

Succession to a trust

Planning succession to the role of appointor is a vital step that needs to be undertaken for each discretionary trust.

The appointor holds the ultimate control over the trust as they can hire/fire the trustee. Unless succession is addressed, the trust's assets may end up in the wrong hands.

A decision needs to be made as to who is best suited for this role. If the wrong choice is made, tax implications can result. These are outlined below.

Trust makes a family trust election ('FTE') or interposed entity election ('IEE')

If the trust wishes to make an FTE or IEE, it must ensure that it can satisfy the family control test in the year in which the election is made. Broadly, this test requires that only close family members of the test individual (and their legal or financial advisers) control the trust.

The execution of a deed of succession does not, of itself, affect the control of a trust. However, if a new appointor (who is not part of the family group) succeeds under the trust in the same financial year an FTE or IEE is made, the control test may not be satisfied.

Trust has not made an FTE or IEE

If an FTE or IEE has not been made, the trust must satisfy (in addition to several other tests) the control test in order to carry forward any tax losses.

Broadly, this requires that the control of the trust remains with the family group and/or test individual. This test needs to be satisfied each financial year the trust has losses.

An exception to control by the family group is available in the event of death, incapacity or marriage break-down, where a temporary controller outside the family group is appointed (typically for a maximum of 12 months). For example, control can be with someone outside the family group during a temporary period if the family person suffers a divorce.

If succession to the role of appointor occurs in the particular year when say a tax loss is sought to be claimed and the family control test is breached, losses will be forgone.

CGT small business concessions

The Commissioner in ATO ID 2004/698 has confirmed that an appointor is a controller of a discretionary trust. This is unless a beneficiary (who is not the appointor or their small business CGT affiliates) is deemed to be a controller due to that beneficiary receiving at least a 40% distribution from the trust in any of the four prior financial years.

If a successor appointor controls the trust, the net value of the trust's assets will need to be included in his/her net value to determine if he/she satisfies the \$5m net asset value test. This test needs to be satisfied to qualify for the CGT small business concessions.

Conclusions

Succession to a discretionary trust is best handled by way of a separate deed of succession. If succession to a trust is dealt with in a person's Will and the Will is contested, control of the trust could be involved in litigation for years. Also, a deed can cover the appointor's loss of legal capacity during their lifetime.

DBA can prepare a succession plan for a trust having regard to the tax issues and the client's overall estate plans.

ATO & record keeping

The ATO have been highlighting the need for trustee minutes and proper record keeping for SMSFs. In particular, the ATO has been taking the stance that:

- all contributions must now be allocated within 28 days of the end of each month, eg, each SMSF should record the amount and to whom it has been allocated by this deadline; and
- each purchase and sale of an investment by an SMSF should be appropriately documented by written resolution. Previously, the general practice was that an overall written investment strategy was considered satisfactory.

Market linked pensions & estate planning

Market linked (or term allocated) pensions ('MLP') can only revert to a single dependant upon the death of a pensioner. This limit stems from the Government's concern that certain (defined benefit) pensions have been used for improper estate planning purposes.

A member about to commence an MLP may wish to revert their MLP to their spouse on their death. However, in the unfortunate event their spouse predeceases them, they may want to revert their MLP equally between their children. The options for achieving this are as follows:

- upon their death commute their MLP back (by internal roll-over) into the fund and commence a fresh pension for each child; or
- take their benefit as one separate MLP for each child from the outset of equal value to allow each child to become a reversionary pensioner of their own MLP. Naturally, this assumes that each child will survive them.

Under the first option:

- The new pension will count towards each child's RBL if they are 18 years or older. Thus, the MLP assets will be re-assessed for RBL purposes. Further, the child's lump sum RBL will be subject to a 2.5% pa discount if they are under age 55 unless they take an MLP (an MLP satisfies the pension and annuity standards). If, however, an allocated pension is taken, the child's RBL will be discounted.
- If an MLP is taken by each child, it must have a term calculated by reference to the child's life expectancy (or the child's spouse's life expectancy, if longer) at the time it commences (with the flexibility of taking a term assuming the relevant person was up to 5 years younger). This could result in a long term and therefore a low income stream.

Trustee Minutes Kit

Due to recent ATO activity, we have updated our Trustee Minute Kit. To assist our clients, we have reduced our price from \$300 to \$200. This kit can also be obtained for \$150 if ordered with a DBA SMSF package.

The advantage of paying an MLP to the children under the second option is that they obtain the money over the term and cannot readily access it as a lump sum soon after the loss of their parent(s).

The second option could also give rise to additional administrative costs and may result in unequal treatment of the children, eg, if one MLP performs much better than the other. Accordingly, the restriction associated with reverting an MLP can be a limiting factor.

Finally, note that the deductible amount for an MLP will typically be spread over the term of the MLP as opposed to the life expectancy of the member. This is because the relevant number for a pension that is to run for a set term reflects the term rather than the pensioner's life expectancy.

SMSFs - GST Trap!

The ATO has clarified its position on GST Partnerships. In particular, the ATO states that the mere co-ownership of leased commercial property will generally constitute a partnership for GST purposes.

The ATO has stated in ruling GSTR 2004/6 that a partnership in receipt of passive commercial rental income is required to register for GST. This contrasts to the practice that a partnership in receipt of passive income is generally not required to lodge a partnership return for income tax purposes.

This ruling impacts an SMSF that jointly owns commercial property with another entity. The \$50,000 GST threshold would apply to the partnership rather than each partner's turnover. Co-owners who need to amend their registration should do so before 30 June 2005.

For further Information please contact:

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