Tax on super death benefits paid to estate v beneficiary

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Two options are available when paying a lump sum superannuation death benefit to a SIS dependant who is a non-tax dependant, such as an adult child:

1. Lump sum death benefit can be paid directly from the deceased member's super fund to the beneficiary, or
2. Lump sum death benefit can be paid to the deceased's estate and then distributed to the beneficiary.

In both cases, the tax-free component can be received tax-free, while the taxable taxed element is subject to a maximum 15% tax and the taxable untaxed element is subject to a maximum 30% tax.

However, whether the lump sum death benefit is paid directly or through the estate can result in different financial outcomes for a non-tax dependant. As an example, this article uses the situation of a deceased member's adult child who is a SIS dependant but not a tax dependant to compare the different tax treatments and other flow-on effects.

The same income tax rates apply to the non-tax dependent beneficiary regardless of whether the beneficiary is a tax resident or a foreign resident, however, the rules are administered differently based on the tax residency status. This article explores these differences.

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Introduction – who is a dependant?

The definition of a dependant for super law purposes (i.e. SIS dependant) determines whom the super fund can pay the deceased member's death benefit to, while the definition for tax purposes (i.e. tax dependant) it determines whether the taxable component of the lump sum death benefit is subject to tax. The starting point is to understand a beneficiary's dependency status.

SIS dependants

The trustee can generally only pay a super death benefit directly to:

- the deceased member's legal personal representative (i.e. deceased estate), and/or
- one or more of the deceased member's SIS dependants stated below:
    - the deceased's spouse or de facto spouse
    - a child of the deceased (any age)
    - a financial dependant of the deceased
    - a person who was in an interdependency relationship with the deceased.

Where a member wishes for their death benefit to be paid to an adult child, the member can either nominate their adult child as a beneficiary to receive the death benefit directly from the fund, or direct their death benefit be paid to their deceased estate, and then to the child as a beneficiary through their Will.

If an intended beneficiary is not a SIS dependant (e.g. a sibling of the deceased who was not a financial dependant or in an interdependency relationship with the deceased), the death benefit can be directed to the deceased estate (by making a binding or non-lapsing nomination to the legal personal representative). The deceased's Will can then instruct the executor of the deceased estate to pay a death benefit to this beneficiary from the estate.

Please refer to Chapter 10 of our **FirstTech Super and Retirement Income Streams Guide** for further details about who is a SIS dependant and how a member's death benefit can be paid.

Tax dependants

A lump sum death benefit can be paid to a tax dependant tax-free regardless of whether the death benefit contains any taxable component or not. In contrast, the taxable component of a lump sum death benefit is subject to tax (see below **'Tax on lump sum super death benefits'** for details) when paid to a non-tax dependant.

A tax dependant can include:

- the deceased's spouse, de facto spouse or former spouse
- a child of the deceased under 18 years old
- a financial dependant of the deceased
- a person who was in an interdependency relationship with the deceased
- a person who receives a super lump sum because the deceased died in the line of duty (e.g. as a member of the Defence Force, or a member of Australian Federal or State police force) regardless of their relationship to the deceased.

A financially independent adult child is generally regarded as a non-tax dependant, even if the adult child and the deceased parent were living together.

For further details on tax dependants, please refer to our FirstTech strategic update **Super death benefit – who is a dependant for tax purposes?**.

Tax on lump sum super death benefits

Tax components

The trustee of a super fund needs to calculate the tax-free and taxable component when a lump sum death benefit is paid.

The taxable component can include two elements:

- taxed element – this is the element the fund has paid tax on; and
- untaxed element – this can occur:
    - if the death benefit is paid from an untaxed super fund where a fund has not paid any tax on the contributions or earnings, or
    - if the lump sum death benefit contains an insurance payout and the fund claimed a

tax deduction for the insurance premium where the member died under age 65. NOTE, If the deceased member was 65 or over at the time of death, the untaxed element would be reduced to $0.

Tax on lump sum death benefits

The rate of tax that will apply to the taxable component of a lump sum death benefit depends on the recipient's tax-dependency status and the amount of each element that forms part of the taxable component:

Table 1: Tax on lump sum death benefits

Recipient	Tax-free component	Taxable taxed element	Taxable untaxed element
Tax dependant	tax-free	tax-free	tax-free
Non-tax dependant	tax-free	Maximum 15%[1]	Maximum 30%[1]

1 Medicare Levy is payable where the lump sum death benefit is paid directly to a beneficiary, but not payable via deceased estate. Please refer to **'Who is liable to pay tax on lump sum death benefits?'** section for details.

Lump sum tax offset and maximum tax rate

Where a lump sum death benefit is paid to a non-tax dependant, the taxable component (both taxed and untaxed elements) forms part of the taxpayer's assessable income. However, the taxpayer receives a lump sum tax offset, calculated by the ATO and based on the tax return information, to ensure the tax payable does not exceed the specified maximum rates of tax.

When a lump sum death benefit is paid to a non-tax dependant (directly or via the deceased estate):

- If the taxpayer's marginal tax rate exceeds the specified tax rate, the ATO will apply the lump sum tax offset to ensure that the taxpayer does not pay more than 15% tax on the taxable taxed element and 30% on the taxable untaxed element.
- If the taxpayer's marginal tax rate is lower than the specified maximum tax rate, the taxable component of the lump sum death benefit is subject to the marginal tax rate.

The relevant taxpayer assessed depends on whether the death benefit is paid direct to the non-tax dependant from the deceased's super or via the deceased estate. Please refer to **'Who is liable to pay tax on lump sum death benefits?'** section below for details.

Order of including income subject to different tax rates

Where a taxpayer has ordinary taxable income subject to their marginal tax rate and also receives a lump sum death benefit containing both taxed and untaxed elements subject to maximum tax rates, it is our understanding that the tax practice is to apply the below steps to calculate the lump sum tax offset:

Step 1 Include the taxpayer's ordinary taxable income subject to marginal tax rate.

Step 2 Add amounts taxed at a higher maximum tax rate, such as the taxable untaxed element of the lump sum death benefit that is subject to 30% maximum tax rate.

Step 3 Add amounts taxed at a lower maximum tax rate, such as the taxed element of the lump sum death benefit that is subject to 15% maximum tax rate.

Who is liable to pay tax on lump sum death benefits?

Depending on whether a non-tax dependant, such as an adult child, receives the lump sum death benefit directly from the deceased's super fund or from the deceased estate, the tax outcome can be surprisingly different for the beneficiary.

1. Payment made directly from super fund

A lump sum death benefit can be paid to a non-tax dependant beneficiary directly from the super fund if the beneficiary is a SIS dependant. This may be the case if the deceased made a binding or non-lapsing nomination to this beneficiary, or the trustee of the fund exercises discretion to pay the death benefit to this beneficiary.

When beneficiary is a tax resident

The trustee of the super fund must withhold tax on the taxable component of the lump sum as follows:

Table 2: Fund's withholding rates for lump sum super death benefit paid to a resident non-tax dependant

Tax component of the lump sum death benefit	Age[1]	PAYG withholding rate[2]
Taxable taxed element	any age	17%
Taxable untaxed element	any age	32%
Beneficiary's TFN not provided - taxed and untaxed element	any age	47%

1 Age of the person at the date the payment is received.

2 Including Medicare Levy.

The resident non-tax dependant beneficiary then needs to declare the taxable taxed and untaxed elements in their tax return as assessable income. The amount withheld by the super fund becomes a tax credit to reduce the individual's tax liability and can be refunded to the beneficiary if in excess.

The inclusion of the taxable taxed and untaxed element in the individual beneficiary's tax return means the beneficiary will have higher assessable and taxable income in the financial year that the lump sum death benefit is received, which can have flow-on effects such as:

- Medicare Levy can apply to the increased taxable income
- Medicare Levy surcharge may be applicable where the beneficiary does not have private hospital insurance. Conversely, if the beneficiary has private hospital insurance, there could be a reduction or elimination of the private health insurance rebate
- reduction or elimination of the low income tax offset and seniors and pensioners tax offset
- impact on Government co-contribution and spouse contribution tax offset
- Division 293 tax – additional 15% tax can apply to concessional contributions that takes the overall Division 293 income, taxable component of the super death benefit included, over and above the $250,000 threshold.
- reduction or elimination of Family Tax Benefit payments
- increase in child care cost due to the potential reduction in Child Care Subsidy
- Increase in the compulsory repayment against the beneficiary's **HECS debt**.

When beneficiary is a foreign resident

The same maximum income tax rates shown above in **Table 1 - Tax on lump sum death benefits** apply. If the beneficiary directly receiving the lump sum death benefit is a non-tax dependant residing overseas (ie a foreign tax resident):

- the tax-free component is free
- the taxable taxed element is taxed at a **flat rate of 15%** and the taxable untaxed element is taxed at **a flat rate of 30%**. This is because a non-resident's marginal tax rate starts at 32.5% which is already higher than the capped maximum tax rates that apply to a lump sum death benefit.

The trustee of the super fund must withhold tax on the taxable component of the lump sum as shown below in Table 3. However, the withholding tax rates can be affected if there's a **double tax agreement** between the two countries specifying which country has the taxing rights over the lump sum death benefit payment.

Table 3: Fund's withholding rates for lump sum super death benefit paid to non-tax dependant who is a foreign tax resident under Australian tax rules

Tax component of the lump sum death benefit	Age[1]	PAYG withholding rate[2]
Taxable taxed element	any age	15%
Taxable untaxed element	any age	30%
Beneficiary's TFN not provided - taxed and untaxed element	any age	45%

1 Age of the person at the date the payment is received.

2 Medicare Levy does not apply to a non-tax resident. Therefore the withholding tax rates are 2% lower (based on the current Medicare levy rate) compared with payment made to a resident non-tax dependant beneficiary by the fund.

Notably any no TFN tax withheld is not a final tax. The beneficiary will need to lodge an Australian individual tax return in order to receive a tax refund for the excess tax withheld.

However, the beneficiary will need to have a TFN in order to lodge an Australian individual tax return. Where a foreign resident beneficiary has never had a TFN, it is possible to apply while living outside Australia. Please refer to **this ATO link** for further details about how to apply.

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It's not uncommon for a foreign resident beneficiary who has never lived in Australia to not have a TFN. Where the TFN is not provided to the super fund when the death benefit lump sum is paid to the foreign resident, the super fund must withhold 45% tax on the taxable component.

Although the foreign tax resident can still lodge an Australian tax return to receive a tax refund, it can take a long time for that to happen.

To avoid the no TFN withholding tax, the foreign resident beneficiary should provide their TFN to the fund before the fund pays the death benefit to the foreign resident non-tax dependent beneficiary. If the foreign resident does not already have a TFN, it is possible to **apply for a TFN while living overseas**.

Double tax agreement (DTA)

If the foreign country where the non-tax dependant beneficiary is residing has a DTA with Australia and the DTA stipulates that only the foreign country has the taxing rights over the lump sum, the super death benefit can then be only taxed in the foreign country. This means that the Australian super fund cannot withhold any tax from the lump sum death benefit and this is the case even if the beneficiary's TFN is not provided to the fund.

If there's no DTA, or there's a DTA but the DTA

- is silent on which specific country has the taxing rights over the lump sum death benefit; or
- allows both countries to have taxing rights over the lump sum;

it is likely that the lump sum death benefit payment can be subject to tax in both countries. The Australian super fund is required to withhold tax as per **Table 3** where the foreign tax resident beneficiary is a non-tax dependant.

Seek independent tax advice

Foreign tax is outside the scope of this article. It is important to seek independent tax advice to confirm the foreign resident's tax liabilities in both countries when they receive a lump sum death benefit payment from an Australian super fund.

2. Death benefit paid to non-tax dependant via deceased estate

The trustee of a super fund can pay the deceased member's death benefit to the deceased estate where:

- the deceased member made a binding or non-lapsing nomination to their legal personal representative, or
- a binding nomination was not made, and the fund's default provisions require payment to the estate, or
- the trustee exercised discretion to do so.

The super fund will pay the entire death benefit as a lump sum to the deceased estate and **as it is not subject to PAYG withholding tax**. It is then the responsibility of the deceased's **legal personal representative** (i.e. executor of a Will or the administrator in the case of intestacy) **to pay tax on** the taxable component of the lump sum when it is paid to a non-tax dependant from the estate. This is the case regardless of whether the non-tax dependant is an Australian tax resident or a foreign tax resident.

FirstTech comment

It is important to note that when a super death benefit is paid from the deceased estate to a testamentary trust that has both tax dependent and non-tax dependent beneficiaries, the death benefit is regarded to have been paid to a non-tax dependant where it is not clear who will benefit.

The executor or administrator needs to pay tax on the taxable component of the lump sum paid to the testamentary trust.

The executor or administrator must include the taxable taxed and untaxed elements in the deceased estate's trust return as assessable income when these amounts are paid to a non-tax dependant (regardless of their tax residency status). The same maximum tax rate and ordering rules mentioned in earlier sections apply. However, for tax law purposes the benefit is taken to be income of the trust to which no beneficiary is presently entitled, which means Medicare Levy is not payable when the death benefit is paid from the deceased estate to a non-tax dependant.

The executor or the administrator must deduct tax from the taxable component of the lump sum before paying the death benefit to a non-tax dependant beneficiary. The beneficiary does not need to declare this income in their tax return, hence no increase in their assessable and taxable income.

Where the non-tax dependant beneficiary is a foreign tax resident, although the lump sum death benefit paid to them from the deceased estate is not subject to Australian tax at their end, this lump sum may still be subject to foreign tax. It is important for the beneficiary who's receiving an after-tax lump sum super death benefit payment from a deceased estate to seek independent tax advice to confirm their foreign tax position.

FirstTech comment

For the first three income years where the estate is still under administration and no beneficiaries are presently entitled to the estate income, the deceased estate income is taxed at individual income tax rates, with the benefit of the full tax-free threshold, but without the tax offsets (concessional rebates), such as the low-income tax offset. No Medicare Levy is payable by the deceased estate during that period.

Example

Phoebe (age 40) is a single parent with two young children under age 5. Phoebe earns $46,000 per year from a part-time job. She is receiving full Family Tax Benefit Part A and Part B totalling of $18,289 per year (based on 2024-25 payment rates).

Phoebe's mum Doris recently passed away. Phoebe is the sole beneficiary of her estate and the executor of her Will. Doris' estate has very little income generating assets. The estimated annual income in her deceased estate is around $5,000.

Doris was 63 at the time of death, and her super death benefit contains a death cover payout. The trustee of Doris' super fund calculated the tax components of her lump sum death benefit as below:

Tax-free component	$100,000
Taxable taxed element	$200,000
Taxable untaxed element	$150,000
Total lump sum death benefit	**$450,000**

Doris didn't bother making a death benefit nomination as in her mind everything would go to Phoebe anyway. Subject to the super fund's governing rules, Phoebe potentially has **two options**:

1 request the super fund to pay Doris' death benefit to her directly, or

2 request the super fund to pay Doris' death benefit to her deceased estate and receive the lump sum through the estate.

Phoebe is a non-tax dependant. With either option:

- $100,000 tax-free component can be received tax-free and will not form part of the taxpayer's assessable income
- $150,000 untaxed element forms part of the taxpayer's assessable income but taxed at a maximum 30%. This amount is regarded to have been received first before the taxed element.
- $200,000 taxed element forms part of the taxpayer's assessable income but taxed at a maximum 15%. This amount is regarded to have been received later than the untaxed element.

The differences between the two options are:

With **Option 1**, Phoebe is the taxpayer. She needs to include the taxed and untaxed elements in her tax return which will increase her taxable income from $46,000 to $396,000 in the year the lump sum death benefit is paid. This means:

- Phoebe needs to pay Medicare Levy on the entire $396,000 taxable income, including the taxable component of the lump sum death benefit payment
- Phoebe will lose the $18,289 Family Tax Benefit payments
- Phoebe cannot benefit from the low income tax offset
- Phoebe's child care costs will most likely increase due to the reduction in her child care subsidy payment as a result of higher income level
- Phoebe will be subject to Division 293 tax on her concessional contributions such as super guarantee, salary sacrifice, voluntary employer contributions and/or personal deductible contributions, given her Division 293 income exceeds the $250,000 threshold.
- If Phoebe were to make a non-concessional contribution, she would not be able to receive the Government co-contribution due to the increased income level.

With **Option 2**, the taxpayer is the deceased estate (i.e. the executor pays tax on behalf of the estate) when the lump sum is paid from the estate to a non-tax dependant of the deceased.

This means:

- Medicare Levy is not payable. For tax law purposes the taxable component of a lump sum benefit is taken to be income in the trust (i..e deceased estate) to which no beneficiary is presently entitled, which means Medicare Levy is not payable when the death benefit is paid from the deceased estate to a non-tax dependant.
- When Phoebe receives a net of tax distribution from Doris' deceased estate, she does not need to report this income in her tax return. As a result, her taxable income will remain unchanged at $46,000. The flow-on effects due to the increase in her income level mentioned in Option 1 won't apply here.
- Doris' deceased estate only has $5,000 of other income. This means the remaining $13,200 tax-free threshold can apply to the untaxed element, and 16% tax rate (rather than 30%) applies to part of the untaxed element that does not take the trust income to the next tax bracket.

The table below compares the amount of tax payable under the two options:

Table 3: Tax comparison of the two options

	Option 1 Phoebe pays tax	**Option 2 Deceased estate pays tax**
Taxable (untaxed element) – $150,000	$48,000[1]	$37,288[3]
Taxable (taxed element) – $200,000	$34,000[2]	$30,000[4]
Total tax on lump sum death benefit paid to Phoebe	**$82,000**	**$67,288**

1 Given Phoebe's other ordinary income pushed her to the 30% tax bracket, the entire $150,000 is taxed at 30% plus 2% Medicare Levy.

2 $200,000 is taxed at 15% plus 2% Medicare Levy

3 ($18,200 – $5,000) @ 0% = $0; ($45,000 – $18,200) @ 16% = $4,288; remainder $110,000 @ 30% = $33,000. Medicare Levy is not payable.

4 $200,000 is taxed at 15% = $30,000. Medicare Levy is not payable.

FirstTech comment

The Phoebe example illustrates the potential tax benefit of receiving a lump sum death benefit from the deceased members' estate, rather than from the deceased super fund directly, by a SIS dependant that is not a tax-dependant. However, tax savings are only one aspect of super estate planning. Other factors must be considered in order to determine an estate planning strategy that will best suit a client based on their circumstances and objectives.

Considerations include:

- Potential uncertainties in a deceased estate. If a death benefit is paid to the deceased estate, it may be subject to family provision claims. In comparison, where a death benefit is paid directly to an individual from the super fund, that amount would not ordinarily form part of the deceased estate and would generally not be subject to the operation of the family provision laws. This is the case in all states except NSW. In NSW, the application of 'notional estate' could bring the deceased super death benefit with a valid binding or a non-lapsing nomination to an eligible person(s) back for the purposes of making a family provision order by the court.

- Administrative simplicity and efficiency. Generally speaking, a lump sum death benefit can be paid sooner from the deceased super fund directly to a beneficiary, compared with paying the death benefit to the estate and then to a beneficiary.

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