Dealing with second marriages in super

By Julie Steed, Technical Services Manager

When clients marry for a second time they are often keen to ensure that their second spouse is well looked after in the event of their death. However, there is often a desire to balance this with leaving assets to children from the first marriage. This can be particularly so when clients remarry later in life, have no children from the second marriage and have accumulated significant assets in their superannuation fund.

In this article, we will examine a method for achieving this objective within superannuation.

Overview

Under the blended family strategy, a member arranges for their death benefit to be paid as a pension to their second spouse (the pension beneficiary) throughout the spouse's life. Upon the death of the pension beneficiary, the remaining capital is returned to the original member's estate. The member's estate distributes the remaining capital to the member's children or other superannuation death benefit dependants (the remainder beneficiaries). This basically provides the second spouse with a life interest in the deceased member's superannuation.

The member determines how the pension benefit will be calculated and the spouse cannot commute the pension or rollover to another fund. If the pension beneficiary dies before the member, the arrangement is voided.

Fund types

Self-managed superannuation funds (SMSF) provide a multitude of unique opportunities for clients. Assisting clients with estate planning and intergenerational wealth transfers is a major part of their appeal. The other type of self-managed super, a small APRA fund (SAF), is essentially an SMSF with a professional trustee. SAFs provide all of the legislative advantages provided to SMSFs and in respect of the blended family solution they provide a distinct advantage – the professional trustee holds the cheque book, not the second spouse. Whilst the blended family strategy outlined in this article is available in an SMSF, the concern of many clients is that things may not go to plan if there is friction between the second spouse and the children from the first marriage. If the second spouse holds the cheque book, they could disappear with the money. Whilst the children would have recourse for breach of the trust deed provisions, locating the spouse and commencing legal proceedings could be a lengthy and expensive process.

Documentation

This strategy requires a special purpose superannuation trust deed that supports the death benefit design. A deed of acknowledgement between the three parties (member, pension beneficiary and remainder beneficiaries) outlining the arrangement and acknowledging that they understand the arrangement is also highly recommended.

Members make a written binding determination to the trustee directing them as to the identity of the pension beneficiary and the remainder beneficiaries. The binding determination also includes the calculation method of the pension beneficiary's maximum pension benefit. The trustee will also formally acknowledge and agree to the binding determination.

Calculating the pension

The pension is calculated as a multiple of average weekly ordinary time earnings (AWOTE). AWOTE is currently $1,396 or $72,592 per annum. The use of AWOTE provides a strong indicator of purchasing power and provides clients with a sound basis for determining the future income needs of their spouse. AWOTE figures are issued by the Australian Bureau of Statistics (ABS) biannually in May and November.

For example, if a client wanted their spouse to receive an annual pension of $100,000 they would currently select an annual pension of 72 times AWOTE ($100,512 per annum).

The annual pension payment will be adjusted as at 1 July each year to reflect the updated AWOTE figure. The multiple of AWOTE will not change. The only other determination in calculating the annual pension amount is that the minimum pension required by superannuation law must always be paid. If the multiple of AWOTE chosen by the member was less than the minimum annual pension required by superannuation law, the higher minimum would be paid.

Variation to pension calculation

The pension beneficiary can vary the annual pension payment between the superannuation minimum annual pension amount and the amount previously determined by the member. However, the pension beneficiary cannot elect an annual pension payment above the amount pre-determined by the member.

The pension beneficiary cannot commute or rollover the pension payment however they can forfeit their benefit and have it pass to the remainder beneficiaries at any time.

On the death of the pension beneficiary

Following the death of the pension beneficiary, any remaining balance is paid to the remainder beneficiaries as lump sums with PAYG tax deducted.

Blended family case study – Paul and Dianne

Paul and Dianne have been married for 15 years and they both have adult children from previous marriages. They have a comfortable lifestyle on an income of $300,000 per annum. Paul earns $250,000 per annum, Dianne does not have paid work and they average $50,000 per annum in income from their investments.

If one of them was to die they want the surviving spouse to be able to maintain a comfortable lifestyle and remain in the same home. Upon the death of the surviving spouse they want all four children to benefit.

Ten years ago Dianne's sister Sue married Bill following the death of her first husband several years earlier. Sue and Bill bought a house together and they also each had two children from their previous marriages.

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

Paul and Dianne have the following assets:

Ownership	Asset	Value $
Tenants in common	Family home	1,500,000
Joint	Shares	200,000
Joint	Cash	80,000
Paul	Superannuation	1,400,000
Dianne	Superannuation	400,000
Total		**3,580,000**

After meeting with their financial adviser and estate planning specialist, Paul and Dianne make a number of changes to their financial arrangements. They have Wills prepared which include a lifetime right to reside in the family home. Upon the death of the second of them, all four children will share the proceeds of the sale of the family home. All of the cash and shares pass to the other on the death of the first.

Paul and Dianne convert their SMSF to a SAF and make binding determinations specifying each other as the pension beneficiary and their own children as remainder beneficiaries. They set the annual reversionary pension as a multiple of AWOTE, acknowledging that they can change the multiple any time prior to death if their lifestyle needs change.

Five years later, Paul dies and their estate plans are activated. Dianne continues to live in the family home and she has access to the cash and shares. Paul's superannuation death benefit is paid to Dianne as a pension at the pre-determined multiple of AWOTE.

Upon Dianne's death, her share of the house will pass to her two children and Paul's share of the house will pass to his two children. It is likely that the children will sell the house and receive a quarter of the proceeds each. The remainder of Paul's superannuation account is paid to his two children and Dianne's superannuation is paid to her two children.

Conclusion

A SAF can provide a powerful estate planning tool for blended families who wish to provide for a second spouse during their lifetime whilst maximising the opportunity to leave a residual estate to children from former relationships.

For more information on this strategy please contact your business development manager.