DBA Butler Pty Ltd Lawyers

NEWS

July 2005

What is tax effective estate planning?

'In this world, nothing can be said to be certain except death and taxes' — Benjamin Franklin, 1789

At the time of writing, Benjamin Franklin meant to say that death was certain and that death duties followed automatically from death. While today there is no death or probate duty, capital gains tax ('CGT') exists, which is a hidden death trap for the unwary. Surprisingly, many still do not plan for these two certainties!

In this issue of DBA News, we briefly explore several issues that illustrate the importance of tax effective estate planning.

Asset protection

Generally, the spouse who is not at risk for asset protection purposes (eg, the home maker) ends up owning the family home and the investments. On the other hand, the spouse at risk (eg, the professional or business partner) generally holds no assets. However, despite this careful planning during life, if the couple have simple Wills, the high risk spouse may end up with all assets and be 'robbed' of asset protection.

Asset protection can be achieved via a testamentary trust Will as the deceased's assets pass to the testamentary trust (unless a specific gift is made) and not directly to the surviving spouse. With a simple Will, however, an absolute gift of an estate is typically made to a spouse.

Advisers are often tempted to recommend that on a person's death, their spouse gains a life interest in the family home. However, the granting of life interests has become less attractive due to the treatment of these interests by the ATO for CGT purposes. An alternative to granting a life interest is to grant a right of occupancy. A right of occupancy may also avail beneficiaries of the CGT main residence exemption, provided that the testamentary trust Will is carefully drafted. However, land tax and other issues should also be considered.

Couples may also want to consider converting joint ownership of a property to tenants in common to capture their share of the property in their estate.

Superannuation and your loved ones

Upon the death of a family's 'breadwinner', the deceased's superannuation benefits may help the family through financial difficulties. For this reason, it can be important to make a 'death benefit nomination' to ensure that the superannuation benefits pass directly to the spouse. However, not all superannuation funds allow such a nomination to be made. Other funds allow such a nomination to be made, but they are non-binding and do not guarantee that the benefits will be paid to the spouse.

If the benefits are not paid directly to the deceased's dependants, they will instead pass to the deceased estate. However, the deceased estate may take years to administer and distribute, especially if there is a legal challenge against the estate, holding up access to much needed funds.

One issue that is often overlooked by some advisers is that superannuation benefits received by adult children are generally not tax-free. Adult children will pay tax on superannuation monies (generally at concessional rates) unless they are financial dependants or if they are still living at home and are reliant on the deceased for financial and domestic support.

Another issue that is often overlooked is how superannuation benefits are dealt with in the Will. Many testamentary trusts limit the range of dependants who can receive superannuation benefits to children under 18. However, if, eg, a person (with one child aged 17 and the other aged 19) dies with all their wealth in superannuation, the youngest might get everything while the oldest gets nothing. While limiting the range of dependants may save some tax, this must be weighed against the resulting inequality between the two children and the possibility that the 17 year old may go and spend it all on their 18th birthday.

CGT — change in ownership of a family company or trust

Just because an asset was purchased before 20 September 1985 does not mean that CGT won't still apply! We will consider some common instances of where this could occur.

Consider 'Dad' who has owned the majority of shares in a family company since before 20 September 1985, but due to the company issuing new shares Dad ceases being the majority shareholder. Consequently, the company's pre-CGT assets are deemed to have been acquired by the company at their market value on the date Dad stopped being a majority holder. These pre-CGT assets now have a 'cost base' calculated using the market value at the date of change of majority ownership. If the company now sells the assets it will be taxed on any capital arising from the proceeds less the cost base.

Many advisers have structured their client's affairs such that shares in family companies are held on trust upon death rather than given directly to beneficiaries. However, this strategy may result in the loss of any pre-CGT status the company's assets might otherwise have had (if the shares were given directly to a natural person upon death, the company's pre-CGT status would have been retained). Accordingly, advisers must consider whether asset protection is more important to the client than tax efficiency. There is a silver lining: even if the pre-CGT status of assets of a business entity are jeopardised, the small business CGT concessions under Div 152 might be accessible.

Tax law also tries to assess Dad upon the disposal of shares owned since before 20 September 1985, where the company's post-CGT assets comprise at least 75% of its net worth. Effectively, in this situation, tax law is trying to trace capital gains on any underlying assets reflected in the disposal of the pre-CGT share. As a pre-CGT company acquires more and more post-CGT assets and takes on new debt, the likelihood of this applying to the disposal of an interest in that entity increases. Accordingly, a careful review of the company's position is required, even if the shares were acquired pre-CGT.

These rules apply in a similar manner to an interest in a trust. Accordingly, before advising clients that any asset acquired before 20 September 1985 is not subject to CGT, you should consider the impact of the above provisions. These typically apply to family companies and trusts.

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This newsletter is based on information from DBA Network Pty Ltd's Wills, Estates & Succession Planning Service. *The* Service *provides a practical approach to handling the critical tax issues arising when dealing with Wills, estates and succession planning.* 'Chapter 3: CGT — Framework & Planning Strategies' *of the* Service *is current up to 4 July 2005 and can be purchased separately for* ***$70*** *per copy, by filling out the form below and sending it to DBA Network Pty Ltd, PO Box 2085, South Melbourne, Victoria 3125. To order the full* Service, *go to http://www.dbabutler.com/default_publications.htm.*

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