the duty of trustees to properly inform themselves is 'more intense' than in trusts of the type in *Karger v Paul* (ie, discretionary trusts), because of the importance that beneficiaries be paid their benefits.

(c) It is not open to the Court to look at:

(i) the factual situation established by the evidence for the independent purpose of impugning the exercise of discretion on the grounds that the trustees' inquiries, information or reasons or the manner of exercise of the discretion, fell short of what was appropriate and sufficient; or

(ii) the factual situation established by the evidence, for the independent purpose of impugning the exercise of the discretion on the grounds that the trustees were wrong in their appreciation of the facts or made an unwise or unjustified exercise of discretion in the circumstances.

5.8 Referring to the decision of *Attorney General v Breckler*[19], in determining whether the trustees have exercised their discretion on real and genuine consideration, the Court noted that:

> *"Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in* ***bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously*** *or* ***irrelevantly*** *to any sensible expectation of the settlor, or* ***without giving a real or genuine consideration*** *to the exercise of the discretion…" (****my emphasis****).*

5.9 The issues which are examinable by the Court are limited to whether there has been a failure to exercise the discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. In short, the Court examines whether the discretion was exercised but does not examine how it was exercised.

5.10 The Trial Decision and Appeal Decision in *Marsella* is a clear indication that a trustee's decision can be examined, reviewed and if necessary, impugned. Given the "more intense" duty of superannuation fund trustees to inform themselves, SMSF trustees prior to exercising discretionary power to pay out death benefits, should:

(a) seek specialist advice;

(b) ensure affected parties are all separately represented to avoid conflicts;

(c) review and be advised on:

(i) the terms of the SMSF trust deed;

(ii) the potential dependants and beneficiaries of the SMSF under the SIS Act and the governing rules of the SMSF;

(iii) any BDBN, or other nomination made by the member during their lifetime (valid or otherwise);

(iv) the financial circumstances of each potential dependant and beneficiary; and

(v) the relationship between the deceased member and each of the potential dependants and beneficiaries.

5.11 Although a negative inference should not be drawn from the non-disclosure of reasons, we should never assume that a trustee's decisions cannot be examined. It would therefore be appropriate in circumstances to have the trustee:

(a) make any necessary enquiries and obtain specialist advice (noted above); and

(b) retain evidence that it has made all necessary enquiries and document retain evidence for its reasons, although not necessarily providing such

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[19] (1999) 197 CLR 87, 99–100 quoting *Wilkinson v Clerical Administrative and Related Employees Superannuation Pty Ltd* (1998) 79 FCR 469, 480 (Heerey J, quoting the trial judge, Northrop J).

reasons to a beneficiary (noting that if provided, such reasons could be examinable by a Court).

5.12 The *Marsella* decisions highlight that a potential beneficiary (eg SIS dependant such as a spouse, child or legal personal representative) may have standing to bring a claim against the trustee of an SMSF in relation to the exercise of discretion and death benefit payments. The strength of such person's position may depend on their financial circumstances and also the steps taken by the trustee in seeking out all beneficiaries in determining the payment of death benefits prior to the exercise of power.

6. Conflicts of interest and disputes involving super funds, the estate and potential claimants

6.1 This section will focus on a discretionary payment of death benefits in the absence of a valid BDBN, where an individual is wearing 'two hats', namely:

(a) as the beneficiary able to receive death benefits in their own personal capacity; and

(b) as the executor or administrator of the deceased's estate.

6.2 Trustees and executors/administrators have fiduciary obligations to beneficiaries. In the context of a deceased estate, an executor or administrator has fiduciary obligations to the beneficiaries of the estate under Will or the laws of intestacy where there is no Will.

6.3 Following on from the above, conflicts may arise where an executor/administrator has the duty to call in the death benefits into the estate, but also has a personal interest in calling for the death benefits to be paid to themselves personally as a SIS Dependant.

6.4 Under equity law, the usual remedy available in situations where a fiduciary has obtained a benefit or gain where a conflict existed between fiduciary duty and personal interest, is for the fiduciary to account for any benefit or gain obtained or received.[20] With respect to deceased estates, the executor or administrator will be required to account to the estate.

6.5 The main cases that involve a conflict of interest in respect of a deceased member's superannuation death benefits are summarised below.

McIntosh v McIntosh[21]

6.6 In the fact circumstances of this case, James McIntosh made non-binding nominations held in several externally managed superannuation funds to his mother, Elizabeth McIntosh. James subsequently died intestate and Elizabeth was granted letters of administration in respect of James' estate. Elizabeth applied to James' superannuation funds to have his superannuation death benefits paid to her personally and each superannuation fund agreed to do so. James' estranged father, John McIntosh sought to have James' superannuation death benefits paid into James' estate (to be divided equally between Elizabeth and John under the laws of intestacy) on the basis Elizabeth had a conflict of interest and had breached her fiduciary duties to James' estate.

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[20] *Breen v Williams* (1996) 186 CLR 71, per Gummow J at 135

[21] [2014] QSC 99.

6.7 The Court held that there had been a clear conflict of duty and that when Elizabeth made the application to the superannuation funds for James' superannuation death benefits to be paid to her personally rather than James' estate, she was preferring her own interests to her fiduciary duties as administrator. By resolving that conflict in favour of her own interests by seeking the superannuation death benefits to be paid to her personally, she acted in breach of her fiduciary duties as administrator of James' estate. The Court accordingly made orders for Elizabeth to account to James' estate for the death benefits paid to her personally.

6.8 Interestingly, Atkinson J noted that an administrator's appointment should be distinguished from an executor's appointment. An executor is appointed by a testator and Atkinson J considered that perhaps the appointment of an executor could impliedly authorise the executor to call for death benefits in their individual capacity, despite the conflict. However this was considered further in *Brine v Carter*, below.

***Brine v Carter*[22]**

6.9 In the fact circumstances of this case, Professor Francis Brine died in 2012 leaving his de facto partner Norma Carter and his 3 children from a prior relationship (Martin, Matthew and Daniel).

6.10 Francis had two UniSuper superannuation benefits: A Flexi Pension lump sum benefit (**the Flexi Pension**) and an Indexed Pension annuity benefit (**the Indexed Pension**). Francis signed a non-binding nomination in respect of his Flexi Pension for it to pass to his estate on his death. Norma claimed all of the deceased's death benefits personally and in August 2013, the Insurance Management Committee of UniSuper resolved that 100% of the Flexi Pension be paid to Norma as de facto spouse and that the indexed pension be paid to Norma as well.

6.11 Francis' children brought an action against Norma for a breach of her fiduciary duties as an executor and that she was obliged to account to Francis' estate for Francis' death benefits received.

6.12 On the facts, it was held that Norma was aware of Francis' death benefits (at least from 10 January 2013) prior to her accepting the position of executor of Francis' estate (16 January 2013). The Court held that Norma owned a duty to disclose such information to the other executors and not to pursue a personal interest in circumstances in which there was a conflict between her duty and personal interest. She chose not to disclose to her fellow executors of the existence of Francis' death benefits until about a month later in mid February 2013, and did not disclose the value of Francis' death benefit or that the estate was an eligible beneficiary of it at all. The Court therefore held that Norma as an executor was in a position of conflict in relation to Francis' superannuation benefits, and breached her fiduciary duties during the period up to 4 March 2013 (when the other executors learned of her true position).

6.13 Norma argued that she was authorised to call for Francis' benefits to herself personally on the basis that Francis appointed her as an executor with full knowledge of the potential conflict. The Court rejected this argument as:

(a) while Francis knew and intended that Norma was the beneficiary of his Indexed Pension superannuation benefit, there was no reason to infer

[22] [2015] SASC 205.

that he knew that she was an eligible beneficiary of his Flexi Pension superannuation benefit;

(b) even if he had such knowledge, there is no reason to infer that he intended Norma to claim the benefit of his Flexi Pension superannuation benefit in her personal capacity or to authorise her to pursue her personal interest in competition with the estate; and

(c) therefore, the circumstances where Francis appointed Norma as executor do not give rise to a necessary implication that she was authorised to act in a position of conflict of interest in this respect.

6.14 In addition, the Court held that even if Francis' appointment of Norma were regarded as conferring some authority on her to act as executor notwithstanding her pursuit of a claim to his death benefits in her personal capacity, that could not be regarded as authorising her to fail to disclose her knowledge to her fellow executors or to mislead them about the superannuation entitlement.

6.15 However, the Court held that on the facts, from March 2013, Francis' children assumed conduct on behalf of the estate of claims to UniSuper that the superannuation benefit should be paid to Francis' estate. By this time, they had become aware of all the relevant facts and circumstances. By their conduct, Francis' children impliedly consented to Norma pursuing her own interests by claiming payment of the benefit in her personal capacity without resigning as an executor. Therefore, Norma was not in breach of her fiduciary duties after March 2013. As the decision by UniSuper to pay out Francis' superannuation death benefits to Norma was made after that time in August 2013, there was no connection between Norma's breach of duty and the benefit (ie Francis' death benefits received). Therefore, the Court held that she was not liable to account to Francis' estate for the benefit she received.

***Burgess v Burgess*[23]**

6.16 In the fact circumstances of this case, Brian Burgess died intestate, leaving his wife Denise and two young children who were all dependent on him. The deceased had benefits and life insurance policies in four externally managed superannuation funds. As a consequence of Brian's death, the trustee of each of his four superannuation funds received reasonably substantial life insurance policy proceeds. No nominations were made by Brian as to how his superannuation death benefits were to be paid.

6.17 After Brian's death but before Denise was granted letters of administration for Brian's estate, Denise made applications to two superannuation funds to have the superannuation death benefits paid to her. The first fund made its payment to her prior to her being appointed administrator and the second fund made its payment to her six months after she had been appointed administrator. A third superannuation fund paid out Brian's death benefits to his estate, and the fourth superannuation fund had not yet decided on who to pay Brian's superannuation death benefits to at the time of the proceedings.

6.18 A conflict issue was raised and Denise made an application to the Court for the issue to be resolved. The Court upheld the principles and decision in *McIntosh v McIntosh*. In relation to the first superannuation fund, Denise was not an administrator when she claimed the superannuation death benefits, and there

[23] *Denise Hilda Burgess (as administrator of the estate of Brian Michael Burgess) v Burgess* [2018] WASC 209.

was thus no conflict of interest. However, the Court held that Denise was in a position of conflict in respect of the superannuation death benefits held in the second fund as she had already been appointed administrator of Brian's estate at that time, and therefore Denise had to pay those benefits to Brian's estate. In relation to the third superannuation fund, the court held that Denise in her capacity of administrator was bound to claim Brian's superannuation death benefits, and not just notify the superannuation fund of the existence of the Brian's estate.

6.19 The Court also noted that the inconvenience in these circumstances could have been avoided with proper estate planning during the deceased's lifetime including the preparation of BDBNs or the preparation of a Will that authorised personal conflicts.

***Gonciarz v Bienias*[24]**

6.20 The fact circumstances of this case involved an application by Alicja Gonciarz (the plaintiff) for the revocation of a grant of letters of administration made to her in respect of the estate of her late husband Boguslaw Bienias, and for the appointment of an independent administrator.

6.21 Boguslaw died intestate on 4 August 2017 leaving his wife Alicja, who was granted letters of administration in respect of his estate on 18 December 2017. Boguslaw had superannuation death benefits in an externally managed superannuation fund. Boguslaw had not made a BDBN, but before marrying Alicja, made a non-binding nomination in favour of his brother. Shortly after Boguslaw's death, Alicja applied for Boguslaw's death benefits personally in October 2017. In this regard:

(a) on 21 May 2018, the Trustee sent a letter to Alicja informing her that the Trustee directed the total death benefit be paid to her as Boguslaw's lawful spouse;

(b) in 8 June 2018, the Trustee wrote to Alicja informing her that earlier in the month it received an objection to the proposed distribution (it was subsequently made known that the objection was made by Boguslaw's brother);

(c) in 13 June 2018, Alicja commenced a family provision application;

(d) on 7 September 2018, the solicitors for Boguslaw's mother and brother sent an email to Alicja demanding that she withdraw her claim for Boguslaw's death benefits as she was acting in conflict of interest to her duties as Boguslaw's administrator (noting *Burgess v Burgess*), and that she instead make an application to the trustee of the fund that Boguslaw's death benefits be paid to Boguslaw's estate;

(e) on 12 September 2018, Alicja wrote to the trustee to amend her claim for Boguslaw's death benefits to be paid to his estate instead;

(f) however, on 2 October 2018, Alicja wrote again to the trustee to confirm that she wanted to withdraw her request on 12 September 2018, and maintained her claim for Boguslaw's superannuation death benefits to be paid to her personally; and

[24] [2019] WASC 104.

(g) in early March 2019, Alicja received a letter from the trustee informing her that it had decided to pay Boguslaw's superannuation death benefits to Boguslaw's estate in its entirety.

6.22 Alicja then applied to the Court on an urgent basis seeking a revocation of the grant of letters of administration made to her.

6.23 The Court held that Alicja was in a position of conflict and she was obliged to subordinate her claim to Boguslaw's death benefits to that of his estate. The Court recognised that this was a difficult situation for Alicja (particularly where she also had a family provision claim against the estate on foot), and made orders revoking the grant of administration made to her. The Court held that having an independent and impartial administrator should permit an efficient and cost-effective administration of the estate, which was in the interest of all beneficiaries.

Conflicts otherwise authorised

6.24 The cases above highlight that the beneficiaries of an estate may have standing to bring superannuation into the estate for division in circumstances where the recipient beneficiary has conflicting duties and interests as legal personal representative of an estate and in their own personal capacity.

6.25 In both *Brine v Carter* and *McIntosh v McIntosh*, it was accepted that an exception to the conflict rule is if the fiduciary is authorised to act by implication arising from the circumstances of his or her appointment, citing the case of *Mordecai v Mordecai* where the Court stated that:

> *'That exception is where a testator or settlor, with knowledge of facts, imposes on a trustee a duty which is inconsistent with a pre-existing interest or duty which he has in another capacity. In that situation the trustee is not thereby debarred from accepting the trust or from performing the duties which are imposed under it.'*

6.26 In circumstances where there are conflicts, one should consider:

(a) the use of BDBNs in the estate plan (noting that prevention is better than a cure);

(b) express provisions in the Will and trust deed authorising conflicts;

(c) the timing of death benefit payment and applying for a grant of representation;

(d) obtaining the consent of all parties as to the payment of death benefits if all parties are sui juris; and/or

(e) having an independent executor to avoid any conflict of interest.

7. Drafting tips for minimising or limiting decision-making and risks

7.1 Recent cases and experience highlight that obviously, prevention is far better and cheaper than a cure. Most contentious matters involving the payment of death benefits that have come across my desk in recent times in my opinion were preventable with careful planning in the estate planning exercise.

7.2 An important consideration is whether the trustee ought to be bound to pay out the death benefits on death in the estate plan. The use of a binding death benefit nomination as noted above, removes the exercise of discretion and essentially

binds the trustee to paying out the death benefits as intended by the member. When drafting binding nominations, it is absolutely critical to ensure that:

(a) the terms of the trust deed and any prescribed procedures are followed;

(b) only persons eligible to receive as SIS dependants are nominated to receive under the binding nomination; and

(c) there is a 'cascading' gift over provision if the intended beneficiary does not survive (eg the member's deceased estate is to receive all the superannuation in the event the spouse fails to survive).

7.3 As noted above, the use of binding death benefit nominations should not be independently considered but rather, it is an estate planning tool and should be considered holistically with the member's Wills, powers of attorney and other succession planning documentation.

7.4 Often in the context of self-managed superannuation funds with young member couples, a common estate planning strategy is to leave discretion to the surviving spouse to pay out the death benefits in a form and manner depending on the circumstances of the surviving spouse and the (young) children at date of death.

7.5 For instance, on the death of a spouse, the surviving spouse (as the nominated executor and/or the surviving trustee/director of the corporate trustee) would continue on with the administration of the fund and will need to pay out the death benefits of the first to pass. Flexibility is key and the surviving spouse should obtain the necessary advice at the date of death in determining the appropriateness of paying death benefits to one or a combination of:

(a) themselves as the surviving spouse;

(b) the surviving children – either as lump sums or child pensions; and

(c) the deceased estate – eg to fund a superannuation proceeds trusts.

7.6 In light of recent case law developments, to minimise risks of conflict or dispute and to ensure that the parties' estate planning objectives can be achieved with as much flexibility as possible, one could consider:

(a) preparing non-binding advisory nominations outlining one's intentions in relation to the payment of superannuation death benefits;

(b) letters of wishes outlining one's holistic estate planning intentions particularly where wealth is held over multiple entities; and

(c) express authority under the Will for the surviving spouse to receive death benefits in their personal capacity even if they are appointed as executor.

8. Strategies for managing disputes between the estate and a super fund

8.1 It has been increasingly the case where individuals (particularly older individuals) hold the bulk of their wealth in superannuation. Outside New South Wales (where the notional estate rules apply), superannuation is generally outside challenge reach against an estate. However, the cases noted above could potentially bring superannuation into an estate dispute particularly where conflicts exist and discretionary power needs to be exercised. A disgruntled

beneficiary need only 'stir the pot' in a dispute setting to create an uncomfortable situation for everyone that is ripe for dispute.

8.2 In dispute settlements involving superannuation death benefits, it is appropriate to consider paying death benefits to the deceased's "tax dependants" as far as possible, as that would minimise any death benefits tax for all parties involved.[25]

8.3 For as long as superannuation death benefits are outside an estate, apart from the notional estate rules under the *Succession Act 2006* (NSW), the Court cannot make family provision orders as to the payment of death benefits. The payment of death benefits should be addressed by deed of family arrangement or terms of settlement at mediation to resolve the dispute, if the parties are agreeable.

8.4 In light of the above, one should consider whether it is in all parties' interests tax wise, to have death benefits paid:

(a) to the surviving spouse;

(b) to other financially dependant children; and/or

(c) into a superannuation proceeds trust established outside the Will, by deed.

8.5 A superannuation proceeds trust can be very tax-effective where the deceased member has a large life insurance policy held in the fund, which would be paid tax-free to a tax-dependant. Once the death benefits have been quarantined in the superannuation proceeds trust and go on to generate income, such income can then be distributed amongst the beneficiary class, namely the tax dependants of the deceased (taxed at adult rates).

9. Conclusion

9.1 The recent trend of cases show that superannuation death benefits are likely to be the subject of much litigation in the future, particularly in an ageing population and given that superannuation often forms a substantial part of clients' overall wealth. It therefore pays to ensure that death benefits are properly and appropriately dealt with in the estate planning exercise.

9.2 Cases also highlight that SIS dependant beneficiaries or executors may have standing to bring a claim against superannuation in the context where discretion is improperly exercised. It therefore pays to consider these issues very carefully in the estate planning context.

9.3 The trustee ought to seek out a valid binding death benefit nomination and examine a nomination as to its validity. For instance, are all beneficiaries SIS Dependants? Has it lapsed? Have all the procedures under the terms of the deed been followed? Remember, just because a nomination is headed 'binding' does not mean it necessarily is binding.

9.4 Possession is nine-tenths of the law. In the absence of a binding nomination, the trustee has the discretion to exercise power. How such discretionary power should be exercised is very much dependant on the context in which the parties find themselves.

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[25] See s 302-195 of the ITAA97 in relation to definition of "death benefits dependants" for tax purposes.

9.5 Although it has long been accepted practice that the trustee of a discretionary trust has complete discretion to determine when and how distributions are to be made to the beneficiaries of the trust, the *Marsella* decisions highlight that in the context of SMSFs, trustee decisions are vulnerable to being scrutinised closely by the Court. It is therefore no longer a simple exercise to 'just pay out the death benefits' in the estate administration phase.

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