Get Smart with Property Series!

Estate Planning: An Introduction

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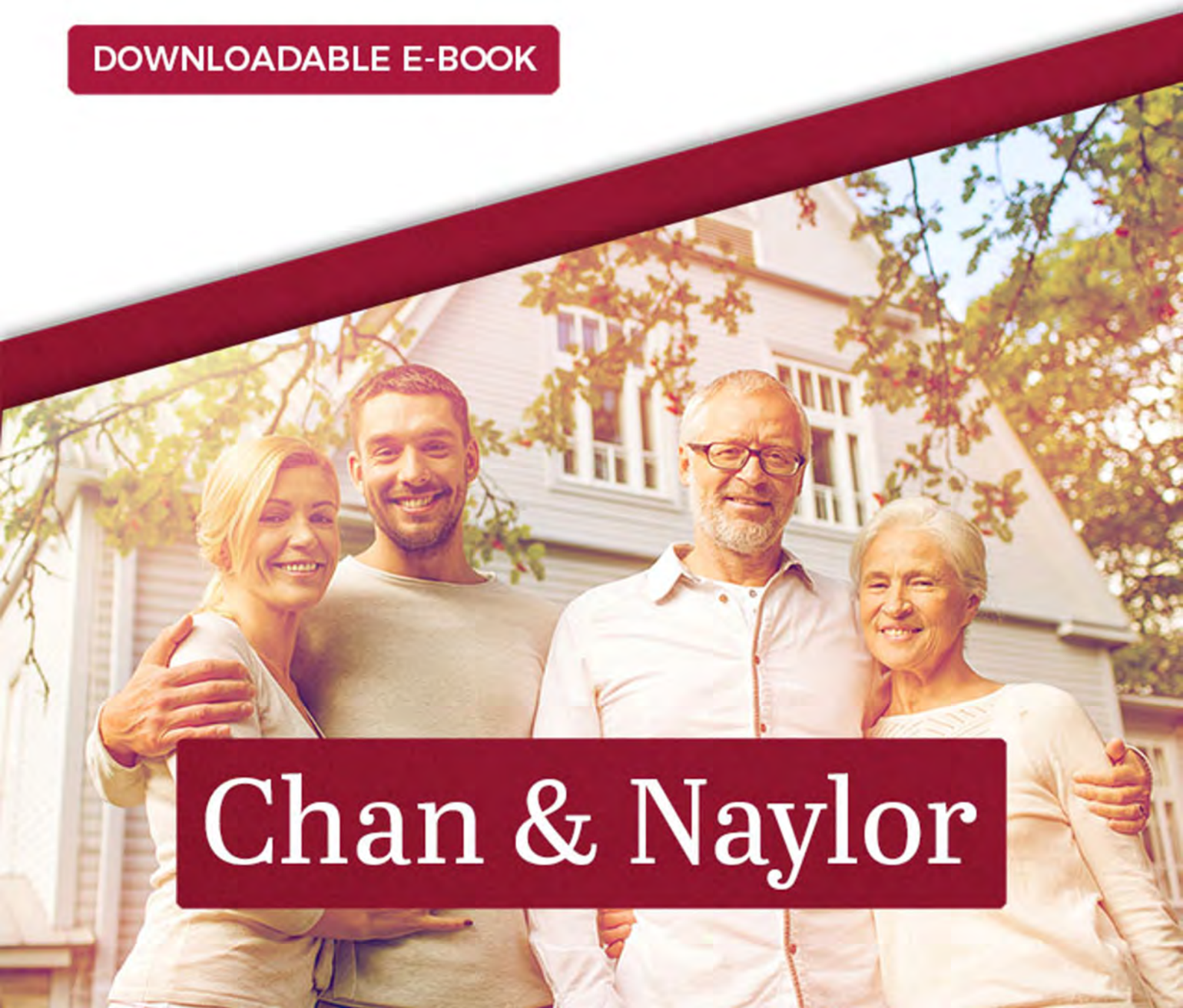

Chan & Naylor

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This e-booklet contains general information only

This information has been prepared as a general guideline. This e-booklet is not intended to be an exhaustive or a complete analysis of the topics in question or issues raised. There are many particular legal, taxation and accounting matters that have not been dealt with in this e-booklet and readers are urged to discuss any aspect of the operation of any of these matters discussed herein with their professional advisers. In particular asset protection, estate planning and superannuation are potentially very litigious areas and you will need specific advice before you take any actions if you want your wishes complied with. Before taking action or implementing any strategy, you should seek professional advice from your lawyer, accountant and/or financial planner who will take into account your specific circumstances and objectives.

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1. Introduction to Estate Planning

Planning your estate is an important matter. Estate planning involves arranging your assets and circumstances in such a way as to ensure that your beneficiaries after your death receive from your assets the maximum use and enjoyment, at a minimum cost in taxes and heartache.

In other words, estate planning should be an efficient and effective intergenerational wealth transfer solution that provides for your required lifestyle and enjoyment ambitions while you are alive.

Before looking at this topic it is important to understand that your will only looks at your estate assets, which will be managed by your will, and not your non-estate assets, which are outside of your will.

a. Estate Assets

These are primarily assets in your personal name and include:

- *Property*
- *Shares*
- *Bank account*
- *Personal assets such as jewelry, car, furniture etc*

b. Non Estate Assets

These are assets or rights not in your name. Typically these include

- ***Assets in a trusts***

1. If you have a company trustee then the shares in the company may be in your name and so these are passed on as estate assets in your will. The new shareholder would vote themselves in as director and now control the trust and as such the assets in the trust.
2. The trust would also typically have an appointer, being you. The position of appointer is a personal one and as such is not part of your estate assets. On death you can move this position to someone else via a memorandum of wishes.

- ***Superannuation***

These assets are not covered by your will, whether in a self managed super fund or a retail/industry fund.

1. Typically people either via a Binding Death Nomination request the super fund trustee to "give" the super to someone direct or to the estate. If you send your super fund benefits to the estate the will then takes over.
2. The super legislation prescribes who can get your super so it is critical to understand who is eligible and what categories of people will be taxed on funds they receive from your super. These rules are the same irrespective of whether you "give" directly to someone or to your estate who then pays it out.

- ***An estate plan ought to:***

1. Ensure your estate assets pass to people or organisations (charities etc) that you intend to receive the funds/assets in the amounts you intend;
2. Minimise the impact of taxes;
3. Ensure assets are not passed onto persons who are in bankruptcy or family disputes.

If you die without a will it is unlikely you will achieve your desired outcomes. The various states have different laws of how assets are to be distributed if you die without a will (intestate).

- ***The most important issues to address in your will are to:***

1. Make certain that the interest of your spouse and children are protected;
2. Minimise the effect of capital gains tax on the bequest;
3. Establish safeguards that ensure your assets are not lost to people outside of the "family".

This ensures that your will is structured in the best way to look after your children and grandchildren while growing up.

2. What is a Will?

A will is a document that outlines your intentions regarding the distributions of your assets and liabilities on your death. Your choices in this respect are almost limitless and depend primarily on your circumstances. If you should die without a will, your assets will be divided according to the law of the state in which you reside, which may not necessarily be in accordance with your desire. It is extremely important not only to have a will but also to make sure that it is valid and up to date.

***The matters to be considered in making a will are*:**

1. Executor: You must appoint an executor of your will. The executor is responsible for carrying out your wishes as expressed in your will and they have control of the process. It may be beneficial for the estate to grant the executor discretion to realise assets of the estate in the most beneficial matter, having regard to capital gains and other taxes. The executor is a personal appointment and is heavy regulated and as such not everyone would want this onerous position. It is therefore critical to ensure you chose wisely and allow for the possibility that your chosen person/s declines and so a back up person/s should be included.

2. When you die, but who will benefit if your first choice beneficiary (or second or third) predeceases you. This is particularly important in terms of your children and grandchildren.

3. Trustee: It is possible that some funds may be held in trust for beneficiaries who you feel are not yet old enough to manage a bequest themselves, or because of their financial position is likely to dissipate any bequest. You should nominate a trustee for the funds and also set guidelines on what sort of investments they can make.

4. Guardians: If you were to leave your assets in a trust type situation the trustee of the trust is different from the guardians of your children. The people who are the guardians should ultimately be those whom you are comfortable will bring up your children in a similar manner to that which you would have chosen. The children do not necessarily reside with the guardian, but your guardian does make the decision as to who your children do live with and what schools they attend etc. Often if people have specific wishes in relation to their children, they include with their will a letter directed to the guardians outlining those wishes. It would be preferable that the guardian of your children and the trustee of your estate are people whom you are confident will work together and who will understand the needs of your children and your desires in relation to them.

Specific Bequest and Devices: You may wish to consider leaving certain items to specific individuals.

a. Ownership of the Assets

Property or assets that are held jointly may pass directly to the surviving owners, depending on the nature of the asset and the relationship between yourself and the persons receiving the assets. There are certain situations regarding joint ownership of property in which assets may pass directly to the surviving owner. Superannuation and roll over investments can and usually do fit within this category.

If you own property or assets as a joint tenant on your death the surviving owners share equally in your interest of that property or asset. Under a tenants in common agreement each person has separate ownership, so upon your death your share of the property or asset will pass to your estate and then to your beneficiaries, as stipulated in your will.

Assets owned by a partnership are automatically deemed to be owned as joint tenants. In considering your will you ought to also consider any possible bequests that you or your estate may receive from your parents. In an ideal situation especially where rural properties are involved, these aspects of your will ought to be discussed and linked with your parents.

b. Ownership of Business assets

It is critical to take into account business assets, especially if you are in partnership with others. Normally partners want you as their partner, not your spouse or children. Consideration as to how your business assets will be handled is critical.

Consideration must be given in your partnership agreement as to how and to whom ownership is to be passed. Many business agreements have “insurances” in place to allow the remaining partner to buy out the deceased partner via insurance receipts to then pay out to your estate or chosen beneficiaries. Care is needed in the wording of these clauses in the partnership agreement and how insurances are set up and how policies are paid out as in some instances they will be tax-free and in others they may be taxed.

c. Capital Gains Tax

We recommend that during the course of preparing your will you also talk to your accountant regarding the taxation implications on passing your wealth on your death.

Most bequests received under a will are not subject to tax by the beneficiary on receipt, however they will attract capital gains tax (CGT) on disposal by the beneficiary. CGT is a complex area that depends primarily on the type of the asset, when it was acquired, and the particular tax situation of the beneficiaries.

You will need to consider the following:

1. Pre 1985 assets - where the deceased acquired an asset prior to 20th September, 1985, the beneficiary will be deemed to have acquired the asset at market value at the date of death. CGT liability will accrue from then on and will be payable when the asset is sold by the beneficiary. The capital gain will be the difference between the net selling price and the market value of the asset at the date of death of the person bequeathing the asset.
2. Post 1985 assets - where the deceased acquired an asset after 20th September, 1985 the beneficiaries inherit any CGT liability attaching to that asset at the date of the death. In other words the beneficiary inherits the original cost base. The tax is then payable when the asset is sold. The capital gain is the same as if the original owner had sold the asset.

3. Gifts to charities - capital gains tax are normally not payable but you should look at this on a case by case basis taking into account the exact circumstances.

Also note that carry forward capital losses that have accrued to you will expire on your death so some estate asset planning before death should be implemented. Comprehensive estate planning including asset protection strategies will also need to be included, as well as consideration of the tax circumstances of the inheriting beneficiaries.

d. Testamentary Trusts

The passing on of your estate assets can take on many forms. Traditionally people pass assets directly to the intended beneficiary i.e. title changes from the deceased to the beneficiary through a will.

The will therefore does not take into account any unforeseen circumstances in the future such as:

1. Beneficiaries being bankrupt
2. Beneficiaries going through family law proceedings
3. Minor children who will be taxed at Minors Penalty Tax rates (66% dropping down to 45%)

The use of a testamentary trust is another way to pass on your wealth. Testamentary trusts are merely discretionary or fixed trusts established in a will that take effect following your death.

A testamentary trust in essence means that instead of passing assets directly to a beneficiary, they are passed into a trust and a chosen beneficiary/s is put in control of the trust. It is not executed until your death but forms part of your will, often appearing as an annexure to your will.

The problem with this is that a will is normally prepared many years before death and as such there is no crystal ball to show what is happening in the future. In many cases people forget to update wills with changes.

There is no standard format for a testamentary trust and they are adapted to suit the needs of a particular family. In many cases they include a lineage clause to ensure only your direct descendants can benefit from the income or capital. A will can include more than one testamentary trust and you can have sole or multiple beneficiaries in control. To effectively use a testamentary trust, the bottom line is to decide whom you want your assets to go to, so you can then set up the testamentary trusts to mirror the decision.

Common areas that require thought and changes are as follows:

i. *Whether to have one or several trusts established under the will;*
ii. *The selection of appointer;*
iii. *The selection of the trustee or trustees;*
iv. *The method of appointing replacement trustees;*
v. *Whether the beneficiaries are limited to your descendants only or whether their spouses might be included;*
vi. *Whether some beneficiaries are limited to income and or capital and when capital can be accessed i.e. at age 25;*
vii. *Whether beneficiaries should include related companies and trusts or indeed charities.*

Testamentary trusts have many benefits as follows:

1. Protection of Estate Assets

In many situations there may be a potential loss of estate assets if given directly to a beneficiary.

For example:

i. If the beneficiary is in debt or bankrupt;
ii. If the beneficiary is of a character that would "waste" the inheritance such as drug or alcohol dependent;
iii. If the beneficiary is on social security benefits part or all of the Centrelink benefits may be lost;
iv. If the beneficiary losses competence.

2. Family Breakdown

If assets are passed directly to a beneficiary who is in or goes into a family dispute then the spouse or partner could then have those assets directed to them.

Situations include:

i. Your child in divorce proceedings;
ii. Remarriage of surviving spouse;
iii. Surviving spouse dies after remarriage.

In these situations, establishing a testamentary trust that prevents the beneficiary from owning the assets absolutely – but entitles them to the income or part of the capital – will protect the asset and ensure that it provides the benefit you intended to whom you intended.

3. Income Tax Planning

While taxation should not be a determining factor, most people would want their beneficiaries to retain the maximum amounts of income and capital after tax. Therefore, flexibility would be an advantage to take into account your beneficiaries changing circumstances.

Income and capital from a testamentary trust can be allocated on an annual basis to persons who can best take advantage of lower taxation rates.

This will have the greatest impact on the following situations:

i. Minors. Usually trust income for children under 18 is tax-free only for the first $643.00. Thereafter punitive tax rates of 66% apply, reducing to 45% (excluding Medicare levy). Testamentary trusts are an exception to this rule as children are treated as adults for tax purposes and accordingly the standard tax-free threshold applies. In large estates where there are a number of beneficiaries including children (grandchildren) under 18, the tax savings can amount to many thousands of dollars each year. Parents can utilise some or all of these after tax monies for education, room and board or other required expenditures.

ii. Adults. Changing circumstances such as stopping work, increase income etc can significantly change a person's tax position. Income from the trust can be changed from year to year to take into account these changes.

3. Family Business Succession Planning

As most people are well aware, problems tend to arise in the management of business assets when they are left to more families/children than they can support or where one child is left running the business whilst others who are not taking part in its management continue to benefit from the asset.

This type of arrangement may make it possible for the trustee to appropriate certain assets to each child at a time in the future. This helpful is where you have children of a young age and cannot foresee how their lives are to be directed. It may well be that when they attain their twenties one child may have an ongoing interest in the family business whereas the other children may choose not to continue being involved.

This type of arrangement might be suitable for a situation where you can include in a trust a discretion allowing the trustee to pay different amounts of income to the children, dependant upon their needs. Usually a standard will simply has that the trustee pays money to the children equally which, depending on what happens in the future, may not be appropriate.

4. Insurance Policies

Life insurance can also be helpful in estate planning. It may help to cover a prospective CGT liability or allow the buy out of a partnership or allow the pay out of large debts on the estate.

5. Enduring Power of Attorney

An enduring power of attorney is a document that empowers someone to act in your shoes should for any reason you be unable to look after your own affairs. It ceases if you pass away. On death, your will or other procedures are required to manage your affairs. If you do not have an enduring power of attorney and become incapacitated there is a danger your affairs will come under the control of the public trustees.

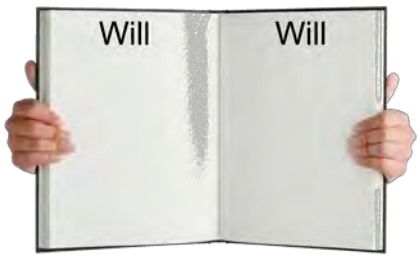
Ultimately your lawyer is someone who will look after your affairs and be able to do basically anything on your behalf except make your will. Therefore, your enduring power of attorney should be someone whom you trust implicitly and should preferably be a member of the family. In a marriage, for instance, it is normal to appoint each partner as each other's attorney and one or two others, should the first person be unable or unwilling to act.

There are some decisions that cannot be taken if operating under an EPOA, such as implementing a Binding Death Nomination in Super. You can, however, rollover or continue a BDN with an EPOA. Again, speak to your lawyer to determine what powers are available.

In most states an enduring power of attorney does not substitute for a Medical Power of Attorney or an Enduring Guardianship (how you want to be looked after if infirmed). These additional powers of attorney may be required.

6. Dying without a will

If you die without a will or indeed a valid will you are said to have died intestate. Under these circumstances the different states have legislation on how your assets will be allocated. This split is unlikely to be in line with what you would have wanted. There is also a danger if you have children from a previous marriage or your spouse remarries and also dies. It is a very complex issue and one that should be avoided.



7. Looking After Minor Children

In many cases how your children will be looked after following your death will be included in your will. You should take into account:

1. Actual guardianship
2. Financial assistance
3. Education
4. Where they will live

In some instances ex-spouses or other parties may be able to have your wishes over ridden by the family court, so again care is needed in formulating your wishes.

8. Superannuation

Super assets do not form part of your estate assets and as such your will cannot distribute funds from super.

Normally people choose one of the following strategies for distributing super on death:

1. Binding Death Nomination

1.1. Directly to beneficiaries
1.2. Directly to the estate for distribution
1.3. Combination of both

2. Auto Reversionary Pensions

3. Superannuation Wills

These lie within the super fund and would normally be applied in self managed super funds and not in retail funds, due to administrative and other legislative issues within non SMSF. This type of strategy is above the normal SMSF and you will need to speak to people who are specialist family super fund administrators. The advantage of this sort of strategy is that funds do not need to leave the super environment, thereby allowing them to continue achieving:

3.1. Asset protection
3.2. Preferential taxation
3.3. Less litigation from family members who dispute what they receive

Consideration needs to be given to the tax implications, which differ as to who receives the funds and how. Generally speaking, spouses and children under 18 receive funds tax-free, as do interdependent and financial dependent persons. There are also special considerations with life insurance payouts from super.

Normally the trustees of the fund decide on superfund distributions and they can be legally directed if one of the above distribution strategies is properly and validly implemented.

9. Other Considerations

1. Stamp duty and CGT are normally not triggered on the passing on of assets on death.

2. Pension entitlements – the assets comprised within the testamentary trust are not assets of an individual. By leaving assets to a testamentary trust rather than to individuals, the individuals are sometimes able to satisfy the Pension Means Test but not the Assets Test. You should talk to an accountant to confirm the situation.

3. Nursing home subsidies – Where people are concerned that by leaving their assets direct to their spouse, their spouse may not meet the means test level for subsidised nursing care, the use of the testamentary trust may assist the spouse in qualifying for any subsidies.

4. Binding Death Nominations – Death will normally impact on your will but note that BDN are not affected by your death or changing marriage situation.

5. Binding Financial Agreement (Pre or Post Nuptials) – This can be useful when looking at what assets are to be treated as matrimonial assets and what is available for distribution in the event of a divorce. You should also note that these agreements do not impact on distributions of your estate on death. If you wish to restrict estate distributions from a spouse then Supreme Court approval under Sec 95 Agreement will need to be applied for.

6. Trusts – This in itself is a major topic when looking at asset protection. Many people choose to hold their assets in a trust (non estate assets) for asset protection. Many different types of trusts are available depending on your specific objectives but when dealing with property you need to consider land tax, stamp duty, CGT, income tax, GST, negative gearing and other taxes. If assets are held outside a trust then asset protection is still achievable without transferring assets into a trust thereby triggering taxation and stamp duty.

There are various strategies for this including:

6.1. Equity Shift™
6.2. Equity Bank Trust™
6.3. Family Estate Agreement™
6.4. Business Restructure Trust™.

The above document is not exhaustive in nature and covers (in summary) some of the more frequently asked questions. Estate planning is a particularly complex matter and subject to litigation from family or other financial dependants who could seek legal redress if aggrieved. In many cases legal action will be paid out of an estate (even if the estate wins) thereby reducing the available assets for distribution. Therefore it is recommended that you seek advice from a specialist legal practitioner who understands estate planning, superannuation, family law and taxation.

Need assistance with your Estate Planning needs?

We provide a free 10-15 minute phone consultation with a Senior Partner of Chan & Naylor – they can answer your general questions and discuss what's possible and what's right for you.

Request a FREE 10-15 minute phone call

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"To help our clients increase and protect their net worth from generation to generation"

If you want to arrange a specific consultation to discuss any of the strategies please contact Chan & Naylor via **www.chan-naylor.com.au** or on **1300 250 122** where you will be able to arrange a suitable time to meet with one of our team.