ESTATE PLANNING STRATEGIES - SOME FACTS

Having an appropriate Will is by far the most important strategy for a well prepared estate plan. This topic is covered in detail in The People in Dairy website www.thepeopleindairy.org.au. There are a number of other strategies that are listed here.

JOINT TENANCY

Many assets are held in one name only. This is particularly common with land that may have been in the family's name for several decades. It was often the practice for the husband to hold the asset in his own name. Statistics show that the male is more likely to 'go' first. If the land is in the one name alone, it is essential that a grant of Probate be taken out through the Supreme Court. There is some complex paperwork and often substantial filing fees involved, together with significant delays.

A transfer of the land (or indeed any other asset) into joint names can avoid several problems. The production of a death certificate and a simple form will remove the deceased owner from the title documents relating to the asset, leaving the surviving owner/s on the record. There is currently an exemption available in New South Wales from stamp duty on a transfer into joint names for the principal matrimonial home. The use of a transfer into joint names can save a thousand dollars or more and several months in the administration of an estate.

Even if there is no stamp duty exemption, it is sometimes still worth considering a transfer of an asset into joint names for ease of administration later. In particular, an automatic transfer on death can protect the relevant assets from any estate creditors or from other claims against the estate.

A word of caution however. If the affairs of spouses have been carefully structured to take advantage of social security or tax concessions, a spouse, on surviving their joint tenant, may receive a significant increase in their own assets, regardless of what the Will may provide. The increase could be enough to undermine or even defeat all the careful planning that had been done with the result that the concessions are lost. Sometimes it is appropriate to undo the joint tenancy so that the first person to die can leave their share of the relevant asset to someone else, allowing the survivor to continue to enjoy the benefits of the relevant concessions.

BUY/SELL AGREEMENTS

Such an agreement can be very useful should one of the proprietors die. If the surviving owner/s have the option to buy that share, then they can be sure that they will not end up in partnership with an executor, beneficiary or buyer that they may not even know. In this way then, they can retain control of their business. For the family of the deceased partner, if there is an option to sell, they can be sure that they will not up with a share in a business that they don't want and may not know how to run. Nor will they have to find a buyer for only a part share of a business. Instead they can be sure of promptly receiving a fair price for the share, and that the business will continue on.

TESTAMENTARY TRUSTS

These are trusts, usually of a discretionary kind established by will. Their major attraction is that they take advantage of income tax law provisions for children. Until 1979, the usual tax thresholds were available to everyone. So, if my business was owned by my family trust and earned a profit of $80,000 for this year, I could split the income between my children, my wife, and myself. If I had enough children, I would pay no tax, because everyone could take advantage of the various thresholds, including the tax-free threshold. A family with six children would pay no tax, whereas if the business operator earned the $80,000 himself, he would pay $19,850 plus the Medicare Levy. In 1979 that changed so that unearned income of children is now taxed at penal rates. But there are some

exceptions to that rule and one of those exceptions is income earned by a child from a deceased estate. And that is why testamentary trusts are interesting as well as useful for tax planning.

There can however be some practical problems with testamentary trusts. Firstly, they do need maintenance and so professional assistance is often required. This costs money. Secondly, the trust will effectively make the beneficiaries into a form of investment partnership – but they may not want to have their investment decisions made by a set of people who probably have very different investment priorities and goals. While an alternative exists through setting up multiple testamentary trusts, one for each beneficiary, administration expenses would increase substantially. Finally, there can be great difficulty and possibly great tax and stamp duty consequences if the trust is varied in some ways. But such variations may become necessary through changes to the law or the circumstances of the parties. Considerable foresight would be required by the person drawing up the Will, and therefore the trust terms, if the need for variations is to be avoided.

Another form of testamentary trust is also available that has some, but only limited, use. A deceased estate can claim the tax-free and other tax thresholds for up to three years from the date of death. This means that income from estate assets can enjoy the concessions of the various tax thresholds. The estate derives the income, pays the tax, at the reduced rates and then distributes the net income to beneficiaries. So tax payments are usually less than if the income was distributed to beneficiaries, who would have to add it to their own income for tax purposes.

A further form of testamentary trust can be established by a beneficiary under the Will effectively transferring part or all of the gift received to a further trust. This must be done within three years of the date of death.

A word of caution: the government announced some time ago that it planned to change the system for taxing trusts. The proposal, known as "entity taxation" was ultimately abandoned. However, the area of trusts and taxation has never been removed from the ATO's attention and it would be very brave to assume that this type of proposal will never be revisited.

Despite these possible difficulties, there can still be a place for such trusts, particularly as a "protective trust" where a beneficiary may be exposed to the financial claims of creditors or an ex-spouse. Although details are currently lacking, the announcement in the 2006 Federal Budget of possible exemptions from the franking credit holding rules for income beneficiaries of testamentary trusts may also provide some further attractions for using such trusts.

THE USE OF REVERSIONARY PENSIONS FROM SUPERANNUATION FUNDS

The characteristics, as well as the amount, of each type of pension that may be available will need to be considered in assessing the appropriate provision for beneficiaries in an estate because that pension, if it exists, will not be paid through the estate but direct to the relevant beneficiary. The combined effect of that pension and gifts under a Will may result in complications for the beneficiary, particularly in relation to their own taxation and social security positions and more so if they are not classified as "dependents". Again, the use of a self-managed fund may provide a desirable flexibility at this time.

LIFE INSURANCE POLICIES HELD IN SUPERANNUATION FUNDS

Procedures exist whereby the owner of a policy can transfer ownership to another party or alternatively nominate a beneficiary under that policy. This is often worthwhile as payment will then bypass the estate administration and should be a lot quicker. The result is that the person who is to benefit gets their hands on some cash a lot more quickly and with a lot less trouble.

ELIGIBLE TERMINATION PAYMENTS

Any amounts constituting an eligible termination payment, now without limit, can be left as a lump sum, tax-free to a spouse, ex-spouse, child or other dependent. This can allow for some significant

estate planning opportunities in providing for these classes of estate beneficiaries. The eligible termination payments need not form part of the estate to qualify for this exemption, provided it is paid because of the death. Therefore, if someone wants to leave part of their estate to dependants, as defined, and the other part to non-dependents, there can be substantial tax savings if the eligible termination payments are left to the dependants with the balance of the estate being divided amongst the non-dependents. It should be noted though that unused leave entitlements can no longer form part of the eligible termination payments for this purpose.

Death benefit nominations

Provided these are held in relation to a self managed superannuation fund or comply with fairly strict and demanding legal requirements and are appropriately maintained, they will ensure that the nominated amounts or shares of superannuation are paid to the nominated beneficiaries. Such nominations in favour of a spouse are usually cancelled by a divorce but not by separation. The nature of binding death benefit nominations means that the trustee/s have no discretion so that, even if the benefit would create an adverse result for the recipient, the estate or other beneficiaries, the death benefit must still be paid exactly as directed. It is often the case that a non-binding death benefit nomination may be preferable as it will allow the trustee/s some flexibility in assessing the respective positions at the time, rather than being bound by the member's expectations of what the future may hold for everyone. In this way the trustee/s have a discretion which can be exercised on more relevant and current information, while still being informed of the deceased's preferences. There may also be some scope for not only nominating the beneficiary but also specifying how the benefits are to be paid. That advantage is even greater when a self-managed superannuation fund is involved.

Such a death benefit, if paid to a "dependent" (as defined), normally attracts significant tax concessions, if not complete exemptions, regardless of whether the death benefit nomination was binding or not.

Superannuation benefits on death

While there should be no problems with payments of some description to a spouse of a deceased superannuant, substantial taxation issues may arise on the death of that spouse. It is quite common, because of the tax sheltering available, for assets to be transferred into a superannuation fund, particularly as retirement approaches and other calls for provision reduce. That situation can work to the disadvantage of the family if there are still substantial assets in the fund when the second parent dies and all children are self-supporting. What can happen is that what were once tax-free capital assets will become fully taxable distributions to beneficiaries in the estate.

Preservation of capital gains tax cost base

An exemption, of sorts, that is still available, is where the deceased acquired an asset before capital gains tax was introduced. Provided there has not been a change in underlying ownership or some other disentitling event, on death the asset will pass to the executor or beneficiary at its market value as at the date of death. This has the effect then of the recipient only being liable to capital gains tax on any gain from the date of death. If however the asset was acquired by the deceased after 19th September 1985, it will come into the recipient's hands at the deceased's cost base and be taxed accordingly. The recipient therefore would be liable not only for the tax on any capital gain accrued while they owned the asset but also for any capital gain accrued by the deceased on that asset. These provisions apply regardless of whether the asset is passing to the executor or a beneficiary, and whether it passes pursuant to a Will or on intestacy.

Main residence exemption

Subject to some restrictions, the main residence of the deceased will continue to be exempt from capital gains tax for up to two years from the date of death. A transfer within that time to the

beneficiary may then allow the capital gains tax exemptions / discounts to be available to that beneficiary.

Capital losses

Any capital losses realised in the estate cannot be carried back to any gains the deceased may have realised, nor can those losses be passed on as such to beneficiaries. To utilise the loss, or potential loss:

- If the estate is to sell the asset, the executors should identify any estate assets which could realise a capital gain if sold and consider such a sale.
- The asset should be transferred to a beneficiary who, taking the asset at the deceased's cost base, will then be able to utilise the capital loss on disposal.

Family trusts / companies

Without some arrangement in place beforehand, whoever receives the unit or share entitlements in unit trusts or companies, respectively, will also be placed in indirect control of the relevant assets. This may not always be appropriate. If the benefit of the asset/s and the income they may produce is to be separated from their control, consideration should be given to splitting distribution / dividend rights from voting rights by creating and issuing the relevant classes of units and shares. The "management" units / shares can then be left in the Will to those whom the testator wishes to be in control, while the distribution / dividend units / shares can be left to those for whom the testator wishes to make provision financially.

Discretionary trusts are a little more difficult as no beneficiary is usually entitled to income or capital, but only entitled to be considered for a distribution. Therefore there are no property rights in any asset which can be left by will. The solution is often found in the trust deed itself where there will often be a reference to an Appointor or a Guardian (or both). That position is usually entitled to appoint, remove or veto the appointment of trustees. These provisions should be carefully examined to ascertain how they are to work and what the testator can do to influence how they will be exercised and who will be able to do so. If the deed has no such provision, consideration should then be given as to the beneficiary of the shares in any corporate trustee as ultimately, in that situation, the holder of the majority of the shares in the trustee company will effectively be able to control the trust.

Special disability trusts

It is now possible to establish, by Will, trusts for those suffering severe disabilities. The advantages are that the assets and income of such trusts will not be considered in applying the assets and income test in assessing the beneficiary's entitlements to social security and Veterans Affairs benefits.

Directorships and death

The office of director of a company cannot be left by Will. Accordingly, if a company requires two directors to form a quorum (which is often the case, particularly with older companies), and one of those directors dies, the remaining director may not be able to transact any business. Accordingly, no share transfers could be approved and so no new shareholder/s can be introduced and, in some cases, there would be insufficient directors to even fill the casual vacancy. Similar problems could also arise if the shareholding has a like arrangement. There are at least two possible solutions, but both need to be implemented before any death:

- appoint a further director, either in their own right (but beware of any share qualification requirements that may exist); or
- change the company constitution to something like the replaceable rules which permit one director companies.

TRUSTEESHIPS

A problem similar to that arising on the death of a director can present itself with the death of a sole trustee or one of several trustees so that a quorum of trustees cannot be reached. This can apply to self managed superannuation funds, although there is some statutory relief. Nonetheless, care and some consideration needs to be given to the complexities which can arise.