

Land tax changes and your Will: Maximise your legacy, minimise your tax bill

This newsletter is mailed to all of DBA Butler's Wills and estate planning clients. It is designed to provide a general overview of important recent changes to the laws affecting Wills and estate plans. To be removed from DBA Butler's mailing list, please email dba@dbabutler.com.au or call 03 9682 0903.

Many people have Wills that will set up trusts upon their death. However, recent land tax changes will apply higher land tax to land held by trusts. Luckily, tax concessions and other strategies are available. It is recommended that Wills and other plans are reviewed to ensure tax effectiveness.

Land tax and estate planning

Recent Victorian land tax changes for trusts ('surcharge rules') highlight the need for careful estate planning for a family's land holdings, particularly the family home, from a land tax perspective especially when preparing and reviewing their Wills and estate plans.

This newsletter outlines how the principal place of residence ('PPR') concessions apply to trusts and, in particular, how the surcharge rules apply to discretionary trusts established under a Will.

Placing land in testamentary discretionary trusts ('TDTs') has become popular in recent years for asset protection and tax reasons. The punitive land tax changes may, however, result in a rethink of this strategy for some clients.

Land Tax and trusts

From 1 January 2006 a higher scale of land tax rates applies to land held by trusts, including TDTs in Wills.

Broadly, unless a nomination (see below) is made:

- there will generally be a 0.375% surcharge applying to land held by a trust up to a \$2.7 million value; and
- only a \$20,000 tax-free threshold applies for trusts (compared to \$200,000 for others).

The new rules particularly target discretionary or 'family' trusts. However, discretionary trusts with pre-2006 acquired land can minimise the surcharge by nominating an adult individual to the State Revenue Office ('SRO') (who is a beneficiary of the trust) to be assessed for land tax on that land ('general nomination'). The trust's land specified under the general nomination will then be added to any other land that beneficiary owns for calculating land tax payable by the beneficiary.

If a discretionary trust acquires land post-2005, that land will be subject to the surcharge unless a PPR Nomination is made to the SRO.

A PPR Nomination will generally only be available to a beneficiary who actually occupies the residence as their private residence. Where a PPR Nomination is made by a discretionary trust (including a TDT), land tax at ordinary rates is payable on the principal residence by the trustee.

Deceased estates and testamentary trusts

There is a general exclusion from the surcharge for three years from date of the person's death. Ordinary rates of land tax apply to TDTs during this three year period.

However, if land continues to be held by a TDT beyond this time, then the surcharge will generally apply unless a fixed interest is created (eg, the land is held absolutely for the surviving spouse).

To overcome the surcharge, people may now wish to make specific gifts of land to individuals rather than to a TDT.

However, asset protection, tax and other issues (see below) still need to be carefully considered.

Thus, each person with valuable land should review their Will and overall estate planning.

Principal Place of Residence

Under the PPR Nomination, a discretionary trust and a unit trust scheme (which cannot apply the PPR Exemption – see below) can make a PPR Nomination thereby securing the ordinary land tax rates at the trustee level.

A 'fixed trust' cannot use the PPR Nomination under the surcharge rules but this is because a range of fixed trusts are already eligible for the PPR Exemption.

Note the PPR Exemption is different to the PPR Nomination because it is an exemption from tax whereas the PPR Nomination only secures tax at ordinary rates.

The PPR Exemption covers:

- protective trusts (eg, a trust for a mentally challenged child);
- land occupied by an executor or beneficiaries under a Will as their main residence;
- land occupied by a life tenant as a PPR and property occupied as a PPR by a beneficiary with a right to reside under the Will; and
- direct freehold ownership by individuals.

However, there is no PPR Exemption if the above scenarios arise under a TDT.

Div 152 — Good news for small businesses

On 9 May 2006 the Treasurer announced that certain recommendations made by the Board of Taxation ('Board') as part of its review of the small business CGT concessions will be adopted.

Whilst the announcements encompass a number of changes to Division 152 of the *Income Tax Assessment Act 1997* (Cth), this article concentrates on the interaction between Div 152 and deceased estates.

Deceased estates with inherited business assets

The current position regarding small business assets passing into a deceased estate is uncertain.

There is no automatic relief or simple test to determine whether an executor or a beneficiary is entitled to the various CGT concessions.

For example, the active asset test period applies to a beneficiary from the date upon which they actually 'own' a business asset and not from the CGT roll-over date under Div 128 (see ATO ID 2004/531).

Once a TDT ceases to be treated as an excluded trust, trustees need to consider whether a PPR Nomination can be made or they become liable to the surcharge rates.

Some TDTs may cease to be excluded prior to 30 September 2006. In this case they will need to act now to assess the impact of the changes once the trust ceases being an 'excluded trust' and becomes a 'discretionary trust' or TDT under the surcharge rules.

Will-drafters also need to be aware of the likely land tax cost (over the life time of a trust) in placing land, especially the family home, in a TDT rather than, eg, creating a simple fixed trust for the main residence or directly transferring it to a beneficiary.

Naturally, individual ownership may expose the property to greater risk and may not be as tax efficient if the property produces income or a capital gain. The best structure to hold property generally depends on a range of factors. Expert advice assists in guiding you to the best solution.

Also, an absolutely entitled beneficiary can choose to apply the retirement relief in certain circumstances (see ATO ID 2004/121).

The Government has adopted the Board's recommendation that an executor or legal personal representative or beneficiary be allowed to access the concessions where the asset is disposed of within two years of the date of death and where the deceased person would have qualified for the relief if they had disposed of the asset/s just before their date of death.

This change will provide more simplicity and certainty.

Other Div 152 changes

The other key changes announced relate to the active assets test, the new significant individual test, the 15 year exemption, maximum net asset value test and how the net value of a partnership is counted in relation to one partner seeking to apply Div 152 relief.

For further information please contact Frank Gianarelli or Dominic Whitehouse of:

DBA BUTLER PTY LTD, Lawyers, 23 Union Street, South Melbourne Vic 3205

Ph 03 9682 0903 Fax 03 9682 0907 dba@dbabutler.com.au www.dbabutler.com.au

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