Nominating a reversionary beneficiary

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When you start an account-based pension, an important decision you need to make is how the remaining balance of your pension will be distributed upon your death (assuming, of course, that there is some money left).

With regard to your superannuation benefits, you can generally make the following nominations:

1. Nominated beneficiary – under this option you may provide direction to a super fund trustee but that does not require them to pay the death benefit to the person you have nominated and/or your estate.
2. Reversionary beneficiary – the nominated person (generally a spouse) will automatically continue receiving the pension after your death.
3. Binding death benefit nomination – gives you certainty that your superannuation benefit will be paid to the beneficiary you nominate – there is no trustee discretion. Your beneficiary may then choose how they want to receive the benefit; either in the form of a pension, a lump sum or a combination of both. These nominations must be updated at least every three years.

Why choose a reversionary beneficiary

Under the nominated beneficiary option, the fund's trustee will always have ultimate discretion as to who will receive your super death benefits. A binding nomination option may not always be valid (eg if your circumstances change and you forget to revise your nomination). The reversionary beneficiary option, however, will provide greater certainty that your intended beneficiary (provided they are an eligible dependant at death) will receive an ongoing pension following your death.

Because of the restrictions on pension payments to child beneficiaries, such as the requirement that it must be commuted and paid out when the child turns 25, many superannuation funds only permit a reversionary option to a spouse.

Advantages of receiving a reversionary pension

- Generally, the pension is tax-free, or at least concessionally taxed, depending on the age of the deceased person and their beneficiaries at date of death – see table on page 2.
- Earnings and capital gains on pension assets are tax-free (in the fund).
- A reversionary pension may be beneficial if social security (under the income test) is involved – see example on page 2.
- A death benefit paid as a pension would retain funds in the super environment. By receiving a death benefit as a lump sum some beneficiaries may not be able to contribute that money back into a superannuation fund due to certain restrictions imposed by law.
- There is no urgency to deal with death benefits at a time of grief as the pension simply switches from the deceased to the reversionary beneficiary.

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Pension beneficiaries in a taxed superannuation fund are assessed as follows:

Age of deceased/ dependant	Tax component	Tax treatment
If either or both aged 60 or over	Tax-free	No tax payable
	Taxable – taxed element	No tax payable
If both under age 60	Tax-free	No tax payable
	Taxable – taxed element	Marginal tax rate, but 15% tax offset applies

Disadvantages of receiving a reversionary pension

- Funds are not readily available to pay off non-deductible debts; however the pension may be commuted to a lump sum if necessary.
- The beneficiary is not entitled to an anti-detriment payment (essentially a possible top-up payment to the death benefit lump sum).

Case study

Reversionary beneficiary option

David, aged 65, is about to commence an account-based pension with $500,000 (tax-free amount is $100,000) for which he nominates his wife, Julie (aged 62), as sole beneficiary.

Julie is retired and wants to keep the funds in the super environment upon David's passing as she has a few super assets of her own. Their financial adviser recommends that David set up a reversionary pension to automatically revert to Julie. The primary reason for this is that, once Julie turns 65, she is unlikely to meet the work test and will be unable to contribute to super if she received the death proceeds as a lump sum. Instead, Julie will inherit the reversionary pension; pension payments will be tax-free because, when he dies, David is over the age of 60.

Case study cont...

Note: If David and Julie were relying on Centrelink support, the non-assessable amount of the pension (or deductible amount) will be based on David or Julie's life expectancy, whichever is longer.

Given Julie's life expectancy of 24.23 years, the pension will have a Centrelink non-assessable amount of $20,636 ($500,000 / 24.23) rather than $26,969 if it was based only on David's life expectancy of 18.54 years ($500,000/ 18.54).

Therefore, if David was receiving a pension of $30,000 pa, his income assessment for Centrelink purposes from this pension with a reversionary setup would be $9,364 ($30,000 – $20,636).

As a comparison, if this money was invested in a direct share portfolio (outside super), a higher income assessment of $16,345 would apply. Centrelink's concessional treatment of income streams may offer a more favourable result.

The following table compares the tax outcomes for Julie if she were to invest the death benefit that was paid as a lump sum compared to it being paid as a reversionary pension.

	Lump sum ($500,000)	Pension ($500,000)
Investment income (6%)	$30,000	–
Pension income	–	$30,000
Taxable income	$30,000	Nil
Tax offsets	$445	N/A
Net tax (including Medicare levy)	($2,842)	N/A
Net cash	$27,603	$30,000

While Julie is $2,397 better off as a result of receiving David's reversionary pension, she may lose her entitlement to the anti-detriment payment when he dies.

For more information, please call DMFS Financial Advisers on 1300 364 650.

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