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Estate & Business Succession Planning

6th edition

A practical and strategic guide for the trusted adviser

Bernie O'Sullivan, CTA

Bernie O'Sullivan Lawyers

Clear Practical Solutions

A Tax Institute Publication

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Foreword

Bernie O'Sullivan is to be commended on creating this invaluable resource for practitioners of the law, accounting and financial planning. Now in its sixth edition, after a very successful launch into the market, *Estate & Business Succession Planning* is one of the first widely available texts on the topic and is undoubtedly a fine addition to the library of the busy planning professional.

Available in both hard copy and online, this publication has proven to be a very useful tool for both the experienced and less experienced adviser in the area of estate and business succession planning.

I would invite the less experienced adviser to peruse the contents pages, which demonstrate the broad scope of the issues that need to be considered in rendering quality advice to clients. The experienced practitioner will find it a very worthwhile and up-to-date aide-mémoir.

This text is practical, clearly expressed and based on a sound appreciation of the law in all Australian jurisdictions. Further, readers are encouraged to enquire more widely through relevant footnote references to the cases and professional articles.

Lastly, trusts, superannuation funds and family law are comprehensively considered. This is a significant and valuable point of difference from many other texts on this topic, as these structures play an increasingly important role in modern family wealth accumulation.

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Director, Schurgott Noolan Pty Ltd (an incorporated legal practice)

How this book is structured

The text is structured to follow a typical chronology of the estate and business succession planning processes. It explains the purpose of the documents that underpin the succession planning process, the traps to be wary of, and the opportunities for effective structuring.

The legislation dealing with much of succession law is complex and differs between jurisdictions in Australia. The chapters dealing with these topics, such as powers of attorney, wills and intestacies and claims against estates, all contain tables that highlight the more important issues dealt with by the laws in each jurisdiction. These chapters then generally discuss the key concepts noting, where appropriate, exceptions to the general rules.

This book reflects the consideration of over 40 separate state and federal Acts.

This publication is also available online (located at www.successionplanningonline.com.au), and includes:

- 12 months of unlimited access to the 2012-13 online book, with updates;
- interactive eLearning with reference links back to the online book (3.5 CPD hours); and
- cross-references.

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About the author

Bernie O'Sullivan, CTA, is principal of Bernie O'Sullivan Lawyers – an independent law firm that advises individuals and family groups in the areas of trusts, wills and estates, business succession planning, superannuation and charitable trusts, all supported by tax and litigation services.

The firm works collaboratively with clients of accountants and financial advisers across Australia, helping them plan succession of wealth from one generation to another.

Bernie is a member of The Tax Institute's State Committee (Victoria) and is a regular presenter and author on the topic of succession planning.

Bernie acknowledges the significant contributions of others to this publication (see p xxxii).

Contacting the author

This book was largely written from the author's technical knowledge and years of experience in personally administering complex estate and trust matters. If any reader believes that an important topic or issue is not covered, or that the commentary is incomplete or even incorrect, they are invited to contact the author at publications@taxinstitute.com.au.

About the publisher

The Tax Institute is Australia's premier tax body. Since 1943, The Tax Institute has provided the tax profession with leading-edge education, information, support and an active forum.

The Institute provides services to more than 35,000 professionals. Membership currently stands in excess of 15,000, which includes a comprehensive cross-section of leading tax accountants, lawyers, tax agents, managers, academics and students.

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Any enquiries relating to membership or purchasing options for this or any other publication, please direct to membership@taxinstitute.com.au.

Preface

This publication aims to explain the importance of succession planning and to identify and discuss in a practical way the issues that professional advisers and their clients should consider when preparing and implementing a succession plan.

We all spend a great deal of time and effort accumulating wealth but, without a proper succession plan, it can disappear very quickly. There are many risks involved in succession planning: poor planning, appointing incompetent or dishonest attorneys and trustees, litigation, lost tax opportunities and lack of entity succession are just some of these risks.

With so many variables and uncertainties, the reality is that not many people correctly implement a succession plan. The consequences of not getting it right can be disastrous – elder abuse, children missing out on inheritances and significant taxation liabilities can result.

Hence, the importance of this publication. If you are an accountant or financial planner, or simply a trusted adviser to others, this book will alert you to matters that your client needs to be aware of when building, protecting and disposing of their wealth.

As is evidenced from the acknowledgments, *Estate & Business Succession Planning* represents the pooled knowledge and experience of a number of respected and successful practitioners in the field. Further, this publication is more than just the sharing of information. It is a strategic guide in the sense that succession planning involves the adviser using the technical information at their disposal and applying it to their client's situation. Within this process, there are many traps and uncertainties which the adviser needs to be aware of in order to properly advise the client. This book identifies these problems and suggests practical solutions. In addition to the significant body of technical information, there are examples of the range of things that could go wrong and strategies for dealing with problems that arise.

Acknowledgments

The following people have made significant contributions to this publication:

Paul Hockridge is the principal writer for chapters 18, 19 and 20. Paul is a partner with Deloitte Touche Tohmatsu (Melbourne). He is a highly regarded tax practitioner specialising in closely held businesses, high wealth families, structuring and succession issues.

Denise Honey is the principal writer for chapter 17. Denise is an executive director with Pitcher Partners (Melbourne) and specialises in international taxation issues.

Chris Beeny and **Bernie O'Sullivan** are the principal writers for chapter 7. Chris is a partner at Maddocks (Melbourne) where he specialises in superannuation and private client services, including charitable trusts.

Kim Cowie and **Bernie O'Sullivan** are the principal writers for chapter 15. Kim is a Melbourne-based consultant specialising in superannuation and advises Australian Financial Services licensees on superannuation and advice-related matters.

Laura Racky and **Bernie O'Sullivan** are the principal writers for chapter 10. Laura is a lawyer at Maddocks (Melbourne) where she specialises in insolvency law.

The author would also like to acknowledge the exceptionally talented publishing group and consultants of The Tax Institute who have worked on all aspects of this publication and are helping to make the Institute the publisher of choice for the tax profession: Alex Munroe (General Manager, Information Products), Renée McDonald (Publisher), Deborah Powell (Managing Editor), Robert Allerdice (Tax Consultant), Louella Brown (Production Manager), Mei Lam (Designer), Gabrielle Herro (Typesetter), Stuart Murphy (Online Publishing), and Kristina Proft (Indexer).

Chapter 2

Attorneys and guardians

¶2-100 Introduction

Documents such as powers of attorney and powers of guardianship are legal documents by which a person appoints another person (the attorney or guardian) to make decisions on their behalf. This power to make decisions can take effect immediately or upon a particular event, such as the donor's incapacity. The person making the appointment is referred to as the donor or principal, depending on the relevant jurisdiction. For consistency we will generally use the term "donor".

These documents play an important role in succession planning. It is becoming more common for a person to suffer a period of incapacity – sometimes lasting years – before their death. It is essential that a person obtains professional advice and implements a formal process for the proper management of their assets and personal affairs during this period.

There have been a number of recent government reports expressing concern about "elder abuse", that is, elderly persons being personally or financially abused. Instruments such as a power of attorney are important tools in preventing this abuse.

There are four common types of powers:

- general power of attorney;
- enduring power of attorney;
- medical enduring power of attorney; and
- enduring power of guardianship.

As with most succession laws, the rules vary significantly from jurisdiction to jurisdiction. Some jurisdictions do not prescribe all of the above types of powers; others have similar powers which are described differently. Some jurisdictions, such as Queensland, are considerably more advanced than others when prescribing rules for matters such as health and personal care matters. In some jurisdictions the legislation is set out in a single Act; in others it is dealt with under several separate Acts.

Some of the differences between jurisdictions include:

- some jurisdictions, such as South Australia, deal with the impact that decision-making by attorneys and administrators can have on wills, the wishes of the willmaker and the rights of the beneficiaries;
- some jurisdictions, such as Queensland, are very sensitive to the importance of managing people's expectations and are demanding in the way that such matters are dealt with; and
- most jurisdictions have complex, interrelating laws regarding the management of a person's affairs – both personal and financial. This is fertile ground for disputes, sometimes to the detriment of the incapacitated person.

It would be fair to say that much of this book is centred around the pure financial benefits that can be gained from successful estate and succession planning. However, we do not retract from the social

observations made in this chapter. When a person is incapacitated – which can be for many years – it is essential that the right person or people manage their affairs.

In this chapter, we will discuss the rules that broadly apply to each common type of power and then look at the specific rules that apply in each jurisdiction. Note that the rules are regularly changing and it is not practical to include every relevant law in the jurisdictional summaries set out in ¶2-125 onwards.

¶2-105 General power of attorney

What is a general power of attorney?

A general power of attorney is a document by which a person (the donor) appoints someone (the attorney) to make financial and legal decisions on their behalf. It is most commonly used to give an attorney specific powers for a fixed period of time.

For example, a donor may give a family member a general power of attorney to manage their financial affairs (for instance, to access their bank account, pay their tax or sell property) while they are overseas.

Is it permitted in all jurisdictions?

All jurisdictions provide for the making of general powers of attorney.

How is a general power of attorney created?

The legislation in each jurisdiction sets out the form a general power of attorney should take. The donor and the attorney must sign the document. If two or more attorneys are appointed, both or all must sign.

Where the donor is able to sign, the law generally does not require a witness. However, it is often considered prudent to have someone witness the general power of attorney.

If the donor is unable to sign the general power of attorney, they may direct someone else to sign it in their presence. Usually in these circumstances, one or more people must witness the signing.

Can multiple attorneys be appointed?

Yes. Where more than one attorney is appointed the attorneys can act jointly (meaning that each attorney must agree on any decisions and every document must be signed by all attorneys) or severally (meaning that each attorney can act unilaterally).

Appointing multiple attorneys to act jointly can offer a degree of protection. However, if the purpose is to act on a particular transaction – for example, to sign a real estate contract, then one attorney would usually be satisfactory.

When does it come into effect?

A general power of attorney can take effect immediately or from a specified date. In Tasmania it has no effect until registered and in some other jurisdictions, such as the Northern Territory, it must be registered before real property can be dealt with under the power.

Can the attorney's decision-making powers be limited?

Yes. The power can be limited to a particular transaction – such as signing a contract for the purchase or sale of a property.

If no limitation is included in the power then the attorney will be able to make most financial or legal decisions on the donor's behalf.

The attorney cannot, however, make certain personal decisions on the donor's behalf. For example, the attorney cannot make a will for the donor or, if the donor is a director of a company, the attorney cannot act in that role as director.[1]

Tip

There is often confusion regarding the role of a director and an attorney. It is important to note that while most company constitutions refer to an attorney being appointed to act on the company's behalf, this is different to the attorney acting on a director's behalf. The general rule is that a director cannot appoint an attorney to act in their place.

How long does it last?

The general power of attorney will continue until it is revoked by the donor or attorney, or if the attorney becomes bankrupt or on the death of the donor. It also ends on the incapacity of the donor (unlike an enduring power of attorney).

While the law allows a donor to revoke a general power of attorney by telling the attorney their power is withdrawn and destroying the power of attorney document, it is good practice to give the attorney, and any people likely to have dealt with the attorney, written notice of a decision to revoke the power of attorney.

An earlier appointment is not automatically revoked by a later appointment.

1 *Cheerine Group (International) Pty Ltd v Yeung* [2006] NSWSC 1047.

Does it need to be registered?

The rules for registering powers of attorney vary considerably between jurisdictions. In summary:

	Legislation	Registration
Australian Capital Territory	*Powers of Attorney Act 2006* (ACT)	A power of attorney may be registered in the General Register of Deeds under s 4 of the *Registration of Deeds Act 1957* (ACT)
New South Wales	*Powers of Attorney Act 2003* (NSW)	A power of attorney may be registered in the General Register of Deeds maintained by the Register-General (s 4). A power of attorney authorising dealings with land (except for a lease for a term not exceeding three years) must be registered (s 52)
Northern Territory	*Powers of Attorney Act* (NT)	A power of attorney may be registered (s 7). A power of attorney is required to be registered if it is likely to be used in relation to a dealing with land, other than a lease of land for one year or less (s 8)
Queensland	*Powers of Attorney Act 1998* (Qld)	A general power of attorney may be registered (s 25) as may an enduring power of attorney (s 60). A power of attorney must be registered before a land instrument can be registered (s 132 *Land Title Act 1994* (Qld))
South Australia	*Powers of Attorney and Agency Act 1984* (SA)	There is no requirement to register a power of attorney. A power of attorney may be registered under Pt 2 of the *Registration of Deeds Act 1935* (SA)
Tasmania	*Powers of Attorney Act 2000* (Tas)	A power of attorney, irrespective of its purpose, must be registered
Victoria	*Instruments Act 1958* (Vic)	There is no provision for registering a power of attorney
Western Australia	*Transfer of Land Act 1893* (WA)	A power of attorney may be registered (s 143 *Registration of Deeds Act 1856* (WA))

What can go wrong?

Self-evidently one of the risks to a person when appointing an attorney is that the attorney might act outside the scope of their authority. It is imperative that powers of attorney be reviewed regularly and kept in a secure location.

There are risks also for persons seeking to rely on the authority of the attorney. For example, there are risks to financial institutions who rely on the authority of an attorney to redeem an investment, withdraw funds from an account or give a loan.

Example

In *Siahos & Anor v J P Morgan Trust Australia Ltd*,[2] a son used the power of attorney he held for his parents to take out a new loan. The new loan was used to refinance an existing loan jointly held by the parents and to provide additional moneys for "future investment use".

The lender paid the additional moneys into a bank account in the son's name. The Court of Appeal held that the additional sum was not recoverable from the parents as it was a loan that had been made to the son only and such a loan was not authorised by the power of attorney.

The court also considered whether the lender could rely on the doctrine of ostensible authority and concluded that it could not as the (disputed part of the) loan was given to the agent without express approval from the principal or the authorising document.

2 [2009] NSWCA 20.

Example

In *Spina v Permanent Custodians Ltd,*[3] a son used the power of attorney he held for his mother to take out a new loan. The new loan was used to refinance an existing loan jointly held by the son and mother and also to provide funds for the son's business. The son signed the loan documentation both in his own right and on behalf of the mother as her attorney.

At first instance, the Supreme Court held that the son had the necessary authority to bind his mother. The Court of Appeal however overturned this decision and found that the son only had authority to bind the mother in respect of one half of the original loan. Interestingly, the Court of Appeal indicated that the decision might have been different if the mother did not have capacity and the transaction was for her clear benefit.

In a lesson for all financial institutions and other persons relying on the authority of an attorney, Young JA said:

> "It is difficult for me to agree that a reasonable person would not see a 'red light' when considering the scenario that the application for finance was being made:
>
> (a) by an 86-year retired lady;
>
> (b) by her son as her attorney;
>
> (c) in circumstances where the son took a benefit;
>
> (d) over the 86-year-old's major asset;
>
> (e) where there was no material to show the lady personally had been given legal advice; and
>
> (f) where, if the son died or was unable to repay the loan out of his income, the lady's home was at risk."

3 [2009] NSWCA 206.

¶2-110 Enduring power of attorney

What is an enduring power of attorney?

An enduring power of attorney is a document by which a person (the donor) appoints someone (the attorney) to make financial and legal decisions on their behalf.

It differs from a general power of attorney in that the appointment continues to have effect even if the donor loses legal capacity.

The importance of choosing the right attorney/s is greater with an enduring power, given that the donor may be without capacity and unable to monitor the actions of the attorney. The attorney must be completely trustworthy and have the time and skills to act on behalf of the donor.

Is it permitted in all jurisdictions?

All jurisdictions provide for the making of enduring powers of attorney.

How is an enduring power of attorney created?

An enduring power of attorney must be:

- signed by the donor or for the donor by a person at the direction and in the presence of the donor; and
- in most jurisdictions, signed and dated by two adult witnesses in the presence of the donor and each other.

In most jurisdictions, a person is eligible to sign an enduring power of attorney for the donor if the person is at least 18 years old, and is neither a witness nor a nominated attorney under the enduring power of attorney.

Who can witness an enduring power of attorney?

A person aged 18 and over may witness an enduring power of attorney unless the person is named as an attorney.

There are some other rules that apply that vary from jurisdiction to jurisdiction.

Certificate of witness

In some jurisdictions, an enduring power of attorney must contain a certificate signed by each witness.

Can multiple attorneys be appointed?

Yes. As with a general power of attorney, more than one attorney can be appointed jointly (meaning that each attorney must agree on any decisions and every document must be signed by all attorneys) or severally (meaning that each attorney can act unilaterally).

As noted above, because an enduring power of attorney can operate when the donor has lost capacity, the choice of attorneys is critical. There is a growing area in Australian law dealing with elder abuse – the trend towards children (and others) taking advantage of the elderly or incapable when acting under the authority of documents such as a power of attorney.

In chapter 3, we discuss at length the importance of appointing the correct people as executors and trustees of a will. Similar considerations apply regarding attorneys – that is, where it may be appropriate to appoint at least two attorneys to act jointly or a trustee company or a public trustee. Where more than one attorney is appointed, it is important that they cooperate with each other and act in the best interests of the donor.

The attorney's role is important not only in making personal decisions and managing day-to-day finances, but also in terms of the investment of assets and the sale of assets such as the donor's home. The honesty and reliability of the attorney is essential.

Alternative attorney

In most jurisdictions, a donor may appoint an adult person as an alternative attorney in case the first nominated attorney cannot accept that role. In other jurisdictions, the legislation is silent on this point and it is not certain whether alternatives can be validly appointed.

Where it is an option, an alternative attorney may act as attorney under the enduring power of attorney in the event of the death, or during the period of absence or legal incapacity, of the first-appointed attorney.

When does it come into effect?

The enduring power of attorney can take effect immediately.

Alternatively, the enduring power can be made so that it becomes operative on a particular event occurring – such as the donor's loss of capacity.

Proving loss of capacity of the donor can be problematic. Some financial institutions may require regular proof to show that the donor remains incapacitated. This usually requires a doctor's report on the donor's capacity.

In Tasmania, as with a general power of attorney, an enduring power has no effect until it is registered and in some other jurisdictions, such as the Northern Territory, it must be registered before real property can be dealt with under the power.

Tip

It is essential that a donor understands exactly when the authority of the attorney commences. For example, if a person makes an enduring power of attorney appointing their daughter as attorney, with immediate effect, then it is important that the donor understands that the daughter may be able to hold herself out as attorney from the date the power was executed.

Does it need to be registered?

Refer above for requirements in different jurisdictions.

What are the duties of an attorney?

An enduring power of attorney is a legal document. By signing it, the donor authorises the attorney to make financial decisions for them. The attorney is in an important position of trust, and is subject to a number of duties. For example, the attorney must:

- always act in the best interests of the donor;
- act with diligence, care and skill;
- act according to any limits or conditions placed on their authority;
- obey the donor's instructions. These instructions may be given in contemplation of granting the enduring power of attorney, at the time of granting the enduring power of attorney or after granting the power of attorney (provided the donor still has capacity);
- advise the donor if instructions cannot be carried out (if instructions are ambiguous, the attorney is entitled to act on a reasonable interpretation of the instructions);
- give proper instructions to other agents;
- take care of the donor's property;
- keep their own finances and property completely separate from the donor's finances and property. This will ensure that the attorney is at all times able to separately identify their assets and the assets belonging to the donor;
- not enter into transactions on behalf of the donor that may involve a conflict between the interests of the attorney and those of the donor (unless the transaction is explicitly authorised by the donor);
- not use their position as attorney to make a profit;
- keep proper accounts and records;
- respect the donor's right to confidentiality; and
- not act in any way that may negate a donor's will.

If the attorney's duties are not carried out properly, they may be required to compensate the donor for any losses occasioned as a result of their actions. However, in practice it can be difficult to identify

occasions of abuse and to bring an action against an attorney – another reason the appointment of an appropriate attorney is crucial. In addition, even if abuse is identified and action successfully taken, it may be that the recalcitrant attorney cannot make good any loss.

Professionals acting as attorney, such as licensed trustee companies and public trustees, accountants, lawyers and financial planners, will be subject to a greater degree of scrutiny than others. Accountants and financial planners in particular should carefully consider the consequences of taking on the role of attorney before doing so. Many of these will be similar to those that apply when considering whether to take on the role of executor (see ¶3-160).

There are also certain things that an attorney cannot do. An attorney is unable to:

- exercise any trusts, powers or discretions vested in the donor;
- perform any non-delegable duties of the donor;
- make a will for the donor (although application for a statutory will may be possible – see ¶3-120);
- swear an affidavit in the name of the donor; or
- pass on his or her powers and duties to another person.

Can the attorney's decision-making powers be tailored?

Yes, although it is not common for an enduring power of attorney to be limited, as the purpose is generally to enable someone to do all things that the donor would otherwise be able to do.

It is also possible for the power of attorney to specifically authorise the attorney to do particular things, such as make gifts, make certain investment decisions or make payments to the attorney for their services.

As with a general power of attorney, the attorney cannot make certain personal decisions on the donor's behalf. There is some uncertainty regarding exactly what an attorney can and cannot do. In particular, there are some interesting scenarios relating to superannuation, such as:

- can an attorney make a binding death benefit nomination for superannuation purposes? The Superannuation Complaints Tribunal (SCT) appears to hold the view that an attorney can make a binding nomination.[4] In the author's view an attorney cannot;
- can an attorney cash the donor's superannuation benefit? In the author's view the attorney can, unless prohibited by the power of attorney. However, depending on the terms of the donor's will, where the donor had made a binding death benefit nomination any cashing of benefits prior to death may mean that the nominated beneficiary will lose any entitlement to receive the superannuation benefit;
- can an attorney roll over the donor's superannuation benefit into another superannuation fund? Again, yes, unless prohibited by the power of attorney. Again, this may affect who will receive the superannuation death benefit – for example, what if the benefit was transferred to a self-managed superannuation fund controlled by the attorney?

4 See decision of SCT No. D08-08\30.

The recent changes to taxation of superannuation death benefits give rise to a potentially valuable "angel of death" strategy for pre-death withdrawal of superannuation benefits, as shown in the following example.

Example

Helen is a widow aged 65 years and no longer has capacity. She has three daughters, the eldest of whom is her attorney under an enduring power of attorney. One of Helen's assets is an interest in a superannuation fund, consisting entirely of a taxed component, valued at $750,000.

Helen's only beneficiaries are her three children, none of whom are tax dependants.

If Helen died with the money still in the superannuation fund, then the death benefit is paid to her children from her superannuation fund; it would be taxed at 16.5%.

Helen is close to death. Her attorney decides to withdraw her benefit which is done tax-free. Helen dies one week later. The $750,000 forms part of her estate and is then distributed to the beneficiaries named in her will, being her three daughters.

If, at the time of Helen's death, the $750,000 was still held in her superannuation fund then, on withdrawal, tax of $123,750 would have been paid as the benefit was not paid to a tax dependant. By withdrawing the whole benefit shortly before Helen's death, the attorney has saved this amount.

Note, for a further discussion of this strategy – including risks – and a description of terms such as "taxed component", see ¶15-145.

How long does an enduring power of attorney last?

An enduring power of attorney continues to operate and have full force and effect notwithstanding that the donor subsequently loses capacity. This contrasts with a general power that will cease to have effect when the donor loses capacity.

An enduring power of attorney is revoked, to the extent of any inconsistency, by a later grant of an enduring power of attorney.

The enduring power of attorney will continue until revoked by the donor or attorney, the attorney becomes bankrupt, or the donor dies. It is possible for a court or tribunal to suspend a power in certain circumstances, or if the donor regained capacity they could revoke the power.

In most jurisdictions, there is one or more statutory authorities that have the power to remove an attorney, in certain circumstances. An attorney could always be removed by a court.

Can an enduring power of attorney be revoked?

An enduring power of attorney can be revoked or changed in the same way as a general power of attorney can be revoked or changed, providing the donor has legal capacity.

The donor should inform their attorney that their appointment has been revoked and destroy the enduring power of attorney document and any copies. It is wise for the donor to formalise their

decision in writing and notify their bank or other relevant institutions that the attorney no longer has power to make decisions on their behalf. Decisions by the attorney bind the donor until the attorney has been informed that the enduring power of attorney has been revoked.

Revocation if there is more than one attorney

If two or more people are appointed jointly and severally as attorneys, the revocation of the power in relation to one attorney does not affect the appointment or powers of the remaining attorneys.

If two or more people are appointed jointly (not jointly and severally) as attorneys, the revocation of the power in relation to one joint attorney also revokes the power of the other joint attorney which effectively leaves the donor without an attorney.

Can the attorney charge a fee?

While an attorney is generally able to bind the donor in regard to expenses, this does not give the attorney the right to charge a fee for their services unless it is a trustee company.

Accordingly, if it is intended that the attorney be paid for their services, it will be necessary to refer to this in the enduring power of attorney document. Options include permitting the attorney to charge an hourly fee (and keeping records evidencing time spent), a fixed fee or a fee based on the value of assets under administration.

Can an attorney pay certain benefits?

It is not uncommon for an attorney to consider that the donor would have wanted gifts to be made to certain persons. For example, an attorney might see that the donor had consistently made gifts to their grandchildren for birthdays etc. Ordinarily, however, such gifts cannot be made by the attorney without an express power to do so in the enduring power of attorney document.

Liability and indemnities

It is also possible for a donor to limit the liability of the attorney or give certain indemnities to the attorney. In practice, this usually occurs in limited instances such as where the role of the attorney includes making difficult decisions such as decisions relating to the running of a business.

SMSFs and enduring powers of attorney

It is a requirement of self-managed superannuation funds (SMSFs) that each member of the SMSF be a trustee, or a director of the corporate trustee, of the SMSF. Section 17A of the *Superannuation Industry (Supervision) Act 1993* (SISA) sets out an exception to this requirement. Under s 17A(3)(b)(ii), a person who holds an enduring power of attorney granted by a member may be a trustee, or a director of the corporate trustee, in place of that member without causing the SMSF to breach the SISA.

The wording of s 17A(3)(b)(ii) is less than clear. It refers to a legal personal representative who has an enduring power of attorney in respect of the member. The definition of "legal personal representative" is broad but the relevant part for this purpose reads "a person who holds an enduring power of attorney granted by a person". The term "enduring power of attorney" is not defined.

The ATO sets out its views on the operation of s 17A(3)(b)(ii) in SMSFR 2010/2. According to the ATO:

- the attorney must be appointed as a trustee, or a director of the corporate trustee, of the SMSF. This means that the attorney performs their duties pursuant to the appointment to the position of trustee or director, rather than in the capacity as attorney for the member and, as a result, any prohibitions on trustees delegating their powers by way of power of attorney are not relevant;
- the attorney assumes the duties, responsibilities and obligations as trustee in their personal capacity and not as agent for the member;
- the power of attorney document must be current and in accordance with the legislation in the relevant jurisdiction. It must authorise the attorney to act in relation to the donor's financial, business and property affairs or the donor's superannuation affairs;
- particular attention must be given to the trust deed to ensure it allows for the appointment of a person who is not a member of the fund as a trustee in place of the member; and
- where a member has appointed more than one attorney, only one of those persons may be appointed as trustee, or director of the corporate trustee, in the member's place.

It is interesting that the ATO is of the view that a member does not have to be incapacitated before the member's attorney is able to step into the shoes of the member. This means among other things that if the power of attorney has immediate effect (eg if it is not expressed to commence only upon the member's incapacity) then the attorney could replace the member as trustee of the SMSF even though the member has not lost capacity (but see below). This is somewhat at odds with one of the purposes of s 17A which was to help ensure SMSF members had a hands-on role in the management of their SMSF.

Practitioners need to remember that the legislation dealing with enduring powers of attorney varies between jurisdictions. For example, in the Australian Capital Territory an enduring power of attorney operates as a general power of attorney while the donor has decision-making capacity.[5] This casts some doubt as to when a person appointed as attorney in the ACT can be said to hold an enduring power of attorney for a member under an enduring power of attorney where the member has not lost capacity. It might be argued that even if the attorney is said to be acting under a general power of attorney, they still "hold" an enduring power of attorney for the member and on that basis would satisfy s 17A(3)(b)(ii), but the position is far from clear.

5 See note to s 8 of the *Powers of Attorney Act 2006* (ACT).

What can go wrong?

As is the case with general powers of attorney, one of the key risks to a person when appointing an enduring power of attorney is that the attorney might act outside the scope of their authority. This is even a greater risk in the case of attorneys acting under an enduring power because if the donor no longer has capacity there might not be anyone to supervise the actions of the attorney. It is imperative that powers of attorney be reviewed regularly and kept in a secure location.

There are risks also for persons seeking to rely on the authority of the attorney. For example, there are risks to financial institutions who rely on the authority of an attorney to redeem an investment, withdraw funds from an account or give a loan.

¶2-112 Elder abuse

Are your clients at risk?

In recent times, there has been significant publicity concerning "elder abuse".

The term is used to describe the situation where a vulnerable person is taken advantage of emotionally, physically and/or financially.

We are living longer and more and more of us are likely to become more reliant on others at a time when our own faculties are diminishing, and it is expected that the incidence of elder abuse will continue to increase.

The following example draws on a case which our practice came across recently.

Example (note: modified for privacy reasons)

Heather has three children: two sons who live interstate and a daughter Deidre, a nurse, who lives nearby. Heather is becoming increasingly dependent on Deidre. She consults her lawyers and decides to make Deidre her sole financial and medical attorney.

The next year, Heather became increasingly frail and Deidre found herself having to reduce her normal working hours in order to look after Heather.

After two years of an ever-increasing workload caring for Heather, Deidre had no option but to place Heather into a high-care nursing home. As attorney, Deidre sells Heather's house to fund the bond for the nursing home. The house – which was in a suburb that was traditionally regarded as average but had recently become popular – surprisingly sells for $1m and, after payment of the nursing home bond, Deidre has $850,000 in the bank.

Deidre has never had so much money. She looks at the situation of her two brothers who are both financially secure and convinces herself that Heather would have wanted her to have a "reward" because of all the sacrifices she has made. Deidre "borrows" $200,000 to pay off her mortgage.

Over the next six months, Deidre then starts frequenting the pokie section of the local "Lucky Strike" Tavern.

Example (cont)

A year later, after Heather's death, her sons discover that Deidre has gambled away all of the $850,000, as well as her own house. They decide not to pursue Deidre.

The financial abuse is never reported and never included in statistics regarding the incidence or extent of such abuse.

A recent Victorian report into financial abuse and what advisers should consider when caring for elderly clients can be located at www.seniorsrights.org.au.

¶2-115 Medical enduring power of attorney

What is a medical enduring power of attorney?

A medical enduring power of attorney allows the donor to appoint someone to make medical treatment decisions on their behalf when they are no longer able to make decisions.

The legislation in each jurisdiction varies significantly.

Is it permitted in all jurisdictions?

In Victoria and South Australia, a person is able to appoint a medical attorney. The Australian Capital Territory has more limited powers. In New South Wales, Tasmania and Queensland, a person can appoint an enduring guardian who can make certain decisions relating to medical matters. In Western Australia and the Northern Territory, a relevant authority may appoint a person to make medical decisions on a person's behalf.

In some jurisdictions, documents such as advance care directives or living wills have no express legislative base but are recognised under common law.

Details of the varying powers in each state and territory are set out at ¶2-125 onwards.

How is a medical enduring power of attorney created?

The relevant jurisdictions each have a prescribed form of medical enduring power of attorney. The legislation in the Australian Capital Territory and Queensland refers to the donor's understanding of the appointment. The legislation in other jurisdictions refers to a witness's view of the donor's understanding.

Tip

If there is a risk that a person will challenge the validity of a power of attorney, the time to address that risk is before the time of signing. Ensure that the witnesses are independent and satisfied that the donor understood the nature and effect – including the commencement date – of the power. Where necessary, consider having a registered medical practitioner as one of the witnesses – preferably the donor's usual practitioner – or obtaining a medical certificate as to capacity.

Who can witness a medical enduring power of attorney?

Most jurisdictions require:

- a qualified person to be the witness or one of two witnesses. The attorney cannot be a witness; and
- one or both witnesses to write on the document that they believe that the donor is mentally competent and understands the nature and effect of the medical enduring power of attorney.

Can the medical attorney's decision-making powers be limited?

The attorney will be able to make any medical treatment decisions on the donor's behalf, unless prohibited by the law.

In several jurisdictions, prohibited procedures include medical procedures that are likely to lead to infertility, procedures that are carried out for medical research, termination of pregnancy or removal of tissues for transplants.

Can multiple medical attorneys be appointed?

In jurisdictions apart from the Australian Capital Territory, it is not permitted to appoint more than one medical attorney; however, an alternative attorney can be appointed. An alternative attorney can make a decision about medical treatment if the original attorney has died, is deemed incompetent, or cannot be contacted, or when the attorney's whereabouts are unknown.

In the ACT, one or more persons can be appointed to attend to "personal health care matters" or "health care matters".

When does it come into effect?

The medical enduring power of attorney only comes into effect when the donor is unable to make medical treatment decisions for themselves. This may occur temporarily (for example, if the donor becomes unconscious as the result of an accident) or permanently (for example, if the donor suffers from acute dementia).

What are the duties of a medical enduring power of attorney?

A medical enduring power of attorney is a legal document. By signing it, the donor authorises the attorney to make medical treatment decisions for them. The attorney is in an important position of trust, and is subject to a number of duties. For example, the attorney must:

- always act in the best interests of the donor;
- act with diligence, care and skill;
- make decisions regarding medical treatment for the donor, such as having an operation or any other medical procedure; and
- refuse medical treatment if it would cause the donor unreasonable distress or it is reasonably believed that the donor would not have chosen to have the treatment.

There are also certain things that an attorney cannot do. Again, the rules vary from jurisdiction to jurisdiction – see ¶2-125 onwards.

In very general terms, in most jurisdictions, an attorney is unable to:

- refuse palliative care, which includes:
  - the provision of reasonable medical procedures for the relief of pain, suffering and discomfort; or
  - the reasonable provision of food and water; and
- make decisions regarding:
  - medical procedures that are likely to lead to infertility;
  - procedures that are carried out for medical research;
  - termination of pregnancy; or
  - removal of tissues for transplants.

Invariably, an attorney will need to make decisions whether to buy, sell or hold investments and other assets. Attorneys need to be aware of the risks in not properly performing this aspect of the role (eg see ¶2-120).

How long does a medical enduring power of attorney last?

The medical enduring power of attorney will continue until it is revoked by the donor, the donor dies or the attorney's authority is removed by an authority or court in the relevant jurisdiction.

Can a medical enduring power of attorney be revoked or changed?

A donor can revoke or change a medical enduring power of attorney in the same way as a general power of attorney can be revoked or changed (see ¶2-105).

A donor will be unable to revoke a medical enduring power of attorney once they lose legal capacity.

An earlier appointment will be automatically revoked by a later appointment. However, it is prudent for the donor to notify the first nominated medical attorney that their appointment has been revoked.

¶2-120 Enduring power of guardianship

What is enduring power of guardianship?

An enduring power of guardianship allows the donor to appoint someone to make personal, lifestyle and sometimes medical decisions on their behalf.

Is it permitted in all jurisdictions?

Most jurisdictions allow for what are commonly referred to as enduring powers of guardianship.

How is an enduring power of guardianship created?

The relevant jurisdictions prescribe the form an enduring power of guardianship should take. The donor must sign the document and the guardian must complete and sign some form of acceptance.

Both the donor and the guardian must sign in the presence of two witnesses – except in the Australian Capital Territory where no witness is required for the guardian. At least one of the witnesses must be a person authorised by law to take and receive statutory declarations (for example, a doctor or solicitor). The guardian cannot witness the document.

The witnesses must certify that both the donor and the proposed guardian signed the document freely and voluntarily and that they both understood the effect of the enduring power of guardianship.

Can the guardian's decision-making powers be limited?

Yes. The guardian's powers can be limited by deleting powers the donor does not wish the guardian to exercise. If no limits are imposed, the donor will be considered to have authorised the guardian to exercise the full powers of a guardian under the relevant legislation.

In most jurisdictions, a guardian can exercise all the powers that a parent may exercise in respect of his or her child, including:

- to decide where they live;
- to decide with whom they live;
- to decide whether they should work and, if so, where, the type of work and other work-related matters;
- to restrict visits that would adversely affect the donor; and
- to consent to medical and dental treatment that is in the donor's best interests.

If the donor has also appointed a medical enduring power of attorney, the donor's medical agent's decision will have priority over the guardian's decision.

Investment and special superannuation rules

Guardians may also be responsible for investment decisions. Guardians need to be alerted to the special taxation rules in s 292-95 *Income Tax Assessment Act 1997* (Cth) (ITAA97) that apply in regard to receipt of payments for personal injuries damages. These rules make it possible for a guardian to contribute the proceeds of a personal injuries settlement or court order into a superannuation account of the represented person without breaching the non-concessional contributions cap. However, to exclude a contribution made from the proceeds of a court ordered damages payment the sums must be paid into superannuation within a 90-day timeframe.

The 90-day timeframe commences from the latter of the date of the court order or the date the payment was made to the guardian – see ID 2008/142. Where an amount is paid from the court to the Office of Protective Commissioner who then directs the payment to the guardian, the 90-day timeframe commences from the payment to the guardian – see ID 2007/224.

As with any fiduciary – especially those who hold themselves out as professionals – guardians need to be aware of all rules such as these or risk being sued for negligence.

Example

In *Re CAC,*[6] the guardian (a licensed trustee company) received a payout of some $5m in respect of a represented person.

The trustee company formulated an investment plan but did not appear to consider the investment opportunity under s 292-95 ITAA97, at least until after the 90-day timeframe had expired.

A complaint was brought against the guardian before the Guardianship and Administration Tribunal. The tribunal held that the trustee company had not properly modelled the investment structure for the client and had not considered the advantages of making a superannuation contribution under s 292-95 ITAA97.

However, where a payment is made to a trustee (eg pursuant to a court order), it may be that the trustee does not have the power to make a contribution to a superannuation fund, as such a transaction would equate to the trustee divesting itself of a legal estate in the money.[7]

6 *Re CAC* [2009] QGAAT 63 (14 August 2009).

7 See, for example, the decision in *McInnes (by her next friend Gayle McInnes) v Insurance Commission of Western Australia* [2011] WADC 17.

Can multiple guardians be appointed?

In the Australian Capital Territory, New South Wales and South Australia, it is possible to appoint more than one guardian and to also nominate alternative guardians. In other jurisdictions, only one guardian can be appointed but an alternative guardian can also be nominated. An alternative guardian will take the place of a guardian if the latter becomes incapable of acting or is absent for a period.

In New South Wales and the Australian Capital Territory, you can have more than one guardian.

When does an enduring power of guardianship come into effect?

The enduring power of guardianship only comes into effect when the donor is unable to make decisions for themselves.

How long does it last?

The enduring power of guardianship will continue until it is revoked by the donor, the donor dies, the guardian loses capacity or dies (assuming no alternative named) or a state authority finds that the guardian is not acting in the donor's best interests.

Can it be revoked or changed?

A donor can revoke or change an enduring power of guardianship in the same way as a general power of attorney can be revoked or changed (see ¶2-105).

A donor will be unable to revoke a power of guardianship once they lose legal capacity.

An earlier appointment will be automatically revoked by a later appointment. However, it is prudent to notify the first nominated guardian that their appointment has been revoked.

¶2-121 Guardianship and administration boards and tribunals

Each state and territory has a statutory body whose role is to deal with matters involving guardianship and administration.[8] For convenience, we will refer to these in this section as "the tribunal". (See ¶2-125 and onwards for legislative references and other information.)

The role of the tribunal is to protect persons (represented persons) aged 18 years or over who, as the result of a disability, are unable to make reasonable decisions about their personal circumstances or their financial and legal affairs. The tribunal does this by making an order giving another person the ability to make decisions on behalf of the represented person.

8 ACT and NSW: Guardianship Tribunal; NT: the Public Guardian; Qld: Guardianship and Administration Tribunal; SA, Vic and WA: Guardianship Board; Tas: Guardianship and Administration Board.

An order will only be made if a person has a disability and their disability significantly affects their ability to make decisions for themselves. A disability is usually defined and may include:

- intellectual impairment;
- mental disorder/mental illness;
- brain injury;
- physical disability; and
- dementia.

As a result of their disability, a represented person:

- may not appreciate fully all of the consequences of his or her decisions;
- may lack a full understanding of his or her or others' actions; and
- may take unreasonable risks affecting his or her health or welfare.

Self-evidently, the tribunal has extremely important powers, as orders will diminish a person's civil liberties by removing their right to manage their own affairs or to make lifestyle decisions. Understandably, significant evidence must be produced to the tribunal before it will make orders.

Although there are some differences from jurisdiction to jurisdiction, the tribunal usually has the power to make orders appointing a person:

- to make lifestyle decisions (eg where to live, who has contact etc) and medical treatment decisions on behalf of the represented person; and
- to manage the financial, property and legal affairs of the represented person.

In most jurisdictions, the order can be a full order (giving a wide range of powers) or a limited order (limited to a particular act or event).

Applications to the tribunal may be made for orders appointing a guardian or an administrator, although again this varies from jurisdiction to jurisdiction. Any appointment may override the power an existing attorney has over the affairs of the represented person.

The decisions a guardian can make may include:

- changing an accommodation facility if the needs of the represented person change;
- changing the residence of the person if need be; and
- making other lifestyle-related decisions, such as who can visit the represented person.

The decisions an administrator can make may include:

- taking control over the person's income (such as a disability or old age pension) and from this paying rent, providing an allowance for food, clothing and other expenses and investing any surplus;
- paying debts (where sufficient funds are available);
- selling or buying a property;

- purchasing furniture;
- leasing or letting a property; and
- issuing or defending legal proceedings.

The legislation in each jurisdiction sets out the matters that the tribunal must satisfy itself with before making orders. This will usually include evidence that:

- the represented person has a disability – this will be ascertained by medical evidence;
- the represented person is unable, because of the disability, to make reasonable judgments about their legal, financial or accommodation decisions;
- there are decisions that need to be made and that there is no alternative arrangement for making these decisions that is less restrictive on the represented person. For instance the tribunal will consider whether there is an enduring power of attorney appointed or whether a family member could take on more involvement in the represented person's life;
- the orders will assist to improve the represented person's quality of life;
- the proposed guardian or administrator is over 18 years of age and consents to the appointment;
- the proposed guardian or administrator will act in the best interests of the proposed represented person;
- existing family relationships will be preserved – as indicated earlier, if there is family conflict the tribunal may appoint an independent person;
- there is a satisfactory degree of compatibility between the represented person and the proposed guardian or administrator; and
- the proposed guardian or administrator possesses the necessary qualities and experience for the task.

The guardian/administrator will often be a family member or close friend. If there is no suitable or willing family member or friend, or if there is a conflict within the family, the tribunal will appoint a statutory body, such as the public trustee (in Victoria, state trustees), a trustee company (as administrator) or the public advocate (as guardian).

The tribunal will look at a number of matters prior to making an order or rejecting an application, including:

- what the wishes of the represented person would have been if he or she had not become mentally incapacitated (where this can be determined);
- the present wishes of the represented person – if these can be expressed;
- whether or not existing informal arrangements for the treatment and care of the represented person are adequate, and should not be disturbed; and
- which decision or order would least restrict the represented person's rights and personal autonomy, while still ensuring his or her proper care and protection.

The tribunal will usually be required to review orders every one, two or three years.

A wide range of information is publicly available about the processes for appointing administrators and guardians in each jurisdiction – see the following websites:

Jurisdiction	Office	Website address
ACT	Public Advocate of the ACT	http://www.publicadvocate.act.gov.au/index.php
NSW	Office of the Public Guardian	http://www.lawlink.nsw.gov.au/lawlink/opg/ll_opg.nsf/pages/OPG_index
NT	Office of Public Guardian	http://www.health.nt.gov.au/index.aspx
Qld	Office of the Adult Guardian	http://www.justice.qld.gov.au/91.htm
SA	Office of the Public Advocate	http://www.opa.sa.gov.au/cgi-bin/wf.pl
Tas	The Office of the Public Guardian	http://www.publicguardian.tas.gov.au
Vic	Victorian Civil and Administrative Tribunal	http://www.vcat.vic.gov.au
WA	Guardianship and Administration Board	http://www.justice.wa.gov.au

¶2-125 Australian Capital Territory

Powers of Attorney Act 2006 (ACT)

Who can make a power of attorney?	An adult (s 13(1))
Can a company be appointed?	For property matters only, a statutory trustee company or public trustee can be appointed (s 14(1) and (2))
Can a child be appointed?	No (s 31(3))
Can the public advocate be appointed?	For "personal care" or "health care" matters only (s 14(3))
Can a person who is bankrupt or who has executed a personal insolvency agreement be appointed?	No (s 14(1)(b))
Is the attorney's role affected by the subsequent appointment of a guardian?	Yes, the Guardianship Tribunal may make orders affecting the authority of the attorney (ss 75 to 79)
Who can sign the document?	The donor or, at the direction of the donor, an "eligible person" (s 20)
Are witnesses required?	Two adult witnesses in the presence of the donor and each other (s 19(2)(a))

Is a witness certificate required?	Yes – a witness certificate must be signed (s 19(2)(b)) Power of attorney must include certificates signed by each witness stating that the donor signed the power voluntarily in the presence of the witness and appeared to the witness to understand the effect of making the power (s 22) Similar rules apply where the donor authorised another to sign for the donor (s 22)
Who can be a witness?	A person other than the eligible person, the attorney or a child (s 21(1))
Can a relative be a witness?	Only one witness can be a relative of either the donor or one of the attorneys (s 21(2))
Must witnesses be qualified?	One witness must be a person authorised to witness signing of statutory declarations
Acceptance of attorney	Enduring power must be accepted to be valid
Can the attorney benefit?	Only if the power of attorney expressly authorises (s 34)
What generally can't an attorney do?	An attorney cannot exercise power in relation to: ■ special personal matters – making or revoking a will, making a power of attorney, voting, consenting to marriage or to adoption of a child; or ■ special health care matters – such as removal of non-generative tissue for donation, termination of pregnancy, treatment for mental illness (s 37)
Can an attorney make gifts?	Only if the power of attorney expressly authorises. If general authority is given then the value must be reasonable (ss 38 and 39)
Can an attorney pay for living expenses for someone other than the attorney or dependant?	Under an enduring power of attorney, yes, but only if the power of attorney expressly authorises payment for a named person Unless stated, only reasonable costs relating to certain types of expenses are authorised (s 40)
Can an attorney pay for maintenance of dependants?	Under an enduring power of attorney, yes. Unless the power of attorney says otherwise, expenditure must be reasonable in the circumstances (s 41)
Are there special rules if an attorney disposes of items bequeathed in the donor's will?	No
Must an attorney keep records?	Yes (s 47)
Can an attorney resign?	Yes, but if the donor has impaired decision-making capacity resignation can only happen with the leave of the Guardianship Tribunal (s 53)
Can irrevocable power be granted?	No (s 54)

What happens if a donor marries?	Power of attorney is revoked unless either the attorney is the new spouse or the power of attorney expressly states that it is to continue (s 58)
What happens if the donor divorces?	If the attorney was the spouse then power is revoked (s 59)
What happens if an attorney becomes bankrupt or executes a personal insolvency agreement?	The power of attorney is revoked to the extent it gives power to the attorney (s 62)
What happens if the attorney loses capacity?	The power of attorney is revoked in relation to the attorney (s 63)
Are powers of attorney from other Australian jurisdictions recognised?	Yes See chapter 6 of this book for more detail

Guardianship and Management of Property Act 1991 (ACT)

This Act gives the Guardianship and Management of Property Tribunal (the tribunal) certain powers, summarised as follows:

Who can the tribunal appoint?	A guardian (ss 7 and 7A) or a manager (s 8) in respect of a person with impaired decision-making ability
What powers can be given to a guardian?	The power to make decisions such as where, and with whom, the donor is to live, what education or training the donor is to receive, whether the donor can work and the power to consider certain medical procedures (s 7)
What can't a guardian do?	A guardian cannot: ■ consent to prescribed medical procedures ■ vote in an election ■ make a will ■ consent to adoption of a child, or ■ consent to marriage (ss 7 and 7A)
What powers can be given to a manager?	A manager can make decisions regarding the donor's property (s 8)
What effect does the appointment of an enduring power of attorney in relation to health care have on a guardian or manager?	The tribunal can revoke part or all of the enduring power of attorney and give the guardian the power to consent to treatment. The guardian must consider the terms of the enduring power of attorney (s 8B)
Who can be appointed as a guardian?	The public advocate or an individual can be appointed as a guardian. The public advocate must not be appointed if a suitable individual has consented to act (s 9(1) and (3))

Who can be appointed as a manager?	The public advocate, an individual, the public trustee or a statutory trustee company can be appointed as a manager. The public advocate, public trustee or statutory trustee company must not be appointed if a suitable individual has consented to act (s 9(2) and (4))
Who can be appointed as a health attorney?	A person who has a close relationship with the protected person – such as domestic partner, carer, or close relative – may be treated as a "health attorney" by a health professional for the purpose of giving consent to medical treatment (s 32D)
Must accounts be filed?	Yes – a manager, other than the public trustee, must file accounts with the public trustee (s 26)

Medical Treatment (Health Directions) Act 2006 (ACT)

This Act aims to protect the rights of patients to refuse unwanted medical treatment and to ensure the right of patients to receive relief from pain and suffering where reasonable.

It provides that an adult can make a "health direction" to refuse or require the withdrawal of medical treatment generally or specifically. A health direction cannot be made by a person for whom a guardian is appointed under the *Guardianship and Management of Property Act 1991* (ACT).

Testamentary Guardianship Act 1984 (ACT)

Under this Act, each parent and each guardian of a child may, by will, appoint one or more people to be a guardian of the child.

Where the appointor is survived by a parent of the child the appointment takes effect:

- if the instrument shows an intention to take effect on the appointor's date of death, on that date; or
- on the date of death of the parent.

Where the appointor is not survived by a parent of the child the appointment takes effect on the appointor's date of death.

Note that the Supreme Court's powers to make orders regarding the guardianship and custody of children remain unaffected by this Act.

¶2-130 New South Wales

Powers of Attorney Act 2003 (NSW)

Allow personal care powers of attorney?	No – the donor must appoint an enduring guardian under the *Guardianship Act 1987* (Sch 3)
Allow health care powers of attorney?	No – the donor must appoint an enduring guardian under the *Guardianship Act 1987* (Sch 3)
Signing requirement – donor	Must be signed by the donor (Sch 3)
Witnessing requirements	One witness. If an enduring power, the witness must be a "prescribed" witness
Who can be a witness?	Anyone over 18 years of age
Qualifications of witnesses	A prescribed witness includes a person who is a lawyer, barrister, registrar of the local court, licensed conveyancer or statutory trustee company/public trustee employee
Witness certificates	A prescribed witness must say that they explained the effect of the power to the donor, and the donor appeared to understand it
Can the attorney benefit?	Only if the instrument creating the power expressly authorises this (s 12)
Can an attorney make gifts?	Only if the instrument creating the power expressly authorises this (s 11)
Are there special rules if an attorney disposes of items bequeathed in the donor's will?	Yes. A beneficiary has an interest in sale proceeds, following the donor's death (s 22)
Can an attorney resign?	Yes – they may renounce their power (s 5(b))
What happens if an attorney becomes bankrupt?	The attorney's position is vacated (s 5(d))
What happens if an attorney loses capacity?	The attorney's position is vacated (s 5(f))
Are powers of attorney from other Australian jurisdictions recognised?	Yes, although limited (s 25)
Can power of attorney be irrevocable?	Yes if the instrument expresses this and is given for valuable consideration
Is power of donor suspended when a guardianship order is made?	Yes (but not terminated) (s 50)

Guardianship Act 1987 (NSW)

This Act gives individuals and the Guardianship Tribunal certain powers to appoint guardians.

Who can appoint a guardian?	A person 18 years of age or older may, by written instrument, appoint a person to be their guardian or two or more people – jointly, severally or jointly and severally – to be their guardian (ss 6 and 6D) The tribunal may appoint a guardian (s 14)
Who can review the appointment?	The tribunal and the court each have power to review an appointment and appoint substitute guardians (ss 6J, 6L and 6MA)
Who can make financial management orders?	The tribunal can make financial management orders – ie order that the estate of a person be managed under the *Protected Estates Act 1983* (s 25E)
What effect does an order have on power of attorney?	An order may operate so as to suspend any power of attorney (s 25E; and see s 76 of the *Protected Estates Act 1983*)
What medical and dental decisions can be made?	A "person responsible" for another may consent to medical or dental treatment for the donor for the sake of their health and wellbeing. "Person responsible" can include a person with parental responsibility, guardian, spouse, carer and others. A hierarchy applies. The tribunal can also give consent (Pt 5)

Protected Estates Act 1983 (NSW)

This Act empowers the court, where it is satisfied that a person is incapable of managing his or her affairs, to make a declaration to that effect and subject the person's estate to management under the Act. The power to make orders extends to the estate of a missing person also.

Management may be given to the Protective Commissioners and private managers who have, and may exercise, all such functions as the protected person has and can exercise or would have and could exercise if under no incapacity.

The Act sets out extensive rules relating to the Protective Commissioner's powers and responsibilities.

Testator's Family Maintenance and Guardianship of Infants Act 1916 (NSW)

Under this Act, the father or mother of a child may, by deed or will, appoint a person to be a guardian of a minor after the parent's death.

The guardian appointed must act jointly with the surviving parent unless the surviving parent objects. In that situation, or where the guardian considers that the parent is unfit to have custody of the minor, the guardian may apply to the court for an appropriate order.

Note that the court retains a range of powers regarding removal of guardians and granting certain persons – such as grandparents – rights of access.

¶2-135 Northern Territory

Powers of Attorney Act (NT)

Signing requirement – donor	Signed by the donor or on the direction in presence of the donor (s 6(2))
Witnessing requirements	Where power of attorney is signed by direction there must be two witnesses present (s 6(4)) Where power of attorney is an enduring power there must be one witness who cannot be the donee or near relative of the donee
Must an attorney keep records?	Yes (s 11)
Can an attorney resign?	Yes, but where there is an enduring power of attorney they must have leave of the Supreme Court
What happens if an attorney becomes bankrupt, insolvent or enters into compounding arrangements with creditors?	The power is revoked (s 16(d))
What happens if an attorney loses capacity?	The power is revoked (s 16(b))
What happens if a protection order is made under the *Aged and Infirm Persons' Property Act*?	The power is revoked to the extent to which it authorises the donee to deal with property that is the subject of the order (s 18, subject to s 19)

Aged and Infirm Persons' Property Act (NT)

According to this Act, a person, their spouse or de facto partner or the public trustee may, with the permission of the Supreme Court, make an application for a protection order in respect of the estate of any person.

In general terms, the Supreme Court will not make an order unless it is satisfied that, due to the person's age or health, it is in the person's best interests for an order to be made.

Under an order, the public trustee or another person is appointed as manager. Joint managers may be appointed. A manager may take possession of and manage an estate as a trustee.

Adult Guardianship Act (NT)

Under this Act, a person may be appointed to act as guardian. The role of guardian can be separate to that of manager or can extend to the management of a person's affairs. When appointing a guardian the court must have regard to the compatibility of the guardian with any manager.

Who may apply to the court for a guardianship order?	The Public Guardian, a near relative of, or a person who has provided or is providing substantial care for a person under a disability (s 8(1))
Who may act as guardian?	A person who is at least 18 years of age and who is suitable having regard to the criteria in the Act (s 14)
What power can the guardian have?	A guardian may be conferred power to decide where the represented person lives, with whom they live, whether they work and whether they have health care other than a major medical procedure (s 17)
What rules apply regarding medical and dental procedures?	If there is a full or conditional order appointing a guardian to a person, no major medical procedure can be carried out on them unless the court has consented (s 21)

Guardianship of Infants Act (NT)

This Act includes a range of provisions regarding the care of infants and rights of recognition of parents.

In the context of succession planning, the father or mother of a child may, by deed or will, appoint a person to be a guardian of a minor after the parent's death. The guardian appointed must act jointly with the surviving parent unless the surviving parent objects. In that situation, or where the guardian considers that the parent is unfit to have custody of the minor, the guardian may apply to the court for an appropriate order.

Note that the court retains a range of powers regarding removal of guardians and granting certain people – such as grandparents – rights of access.

¶2-140 Queensland

Powers of Attorney Act 1998 (Qld)

As with the legislation in the Australian Capital Territory, Queensland has extensive provisions dealing with powers of attorney. One notable feature of this legislation is the different tests that apply when assessing a donor's ability to make an enduring power of attorney and an advance health directive. These different tests are also reflected in the provisions dealing with the donor's ability to revoke a power or directive.

The Act also authorises a "statutory health attorney" for an incapacitated adult's health matter.

Allow advance health directives?	Yes (Pt 3)
Can a company be appointed?	For enduring powers of attorney the only company that can be appointed is a statutory trustee company or the public trustee
Other rules as to who can be an attorney	For enduring power, an attorney must be a public trustee, a statutory trustee company, a person who is over 18 years of age, not a paid carer or similar and – if the person would have financial powers – not a bankrupt or similar (s 29(1)) For an advance health directive, the person must be over 18 years of age and not a paid carer or the like, the public trustee or an adult guardian (s 29(2))
Signing requirement – donor	Signed by or at the direction of the donor An enduring power not signed by the donor must satisfy the following: ■ be signed by an "eligible signer" (defined as over 18, and neither a witness nor the attorney); and ■ signed and dated by an "eligible witness" (defined as notary public or lawyer). The following are **not** able to be eligible witnesses: ■ the eligible signer, attorney, relative or donor ■ an attorney of the donor, or ■ a paid carer or the like, if it relates to personal matters (ss 41, 30 and 31)
Other formal requirements	An enduring power of attorney must be in an approved form (s 46(1)) An advance health directive must be in writing and may be in the approved form (s 46(2))
Must witness certificates be included?	Yes for enduring powers – whether signed by or at the direction of the donor (s 44(4) and (5)) Yes for an advance health directive. They must be signed and dated by a doctor – other conditions apply (s 44(6))
Revocation by donor	A donor can revoke a power or directive only if the donor has capacity to give a power or directive (ss 47 and 48) Revocation of an enduring power must be in the approved form (apart from in regard to revocation of a health directive) and signed by the donor or an eligible signer on the instruction of the donor (s 49)
Revocation by attorney	An enduring power is revoked to the extent it gave power to an attorney upon that attorney's resignation, impaired capacity, bankruptcy or insolvency, death or upon becoming a paid carer or health provider or service provider for a residential service where the donor is a resident (Div 3)
Who will be the statutory health attorney?	It is a matter of working through a list, in order, starting with a spouse and ending with a close friend over 18 years of age who is not a paid carer (s 63)
What health matters can the statutory health attorney deal with?	Any matter relating to health care of the donor other than "special health care" (Sch 2)

What is "special health care"?	Removal of tissue for donation, sterilisation, termination of pregnancy, and others (Sch 2)
What happens when there is conflict between the role of attorney and the role of a guardian appointed under the *Guardianship and Administration Act 2000?*	The *Guardianship and Administration Act* (Qld) prevails (see ss 23 and 66 of that Act) (s 6A(4))

Guardianship and Administration Act 2000 (Qld)

The Act is a substantial piece of legislation that sets out in considerable detail the appointments that can be made by the Guardianship and Administration Tribunal and the rules relating to these appointments.

What appointments can be made?	The tribunal can appoint one or more guardians for personal matters or one or more administrators for financial matters (ss 13 and 14)
When will the order override enduring power of attorney?	Where the tribunal (in the knowledge that an enduring power gave power in respect of a non-health matter) makes an order giving the guardian or administrator that power, then the attorney may exercise power only to the extent authorised by the tribunal (s 23)
What if the court, guardian and/or administrator was unaware of the enduring power?	The guardian's or administrator's power is suspended pending a review (s 23)
When will the guardian or administrator's power cease?	Upon death or, if they were married to the principal, divorce, or in the case of the administrator, upon bankruptcy or insolvency (s 26)
Are health matters dealt with?	Yes See chapter 5 onwards. Note that attorneys may have a role (s 66)

Mental Health Act 2000 (Qld)

This Act provides for the involuntary assessment and treatment, and the protection, of persons who have mental illnesses. It applies to adults as well as children.

The Act gives the Mental Health Tribunal the authority to make an involuntary treatment order, in certain circumstances.

Succession Act 1981 (Qld)

This Act provides that a parent or guardian of a child may, by will, appoint a person as a guardian of the child. If the appointor is not survived by a parent of the child, the appointment takes effect on the appointor's death. If the appointor is survived by one or more parents of the child, the appointment

takes effect (1) if the will shows that the appointor intended the appointment to take effect on the appointor's death, on that date, or (2) otherwise, on the death of the last surviving parent.

¶2-145 South Australia

Powers of Attorney and Agency Act 1984 (SA)

The brevity of the South Australian legislation is in stark contrast to the Queensland legislation.

It is, however, notable that this Act includes rules that specifically deal with what happens if an attorney disposes of items bequeathed in the donor's will.

What happens if the donor becomes subject to an order under the *Mental Health Act 1977* or the *Aged and Infirm Persons' Property Act 1940*?	The administrator, manager etc appointed under the other Acts are deemed to be the donor of the power of attorney (s 10)
Are there special rules if an attorney disposes of items bequeathed in the donor's will?	Yes. The Supreme Court may make orders to protect the beneficiary (s 11)

Consent to Medical Treatment and Palliative Care Act 1995 (SA)

This Act deals with consent to medical treatment and aims to regulate medical practice so far as it affects the care of people dying and others.

The Act provides that a person over 16 years of age may make decisions about their own medical treatment as validly and as effectively as an adult.

What directions can be given about future medical treatment?	A person over 18 years of age may give a direction about the treatment the person wants or does not want if they are in the terminal phase of a terminal illness and incapable of making decisions about medical treatment (s 7(1))
How must directions be given?	In the form set out in the regulations witnessed by an authorised witness (s 7(2))
Who is an authorised witness?	A justice of the peace, commissioner for taking affidavits, member of the clergy or registered pharmacist (s 4)
What other directions can be given?	Medical power of attorney can be given by a person over 18 years of age in prescribed form witnessed by an authorised witness (s 8(1) and (2))
Who can be appointed as an agent?	A person who is over 18 years of age but not someone responsible for or involved in the medical care or treatment of the donor (s 8(5))
What can the agent do?	Make decisions about the medical treatment of the donor if the donor is incapable of making such decisions (s 8(6))

What can't the agent do?	Refuse the natural provision or natural administration of food and water, refuse administration of drugs to relieve pain or distress or refuse treatment that would result in the donor regaining capacity (s 8(7))

Guardianship and Administration Act 1993 (SA)

This Act deals with the guardianship of persons unable to look after their own health, safety or welfare or to manage their own affairs. The Act establishes the Guardianship Board which makes appointments and also the Public Advocate whose functions include overseeing programs to meet the needs of incapacitated persons.

Again, the Act is notable in that it specifically addresses succession issues not dealt with in similar legislation in some other jurisdictions, such as the dealing with property by the administrator that disadvantages a beneficiary under the will, and the making of testamentary dispositions by the protected person.

Who can be a guardian?	The Guardianship Board may by order place a person under a limited or full guardianship (s 29(1)) A guardian must be a natural person but cannot be a person who cares for the protected person on a professional basis. The Public Advocate may be appointed guardian (s 29)
What decisions can a full guardian make?	Decisions as to where and with whom the represented person lives, whether the represented person can work, may consent to certain health care and may restrict visits to the represented person (s 24)
What decisions can a limited guardian make?	As set out in the tribunal order (s 25)
Who can be appointed administrator?	The Guardianship Board may appoint the public trustee, a trustee company or any individual the board considers suitable to act as administrator. However, only the public trustee may be appointed sole administrator (s 35)
Access to wills and other records	Subject to the terms of appointment, an administrator is entitled to view and take an extract from or copy of any will or testamentary disposition of the protected person (s 40)
What if the administrator disturbs entitlements of beneficiaries?	Where at the death of a protected person it appears that, as a consequence of actions of the administrator, a person's benefit under the protected person's will has been affected, the Supreme Court may make orders addressing the matter (s 43)
Are health matters dealt with?	Yes – medical and dental treatment (Pt 5)
Can testamentary dispositions still be made by the protected person?	Yes – with the direction of the Guardianship Board and in compliance with precautions set out by the board (s 56)

Guardianship of Infants Act 1940 (SA)

Similar to equivalent Acts in other jurisdictions, this Act provides that the father or mother of a child may, by deed or will, appoint a person to be a guardian of a minor after the parent's death. The guardian appointed must act jointly with the surviving parent unless the surviving parent objects. In that situation, or where the guardian considers that the parent is unfit to have custody of the minor, the guardian may apply to the court for an appropriate order.

¶2-150 Tasmania

Powers of Attorney Act 2000 (Tas)

Signing requirement – donor	Must be signed by the donor (Sch 3)
Witnessing requirements	Enduring power must have two witnesses, neither of whom is a party, both signing in the presence of donor and each other. Other powers of attorney must have one witness who is not a party and signs in the presence of the donor (s 9)
Peculiar signing requirements	Yes. For example, the power must be on A4-sized paper, have each page consecutively numbered, alterations must be initialled etc (s 9)
Is a witness certificate required?	No, but a registration certificate is required for lodgment with the Recorder of Titles
Other special rules	Special form for appointing public trustee
When does an attorney's authority cease?	Upon revocation by the donor or upon the death, bankruptcy or insolvency of the donor (s 27)
Interaction between power of attorney and *Guardianship and Administration Act 1995*	The Guardianship and Administration Board may vary, revoke or substitute a power of attorney (s 33)

Guardianship and Administration Act 1995 (Tas)

This Act enables people with a disability to be represented by a guardian or administrator and to provide for medical and dental treatment for people with a disability. It establishes the Guardianship and Administration Board and provides for the making of guardianship orders, administration orders and to facilitate medical and dental treatment of people incapable of giving informed consent to such treatment.

Who can be guardian?	The Guardianship and Administration Board may by order place a person under a limited or full guardianship (s 20(1)) A person over 18 years of age (provided the board is satisfied that the person will act in the represented person's best interests) is suitable and will not be in a position where there is a conflict of interests (s 21)
What decisions can a full guardian make?	Decisions as to where and with whom the represented person lives, whether the represented person can work, may consent to certain health care and may restrict visits to the represented person (s 25)

What decisions can a limited guardian make?	As set out in the tribunal order (s 26)
Can a person appoint an enduring guardian?	Yes, a person over 18 years of age may by written instrument appoint a person or two or more people jointly to act as enduring guardian The appointment must be in the prescribed form witnessed by two or more witnesses and accepted by the guardians (s 32)
Who can be an enduring guardian?	A person who is not in a professional or administrative capacity, directly or indirectly responsible for, or involved in, the medical care or treatment of the appointor (s 32)
Interaction between power of attorney and administration orders	Appointment of attorney will generally take precedence unless emergency order is required (s 53)
Who can be appointed administrator?	The Guardianship and Administration Board may appoint the public trustee, the public guardian, a trustee company or any individual the board considers suitable to act as administrator (s 54)
How does an administration order affect enduring power of attorney?	Where a proposed represented person has granted an enduring power of attorney under s 11A of the *Powers of Attorney Act 1934* (Tas) or s 30 of the *Powers of Attorney Act 2000* (Tas), it is not competent for the board to make an administration order in respect of his or her estate so long as the enduring power of attorney is in force unless the order is made under Pt 8 (s 53)
What if the administrator disturbs the entitlements of beneficiaries?	Where action by the administrator is likely to affect a likely interest under a will the board may give directions including to hold money in a separate account and to keep a record of such proceeds (s 60)
Are health matters dealt with?	Yes – medical and dental treatment (Pt 6)

Guardianship and Custody of Infants Act 1934 (Tas)

Similar to equivalent Acts in other jurisdictions, this Act provides that the father or mother of a child may, by deed or will, appoint a person to be a guardian of a minor after the parent's death.

However, the Act appears to give the father greater power to appoint a guardian to act jointly with the mother than it gives the mother to appoint a guardian to act jointly with the father. In the latter case, it must be shown to the satisfaction of the court that the father is for any reason unfit to be the sole guardian of his children.

¶2-155 Victoria

Instruments Act 1958 (Vic)

Signing requirement – donor	May be signed by the donor or at the direction of the donor (ss 106 and 123(2)(b))

Witnessing requirements	For general power, no requirement (s 107 and Sch 12) For enduring power it must be signed and dated by two adult witnesses in the presence of the donor and each other. A witness cannot be the donor or attorney. Only one witness can be a relative of the donor. One witness must be a person authorised to take statutory declarations (s 125)
Is a witness certificate required?	Yes (ss 123(5) and 125A)
Must an attorney sign a statement of acceptance?	Yes (s 125B)
Who can be an attorney under an enduring power?	Any person over 18 provided they are not insolvent (ss 119 and 121)
How does the role of the attorney interact with that of guardian?	An enduring power does not authorise the attorney to make a decision about medical treatment. If any decision by a guardian conflicts with the decision of the attorney, the guardian's decision prevails (s 125F)
How does the role of the attorney interact with that of the administrator?	Where the tribunal has made an administration order the attorney may act only to the extent authorised by the tribunal (s 125G)
How is an enduring attorney revoked?	Orally or in writing or by other means Powers expressed to be irrevocable and granted to secure a proprietary interest or the performance of an obligation generally require the consent of the donor before being revoked The donor of an enduring attorney may revoke by executing an approved form, or the enduring power may cease according to its terms – eg time period expired – but will expire on the death of the donor The attorney may resign by signed notice to the donor. However, if the donor no longer has capacity the attorney must obtain leave of a court or tribunal. Power is revoked to the extent it confers power on an attorney who ceases to have legal capacity or becomes insolvent or dies The tribunal may revoke (ss 125I to 125Q)
What powers does the tribunal have?	In addition to the power to revoke, the tribunal has broad powers including to direct an attorney and vary the effect of an enduring power (Div 6)

Medical Treatment Act 1988 (Vic)

Who is an authorised witness?	At least one of the witnesses must be a person authorised by law to take and receive statutory declarations (s 5A(2)(a))
What can the agent do?	Make medical decisions including a decision to refuse medical treatment. This is on the condition that: ■ the medical treatment would cause unreasonable distress to the donor, or ■ there are reasonable grounds for believing that the donor, if they had been competent, would consider that the treatment is unwarranted after giving serious consideration to their health and wellbeing (s 5B)
What conditions apply?	A registered medical practitioner and another person must be satisfied that the agent or guardian was properly informed before making the decision. If refusing medical treatment, the agent or guardian must complete a certificate in the prescribed form (s 5B and Sch 3)
Can a person have two or more medical agents?	Not acting at the same time. An alternate agent can be appointed (s 5A)
What type of decisions cannot be made by an agent?	An agent cannot *refuse* palliative care – defined to be the provision of reasonable medical procedures for the relief of pain, suffering and discomfort or reasonable provision of food and water (Sch 3)

Guardianship and Administration Act 1986 (Vic)[9]

Who can be a guardian?	The Guardianship Board may, by order, appoint a plenary guardian or a limited guardian (s 23(1)) A person over 18 years of age (provided the Guardianship Board is satisfied that the person will act in the represented person's best interests) is suitable and will not be in a position where there is a conflict of interests (s 23 (1))
What decisions can a plenary guardian make?	Decisions as to where and with whom the represented person lives, whether the represented person can work, may consent to certain health care and may restrict visits to the represented person (s 24)
What decisions can a limited guardian make?	As set out in the tribunal order (s 25)
Can a person appoint an enduring guardian?	Yes, a person over 18 years of age may by written instrument appoint a person or two or more persons jointly to act as enduring guardian Appointment must be in the prescribed form and witnessed by two or more witnesses and accepted by the guardians (s 35A)

9 The Victorian Law Reform Commission is currently (2011) conducting a review of this Act.

Chapter 5

Testamentary trusts

¶5-100 Introduction

In this chapter, we discuss one of the most popular succession planning strategies today – testamentary trust wills. Testamentary trust wills can deliver significant taxation and asset protection benefits to beneficiaries and are a common subject of discussion between accountants, financial advisers and their clients.

Any trust established under a person's will is technically a testamentary trust. However, the term "testamentary trust" is commonly used to describe a discretionary trust established by a will that operates in a similar way to a family trust, in that the trustee has a broad discretion to distribute income and capital among a wide class of beneficiaries. In this chapter, the terms "testamentary trust" and "a testamentary trust will" are used in this context.

This chapter will also refer, from time to time, to the term "primary beneficiary". We use that term to describe the person who is intended to be the main beneficiary. For example, when a husband dies, his wife will usually be the primary beneficiary of a testamentary trust established under his will. When the wife dies – if her will establishes a separate testamentary trust for each of her children – each child will usually be the primary beneficiary of their own respective trust. It is not essential to have a particular primary beneficiary, but in practice – just as is the case with family trusts – it is common for each trust to have one as it helps with the operation of the trust.

¶5-105 What are testamentary trusts?

Testamentary trusts are simply trusts established under a will. Because a will only operates upon the death of the willmaker, a testamentary trust only comes into operation (if at all) after the willmaker's death – generally when the executor first transfers assets into the trust. A will may make provision for one or more testamentary trusts.

A will can be drafted so that the testamentary trust is effectively bypassed. It is possible to draft a will that provides for a testamentary trust but, at the same time, allows a beneficiary to elect to take a distribution directly and avoid the expense of operating a testamentary trust.

Cost is a factor when considering testamentary trusts, both at the willmaking stage and when the trust is established following death. Willmakers should understand that the cost of a testamentary trust will is usually considerably more than the cost of a normal will. The cost can vary significantly, but generally tends to be in the range of $1,500 and above. Once created, a testamentary trust will incur certain ongoing annual costs – such as the cost of lodging a taxation return. These costs can also vary, but would generally be at least $400 per annum per trust.

Whether it is worthwhile making a testamentary trust will usually depend on the following factors:

- the size of the estate – the annual operating costs usually make the cost of a testamentary trust prohibitive if the trust will have less than about $300,000 in assets;

- the protection needs of the primary beneficiary. If a beneficiary is at risk of bankruptcy or suffering a disability, then it will generally be worthwhile making a testamentary trust will – regardless of the likely value of the assets; and
- the personal needs of the beneficiary. If the beneficiary has no need for protection and will simply use the funds to pay off their mortgage, then the cost of maintaining a testamentary trust will may not be justified.

¶5-110 Income tax advantages

The taxation advantages of a testamentary trust can be significant.

Excepted trust income

The main advantage arises because minor beneficiaries – that is, beneficiaries under 18 years of age – are taxed at normal adult rates on excepted trust income distributed to them.[1] This means that minor beneficiaries are not taxed at the penalty rates[2] that generally apply to minors. They are taxed as adults and therefore receive the benefit of the progressive taxation rates, including the tax-free threshold. Income earned on assets forming part of the trust will generally be "excepted trust income".

Although the extent of the taxation benefit will vary depending on the circumstances of the willmaker and the beneficiaries – and the tax rates and law at the relevant time – the tax benefit derived from testamentary trusts can be substantial.

Example

Chang dies leaving an estate comprising an investment portfolio valued at $1.2m.

Chang leaves his whole estate to his widow Li, who already earns $120,000 per annum. Li is glad that Chang left her the investment portfolio which she will use to look after their three children, aged between eight and 14.

In the first year after Chang's death, Li receives income of $72,000 from the investment portfolio.

As she already has income of $120,000, the tax that Li will pay on the $72,000 will be approximately $30,500.

If Chang had established a testamentary trust instead, Li could have distributed the $72,000 trust income in that first year equally between the three children – that is, each child would have received $24,000 income. As each child would be taxed as an adult, the tax payable per child could be said to be:

Tax on $24,000 = approximately $700

Total tax payable 3 x $700 = $2,100

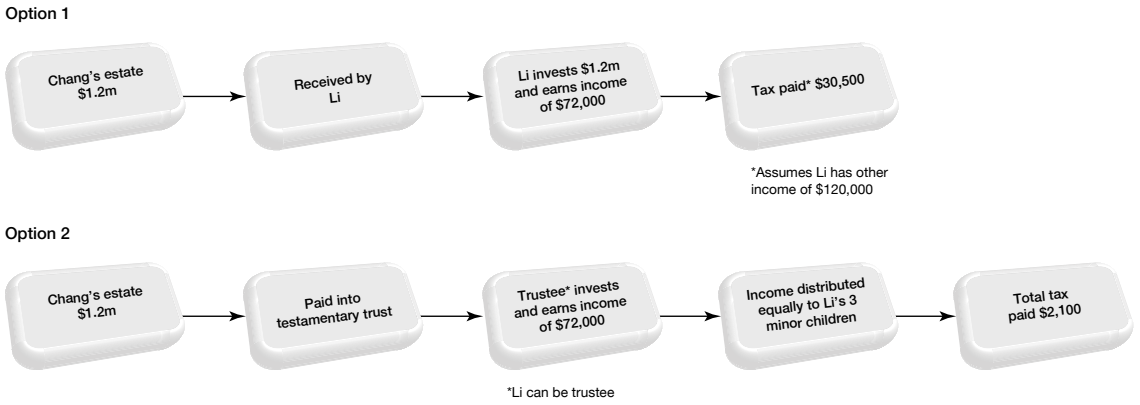
The tax saving would be $30,500 – $2,100 = $28,400 in one year alone!

1 S 102AG(2)(d)(i) ITAA36.

2 Penalty rates are imposed by Div 6AA ITAA36. The penalty rates provide that the first $416 of "eligible taxable income" is tax-free, the amount between $416 to $1,455 is taxed at 46% and any excess is taxed at 47%.

Example (cont)

The savings over a number of years would be highly significant.



Other taxation advantages

Testamentary trusts can be used to deliver other tax-related benefits to certain beneficiaries, similar to the benefits enjoyed by family trusts.

Streaming of income

Testamentary trusts can be used to stream different categories of income – such as franked dividends – to different beneficiaries. Having this flexibility can help reduce the overall taxation burden of beneficiaries.

Example

Bridget is trustee of a testamentary trust that has earned income of $6,000 in interest and $6,000 in fully franked dividends. She wishes to distribute $6,000 to each of two beneficiaries. One beneficiary, Yuval, is a minor with no other income. The other beneficiary, Isabella, is an adult with $20,000 in other income. Bridget can choose to help Isabella obtain a better tax position by distributing the interest income to Yuval and the dividend income – with franked credits attached – to Isabella.

Tax-exempt entities

By naming tax-exempt entities – whether charitable or not – as a class of beneficiaries in a testamentary trust, a trustee will be able to distribute pre-tax income from the trust to a tax-exempt entity. This can deliver a better outcome for a beneficiary who otherwise might have given their own after-tax income to the tax-exempt entity.

Example

John wishes to donate money to the Collingwood Football Club. Being a tax-exempt entity, the Collingwood Football Club is also a beneficiary of the testamentary trust of which John is trustee. Instead of making a personal donation of after-tax income to the club, John can make a distribution directly from the testamentary trust.

Lower taxed beneficiaries

The discretionary nature of a testamentary trust also enables the trustee to distribute income to adult beneficiaries whose marginal taxation rate is low. This provides the flexibility to distribute income to, for example, the spouse of a primary beneficiary.

No CGT on passing of assets owned by deceased to beneficiary

Division 128 ITAA97 does not make it clear whether a CGT event arises when assets owned by the deceased are transferred to the beneficiary of a testamentary trust. It has generally been argued that there should not be a taxing point at that time based on the intention of the government when introducing the legislation as evidenced by (among other things) the explanatory memorandum to s 160X ITAA36 (the precursor to s 128-15 ITAA97).

In 2003, the ATO issued PS LA 2003/12 in which it acknowledged the uncertainty surrounding this issue and confirmed that the ATO "will disregard any capital gain or capital loss that arises when an asset owned by a deceased person passes to the ultimate beneficiary of a trust created under the deceased's will".[3]

In the 2011 federal Budget, the government announced that it would amend legislation to reflect the ATO's approach.

Note that gains or losses are not disregarded where the gift passes to a tax-advantaged entity under s 104-215 (see ¶11-120).

3 Para 3.

Public policy and future reform

The taxation advantages of a testamentary trust can be significant. It is possible that they will be the subject of legislative reform.

Governments in Australia – on both sides – have traditionally shied away from making any type of reform that involves death and taxes. Perhaps such changes are perceived to be election risks, often as a result of "death duty" scaremongering. It will be interesting to see if, in the future, a government forms the view that the excepted trust income rules require legislative reform.

¶5-115 Asset protection advantages

Testamentary trusts also offer significant asset protection advantages. A beneficiary does not own the assets in a testamentary trust so this provides scope for asset protection, similar to that which a family trust provides. However, there is a degree of uncertainty about the extent of protection that will extend to trusts in certain circumstances.

Protection from creditors: beneficiaries

Creditors pursuing a person who is a beneficiary of a testamentary trust generally will not be able to access the assets of the testamentary trust as these assets are not owned personally by the beneficiary.

As the testamentary trust is a discretionary trust, a beneficiary does not have a proprietary right in the assets of the trust – they only have a right to ensure that the trust is properly administered. The beneficiary, therefore, does not have a right that can vest in the trustee in bankruptcy[4] and the assets of the trust cannot be accessed by creditors. However, some commentators[5] have noted that the beneficiary has a right to ensure that the trust is properly administered. Arguably, this is a personal right that could vest in – and be exercised by – a trustee in bankruptcy. If this is the case, the trustee in bankruptcy might be able to cause the trustee and beneficiaries some discomfort by seeking to be satisfied that the trust is being properly administered. However, the trustee in bankruptcy would still have no entitlement to, or real control over, the trust assets.

Protection from creditors: trustees and appointors

Often the primary beneficiary will also be, or control, the trustee and appointor of the testamentary trust. The question that arises is whether the trustee in bankruptcy can step into either or both roles and help cause income or assets to be distributed to the beneficiary – which would expose the income or assets to the trustee in bankruptcy. There is little doubt the trustee in bankruptcy could not step into the trustee's shoes and act in this manner. The *Bankruptcy Act 1966* carves out property held by the bankrupt on trust for another person. Arguably the trustee in bankruptcy would, in any event, be

4 See, for example, *Gartside v Inland Revenue Commissioner* [1968] AC 553; *Dwyer v Ross* (1993) 34 FCR 463.

5 See, for example, the paper by G Halperin, "Defending the trust ramparts", The Tax Institute Victorian State Convention 2007, available from taxinstitute.com.au.

restrained from taking on the role of trustee because of the clear conflict of interest that would arise if they did.

There is strong authority[6] to support the view that the role of appointor is also fiduciary in nature and does not give rise to proprietary rights that could vest in the trustee in bankruptcy. It is unlikely that a trustee in bankruptcy could step into the shoes of a bankrupt appointor and use the appointor powers to appoint a new trustee who would then act in accordance with the trustee in bankruptcy's wishes.

The view that the role of appointor is fiduciary in nature does not appear to be shared by the Family Court (see below), and it remains to be seen whether other courts will take a similar approach in the future.

Decisions of the Family Court – and, arguably, cases such as *Richstar*[7] – serve as a warning to advisers and their clients. The view of the courts towards trusts and protection of assets is understandably influenced by the circumstances of each particular case. There is a risk that the level of protection to beneficiaries from creditors traditionally associated with family trusts may deteriorate. It might be argued that the historical notion of equity protecting the rights of beneficiaries is being challenged by the modern-day use of trusts to avoid responsibilities in some cases. Note the following comments by Justice Young in *Gregory v Hudson*:[8]

> "During argument, I remarked that the discretionary trust set up in the instant case was one which makes a Judge in Equity in 1997 wonder why equity courts are bothering with this sort of trust at all. Trusts, and at an earlier time, uses, were enforced by courts of equity because it was against the conscience of the holder of the legal estate not to carry out the promise that had been made to hold the property concerned on the trust expressed in the instrument. However, where the trustee can virtually designate who is to be the beneficiary, this ground has no validity at all. When one sees that discretionary trusts are used for the anti-social purpose of minimising taxation or defeating the rights of wives (see for example *Re Davidson's Trust No 2* [1994] FLC ¶92-469), there does not seem to be any reason in conscience why a court of equity should take any notice of them at all. Counsel were surprised that any judge should take this view and accordingly I announced during the argument that I would not seek to develop it in this case, but I believe that the message should be put abroad that the time may well have come where equity will have to reconsider its attitude to enforcing this sort of trust."

Tip

To reduce the possibility of creditors having access to the assets of a testamentary trust, a willmaker might consider appointing two appointors and trustees – who truly act jointly – or including provisions in the trust term that terminate a person's role as trustee and appointor if they are declared bankrupt.

6 See, for example, *Re Burton*; *Ex parte Wily v Burton* (1994) 126 ALR 557; *Pope v DPR Nominees Pty Ltd and Ors* [1999] SASC 337.

7 *Richstar Enterprises Pty Ltd v Carey* [2006] FCA 814.

8 [1997] NSWSC 140.

Protection from divorce

In recent years, the Family Court has shown a willingness to treat assets held in a family trust as property of a party in circumstances where that party (directly or indirectly) controlled the trust or otherwise treated the assets of the trust as their own property. In these cases, the Family Court has either:

- regarded the assets of the trust to be a "financial resource" of the party, which were taken into account when the court divided the property pool;[9] or
- regarded the assets of the trust as part of the property pool that can be divided between the parties.[10]

One question that arises is whether the Family Court will distinguish between a person's interest in a family trust created by another person during that person's lifetime or a person's interest in a testamentary trust.

In *Ward & Ward*,[11] the husband was one of three siblings. His mother amended her will and instead of giving him a one-third share of the estate absolutely the one-third share was to pass to a testamentary trust, the beneficiaries of which were the husband and his two children and the trustees of which were the husband's sister and the mother's solicitor. The husband admitted under cross-examination that the purpose of the change was to put the inheritance out of reach of his wife. The mother died in 2003 and the family law case came before the court in 2004. The court said that the trust assets would not be brought into the marital property pool, but were a financial resource. Notwithstanding this decision, in my view a court would not hesitate to regard assets held in a testamentary trust as being part of the divisible property pool if that was required in order to produce a just outcome for the parties.

The following principles (some of which are not new) emanate from the cases referred to above:

- if a person controls a trust as appointor or trustee, the Family Court can regard the assets of the trust as effectively belonging to that person, and make orders which affect the trust (eg ordering the trustee to distribute assets from the trust to the person's spouse);
- the Family Court can regard a person to be in control of a family trust even if the person is not trustee or appointor (eg where the person's accountant or sibling is appointed to those positions);
- the Family Court can make orders affecting a trust even where the trust has been established and funded by the person's parent(s) (ie it is not necessary for the assets of the trust to be accumulated through the efforts of the parties of the marriage, during the marriage – see *Ogden & Ogden*[12] and also *Essex & Essex*[13]); and

9 See, for example, *Essex & Essex* [2009] FamCAFC 236 and *Ogden & Ogden* [2010] FMCAfam 865.

10 See, for example, *Kennon v Spry* [2008] HCA 56; *Ashton v Ashton* (1986) FLC ¶91-777; *Goodwin v Goodwin* (1991) FLC ¶92-192; and *Davidson v Davidson* (1991) FLC ¶92-197.

11 [2004] FMCAfam 193.

12 [2010] FMCAfam 865.

13 [2009] FamCAFC 236.

- where several people control a single trust but the will/trust deed gives certain beneficiaries the power to control a portion of the trust (eg the power to appoint a separate trustee to "their" portion of the trust) the court can treat each "portion" as property belonging to a sibling (this was the case in *Ogden*) and make orders which affect a sibling's "portion".

So, what does a willmaker do if they are concerned their child might, after receiving their inheritance, suffer a relationship breakdown which will result in the ex-spouse getting a share of that property? Options may include:

- if the willmaker has several children, establish a single testamentary trust with all children as joint controllers (but without the ability to control portions, as per *Ogden*). However, this assumes the children will get on well enough to successfully manage the trust, including making decisions regarding investments and distributions. And what happens if one child dies? Careful planning and drafting is required;
- appointing a truly independent trustee, perhaps accompanied by a letter of wishes. Is this worth the cost and lack of control for the children?
- giving the children only a limited interest (eg income only) in the trust;
- by-passing the children by setting up trusts for the grandchildren; and
- suggesting to the child that they and their partner enter into a binding financial agreement.

See chapter 21 for a more detailed discussion of family law issues and strategies.

Recent changes to relationship laws in Australia mean that a de facto (including same sex) partner may have an entitlement to assets of a trust following a relationship breakdown.

Tip

The Family Court has very broad powers and can direct trustees of trusts to make provision to parties of a relationship that has broken down.

It is crucial that clients are made aware of all of the relevant issues.

Protection from beneficiary

If a primary beneficiary has a problem such as gambling or drug dependency, a testamentary trust controlled by an independent trustee can protect the assets from being wasted. At the same time, the trust can be used to look after the long-term interests of the beneficiary, as well as others such as the beneficiary's children.

Example

Mika makes a will leaving her estate (valued at $3m) to her three children equally. Sadly, Mika dies soon after.

Shortly after Mika's death:

- her eldest son Zoran, an accountant, was sued by a client and his inheritance formed part of a settlement with the client;
- her daughter Marina used her inheritance to pay off the mortgage on her marital home. Unfortunately, her husband was awarded half of the value of the home when they divorced some years later; and
- her youngest son Novac wasted his inheritance on drugs. He is now reformed, but regrets squandering the money.

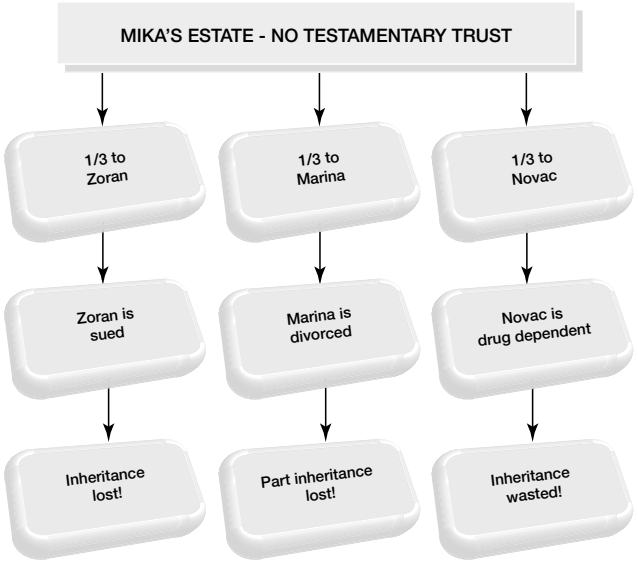
If Mika had established three testamentary trusts:

- Zoran's inheritance would have been protected from creditors;
- Marina's inheritance may have been out of her husband's reach (but may not – see ¶21-110); and
- Mika could have appointed an independent trustee of the trust for Novac and prevented him from wasting his inheritance on drugs.

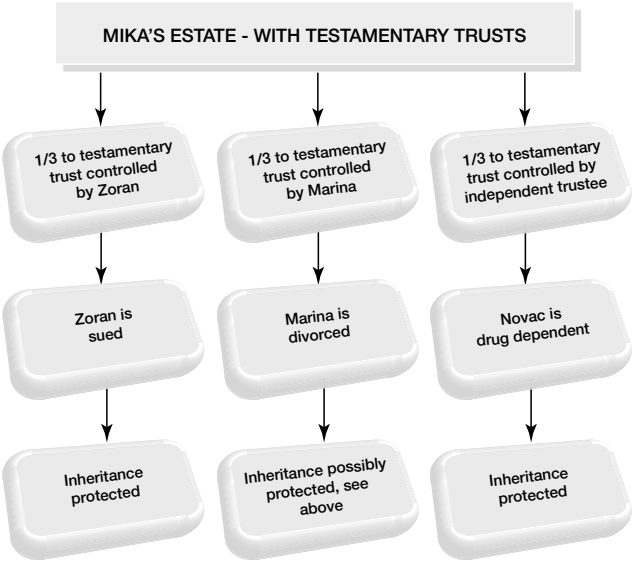
Tip

It may be prudent to suggest to clients that they (or their children!) consider entering into binding financial agreements in an attempt to protect the inheritance.

Scenario 1



Scenario 2



Protection for beneficiary

If a beneficiary is unable to manage their inheritance, a testamentary trust with independent trustees will help protect the assets and provide for the beneficiary's long-term needs.

As noted above, a willmaker may wish to encourage a beneficiary to enter into a binding financial agreement in order to protect a planned inheritance. Binding financial agreements should be prepared by a family law lawyer and the same lawyer/law firm must not advise both parties.

Advisers need to be aware of situations that may give rise to a conflict of interests.

¶5-120 Possible disadvantages

It is important to be aware of the possible shortcomings of testamentary trusts. These will not be relevant to every testamentary trust.

Cost

In addition to the likely additional cost borne by the willmaker when making a testamentary trust will, establishment and operating costs will be incurred by the testamentary trust itself. For example, taxation returns must be lodged for each testamentary trust and, in most cases, separate accounts need to be kept. These costs are relevant when considering not only whether to establish a testamentary trust but also how many to establish – see Michael's example in ¶5-125.

Loss of main residence CGT exemption

Depending on the structure of the testamentary trust, the main residence CGT exemption may not be available in respect of a dwelling held by the trust – see ¶11-120.

Family trust elections

A non-fixed trust – which a "typical" testamentary trust will be – will need to make a family trust election in order to transfer trust losses. Making a family trust election may be problematic where the trustees attempt to clone a trust. According to the ATO,[14] if the original trust made a family trust election the "cloned" trust must follow that election – although there is some doubt as to the correctness of this view.

Land tax

In certain jurisdictions, holding land in a testamentary trust may give rise to land tax issues.

Control

Always be aware that the trustee of a testamentary trust has significant discretions and usually there is little or no real-time monitoring of their activities. This may not be an issue where the alternative (to establishing a testamentary trust) was to leave the inheritance directly to the "controller" – either way they could misappropriate/waste the money. However, where the intention is to benefit beneficiaries of the testamentary trust other than the controller, the selection of trustees is particularly important. Of course, trustees can be overseen by an appointor.

Tip

It is possible to limit the trustee's discretion by inserting certain default provisions in the terms of a testamentary trust, such as a provision directing that each child and their descendants receive a fixed share of the capital and even income of the trust.

Trap

However, this may make a fixed share more likely to be regarded as property of the marriage of the relevant child by the Family Court – see ¶21-110.

14 TR 2006/4.

Transferring control

The discretionary nature of a testamentary trust necessarily means that there will be risk that at some stage the control of the trust will rest with people who may not be the most appropriate trustees or appointors – see ¶5-125 onwards.

¶5-125 Structuring issues

Many of the features of a testamentary trust are similar to those of a family trust. Matters such as the discretionary nature of the trust, the presence of broad investment powers and the nomination of appointors' provisions are usually features of both types of trusts. However, this should not automatically be the case. The terms of a testamentary trust should be tailored according to the willmaker's wishes, which are usually influenced by the beneficiary's likely needs.

Who should be trustee?

In many cases, it will be appropriate for the primary beneficiary to be nominated as trustee of "their" testamentary trust. However, the nomination happens at the time the will is made and so the usual caveat applies. Lots of things can happen between then and the date of death, so a willmaker should always consider the possibility that circumstances may change during that time – and these changes could make it inappropriate for the primary beneficiary to be the sole trustee of the testamentary trust.

As discussed at ¶5-115, the changing attitude of the courts also suggests that it may be worthwhile considering appointing two trustees and appointors to reduce the risk of the trust assets being regarded as the primary beneficiary's own property.

This leads to other issues – if a second trustee and appointor is going to be named, who should it be? If the concern is that the primary beneficiary may divorce, then clearly it should not be their spouse. Often it is appropriate to appoint an independent person, such as the primary beneficiary's accountant or adviser – see the discussion on appointing executors and trustees in ¶3-160.

If the primary beneficiary is a minor, or not at an age at which the willmaker would want them to take control of their inheritance, it is common for the willmaker's executors to act as trustees of the testamentary trust until the beneficiary reaches the appropriate age. Further consideration could be given to not making the child's appointment as trustee automatic in case the child is experiencing problems at that time – for example, family law or creditor issues.

A will should clearly set out the process to be followed when appointing new trustees. Explaining these options to the willmaker and carefully drafting the will is a critical part of planning for testamentary trusts. For example, the will can name who is to become the trustee if the nominated trustee is unable to act or continue to act. Alternatively, the power to appoint additional or replacement trustees can rest with the appointed trustees.

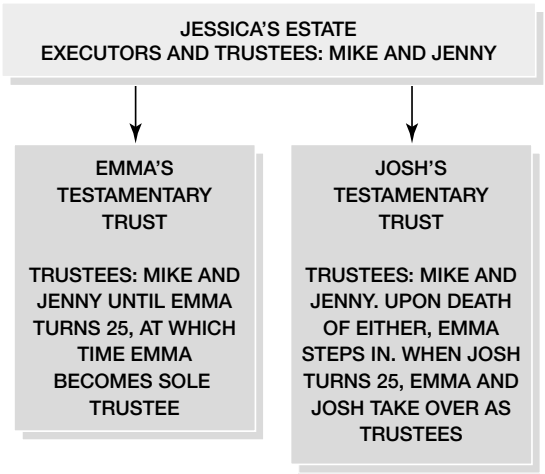
Example

Jessica has two children, Emma and Josh. She wishes to make a will under which separate testamentary trusts will be created for them. The executors and trustees of Jessica's will are her siblings, Mike and Jenny.

Jessica is confident that Emma, aged 21, is a mature and stable young woman. Josh is 18 years of age but has some behavioural issues and Jessica is concerned that he has some friends who could easily manipulate him. Jessica would prefer it if Emma took control of their inheritance when she reached 25 years of age and that Josh never had sole control of his trust. However, Jessica would like Josh to feel that she at least trusted him to have a role in the management of his trust.

Jessica could choose to structure trusteeship so that:

- Mike and Jenny act as trustees of each trust until the primary beneficiary turns 25;
- when Emma turns 25, she becomes the sole trustee of her trust; and
- if either Mike or Jenny cease to be a trustee before Josh turns 25, Emma steps in. When Josh turns 25, both Emma and Josh become trustees of Josh's trust.



By making this arrangement, Jessica is confident that Josh will not waste his inheritance. She could also consider providing that Josh becomes the sole trustee of his trust at a later age, such as 35.

Predeceasing beneficiaries

It is always important for a will to cater for the possibility of a beneficiary either predeceasing the willmaker or dying before attaining the age at which they inherit their gift or take control of any testamentary trust. In the context of testamentary trusts, one option of addressing this risk is to make the establishment of the testamentary trust conditional upon the beneficiary attaining the age at which they take control of their trust. However, many wills are drafted so that the testamentary trust is created upon the death of the willmaker. This raises the question as to what should happen if the beneficiary does not live to attain the age at which they can control their trust. In the example above, if Emma died at the

age of 24 – leaving a child of her own – who would control her trust and what risks would arise? Having considered these risks, does the willmaker wish to address them?

Example

Emma dies at the age of 24 and is survived by a son Harry, aged one. Harry is cared for by Emma's partner Tom.

Assume that the will directs Mike and Jenny to continue to act as trustee of the trust until Harry is 25 years old. What can go wrong and how might this be addressed?

Risk	How addressed
Mike and Jenny always disapproved of Tom and don't feel particularly close to Harry. In reading the trust deed one night they were delighted to discover that their own children are included in the class of general beneficiaries – because they are first cousins of the primary beneficiary, Emma. Mike and Jenny decide to pay income to their own children with only a paltry amount to Harry.	If this is a concern, then Jessica could consider appointing an independent trustee if Emma dies and was survived by a child.
Mike and Jenny have little idea about investments, but regularly receive emails from a friendly chap in Nigeria who seems to need a bit of help.	Jessica could consider appointing an independent trustee with expertise in investments and excellent account-keeping procedures. She could require the trustee to provide Mike, Jenny, and/or her accountant with regular statements. Alternatively, Jessica could appoint Mike and Jenny as trustees and clearly direct them to consult with her financial adviser before making any material investment decision for the trust.
Mike and Jenny are already well into their 60s and are not likely to still be alive by the time Harry turns 25. Already their memories are starting to falter.	Jessica could provide for the automatic appointment of an independent trustee following the death or incapacity of either Mike or Jenny – or when they reach a certain age.

This example demonstrates a key component of the succession planning process – identifying risks and solutions and then considering whether the willmaker wishes to spend time, effort and money to eliminate or reduce those risks. Some people will look at risks and be willing to spend a reasonable amount to get their succession plan right. Others' eyes will glaze over and they will simply say that near enough is good enough. There is really no right or wrong decision – the critical thing is:

- if you are an adviser – you look after your client's interests by telling them what can go wrong and how it can be addressed; and
- if you are the willmaker – you make an informed decision.

How many trusts?

Some people spend a lot of time on proper structuring (or expensive restructuring) of their affairs, but then fail to get it right when establishing testamentary trusts.

For example, wills for a married couple often provide that – on the death of either of them – a single trust is established for the survivor. On the death of the survivor, separate trusts are set up for each of the children. In this situation, when the surviving spouse dies, there will be:

- an existing testamentary trust that arose after the first spouse died; and
- new testamentary trusts for each of the children arising from the will of the spouse who died second.

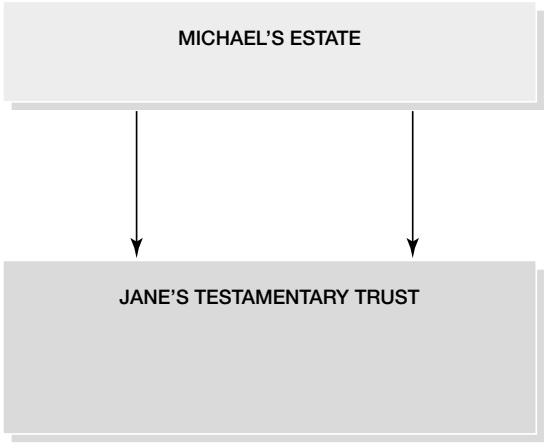
One potential problem here is the control of the existing testamentary trust. Dealing with this requires an analysis of issues similar to those that apply when dealing with transferring control of a family trust (see chapter 14). However, the need to deal with this might have been avoided if – when the first spouse dies – a number of testamentary trusts mirroring the number of children are established. The surviving spouse could maintain control of each trust – as trustee/appointor – but the terms of each trust could provide that when he or she dies each child automatically becomes trustee and appointor of their respective trust.

Example

Michael and Jane make wills leaving the whole of their respective estates in a testamentary trust to be controlled by the survivor. When the survivor dies, their assets are to be split into three equal shares and held in a testamentary trust for their children – Jack, Annie and Joseph.

Let's look at what happens when the first of them, Michael, dies:

Figure 1

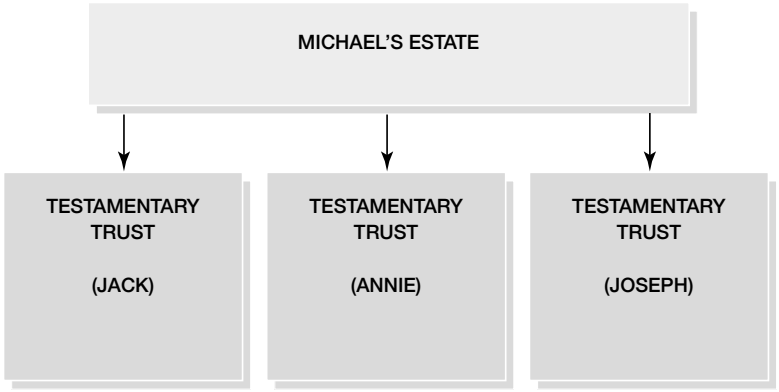


The potential issue this creates is that – when Jane dies – control of the testamentary trust needs to be transferred to Jack, Annie and Joseph. This may not be prudent – for example, they may not get on with each other.

Example (cont)

If Michael had established three testamentary trusts instead, he could have named Jane as trustee and appointor of all three trusts during her lifetime – and nominated one child as the new trustee and appointor of each trust after her death.

Figure 2



There are other advantages of this strategy – but also some disadvantages and risks. The advantages include the following:

- If Jane advances money for a particular child, she can do that from the trust allocated to that child. This is a neat way of ensuring that each child is treated equally – assuming that this is desirable – and removes the need for complex recording of transactions. It also eliminates the risk of disputes arising about adjustments for inflation if different children receive distributions or loans at different dates.
- If one child, such as Jack, predeceased Jane – leaving children of his own – then Jane could appoint independent trustees to take over trusteeship on her death so that the trust benefits Jack's children. If there was a single trust, it could be more difficult to ensure that Jack's children are provided for. For example, Annie and Joseph might have control of the single trust and look after themselves to the detriment of Jack's children and spouse.

Some disadvantages and risks with this strategy include:

- the cost of operating multiple testamentary trusts;
- the possibility that Jane will invest the money in each trust differently, resulting in the children receiving unequal amounts;
- the possibility that Jane will not take equal drawings from each of the trusts, resulting in the children receiving unequal amounts; and
- is there an increased risk that the Family Court will treat property of a trust as a financial resource or property of the relevant child?

¶5-130 Nominating appointors

It is common, but not essential, for a testamentary trust to create the position of appointor and to nominate the first appointor – typically the primary beneficiary. The role of appointor is important as they have the right to replace the trustee. This means that they generally have the real control over a trust fund. A properly drafted appointor clause can also help ensure that control of the trust passes to the desired person when the original appointor dies.

When drafting an appointor clause, you need to consider:

- empowering the appointor to appoint a replacement on their death or incapacity. Death is often dealt with but incapacity overlooked, which means that the trust has no active appointor during any period in which the appointor is incapacitated;
- naming an alternative appointor in case the preferred appointor dies or becomes incapacitated without appointing a replacement;
- empowering the appointor to appoint and remove additional appointors;
- directing whether decisions by multiple appointors must be unanimous or by majority; and
- setting out rules for meetings of multiple appointors.

Tip

Although the role of the appointor is a valuable one, don't forget that the trustee also has significant powers. For example, by the time the appointor becomes concerned that the trustee may be acting inappropriately, the trustee may have already resolved to distribute most of the assets to a particular beneficiary. The appointor could still exercise their right to remove the trustee, but by then it might be too late – the resolution would usually stand.

¶5-135 Testamentary trust powers

Investment powers

When drafting a testamentary trust, you need to consider if it is desirable to:

- expressly forbid certain investments or limit the trustee's power to vary investments;
- impose a different standard of care on the trustee when investing trust funds – this level could be higher or lower than that which would otherwise apply; and
- remove or vary the requirement that trustee legislation imposes on trustees to review the performance of trust investments at least annually.

Power to lend

Another issue to consider is whether the trustees should be permitted to lend moneys to beneficiaries – including a trustee/beneficiary – and, if so, on what terms and with what security.

For asset protection reasons, a loan to a beneficiary may be preferable to a capital distribution.

Example

James is a beneficiary of a trust and has recently married. He asks the trustees to make a capital distribution from the trust to enable him and his wife to buy a house. The trustees could simply make a distribution, but a better result for James (and other beneficiaries) might be for the trustees to provide an interest-free loan secured by a first mortgage over the property.

By doing this, the loan from the trust would be repayable and, hopefully, able to be repaid, if James subsequently divorced. James might then have the opportunity to benefit from the repaid capital at some time in the future. This contrasts with the situation where a capital distribution has been made to finance the purchase, in which case James's spouse might end up with a percentage of the property as part of the divorce settlement (although see comments at ¶5-115 regarding rights of spouses in relationship breakdowns).

Tip

Consider whether the first mortgage can be entered into at a rate of interest payable "on demand". This might further protect the testamentary trust in the event of divorce as the amount owing to the trust would – once the demand is made – increase above the original principal amount by the inclusion of accrued but unpaid interest.

Power to amend

Many testamentary trust wills in the marketplace include a broad amending power. However, it is not clear whether such a power is valid. A testamentary trust is part of a will and it is unusual for anyone to have power to amend a will after the willmaker's death. Therefore, care needs to be taken on this issue. Rather than rely on the existence of an amendment power, it is better to include all the necessary clauses in the first place.

Assuming that such an amending power is valid, how broad should the power be? Should the trustee have the power to add or remove beneficiaries? Would that infringe the rule against delegation of testamentary power[15] – at least in those jurisdictions where the rule remains?[16] The New South Wales decision of *Gregory v Hudson*[17] stands as authority that a will can gift property to an existing family trust without breaching the rule against delegating testamentary power. This is despite the fact that the

15 As enunciated in *Tatham v Huxtable* (1950) 81 CLR 639.

16 Currently NSW, WA and SA.

17 [1997] NSWSC 140; then on appeal [1998] NSWSC 582.

trustee of the family trust had the power to vary beneficiaries. In that case, the family trust contained a clause giving the trustee power to add anyone as a beneficiary – apart from the settlor, his legal personal representative and his children.

Self-dealing

The self-dealing rule is different to the fair dealing rule.[18] Together these rules properly fall under a discussion of conflict of interests – a topic beyond the scope of this book.

A common feature of a typical testamentary trust is that a trustee is also a beneficiary. Obviously this gives rise to a conflict of interests. But a trustee has a duty to avoid a conflict of interest – so how can a person remain as both a trustee and a beneficiary? The answer is that the trust instrument has authorised the beneficiary to be a trustee, notwithstanding the conflict.

But what about a situation where a primary beneficiary was not an original trustee of a trust and the trust instrument does not expressly authorise the trustee to distribute income to themselves? In that case – if the primary beneficiary becomes the trustee – could the primary beneficiary distribute income or capital of the trust to themselves? It is likely that they couldn't.

Another situation that needs to be considered is if the trustee wishes to purchase trust property or borrow from the trust. In such cases, is it enough for the trustee to rely on a clause in the will that empowers the trustee to sell an asset to a beneficiary or to lend trust moneys to a beneficiary – on the basis that the trustee themselves is a beneficiary? The better view is that the will should expressly give a trustee that power.

¶5-140 Alternatives to testamentary trusts

If a person has a family trust, one alternative to establishing a testamentary trust is to name the family trust as a beneficiary of the estate. Income from assets that pass to the family trust that is distributed to minors would be taxed concessionally.[19] However, entitlement to concessional rates of taxation will generally be limited to income from the transferred assets – and not from any asset subsequently acquired. This is in contrast to a testamentary trust where all the income of the trust estate is able to be taxed concessionally.[20]

There may be other disadvantages in transferring assets into a family trust. These include:

- uncertainty surrounding the control of the family trust at the time of death;
- possible liabilities of the family trust – especially if it carries on a business; and

18 For a useful description of the two, see *Tito v Waddell (No. 2)* [1977] Ch 106 at 241.

19 S 102AG(2)(d)(i) ITAA36.

20 S 102AG(2)(a) ITAA36.

- possible disputes in the family trust – such as claims by disaffected children or claims by a former spouse.

Also, as the family trust will have been established prior to the deceased's date of death, the vesting date for the family trust will necessarily be sooner than the possible vesting date of any testamentary trust that the deceased might have established.[21]

¶5-145 Forward planning and Pt IVA

One of the peculiarities of testamentary trust planning is that they are often created for wealthy willmakers. However, for asset protection reasons, wealthy willmakers, such as professionals and business owners, tend to hold very few assets in their own name. As we have seen above, the benefits that flow from a testamentary trust are maximised where assets of a significant value form part of the estate – such as assets in the willmaker's sole name.

This gives rise to the question: when is it possible to move assets into a person's name to take advantage of benefits that flow from testamentary trusts?

Example

Michael and his wife, Cate, are both partners in a leading law firm. On the advice of their accountant, Michael and Cate have been careful to structure their affairs for asset protection purposes. Michael has a family trust that holds $5m in investment assets.

Michael is diagnosed with cancer and the doctor tells him that he has three months to live. His immediate thoughts are for Cate and their two young children. His accountant tells him that he could transfer $3m cash and other investments from the family trust into his sole name with minimal CGT consequences.

Michael is attracted to the tax advantages that a testamentary trust would provide to Cate. The $3m transfer is made from the family trust into his sole name. He makes a will that establishes a testamentary trust to be controlled by Cate.

Would the ATO have concerns about this arrangement from a Pt IVA perspective? What was the dominant purpose?

There are many alternatives to the above types of strategies, and the involvement of other family members (such as parents) and other asset-holding vehicles such as superannuation can add to their complexity.

Suffice to say, if any planning strategies are entered into, consider documenting the reasons behind the strategy and, where appropriate, seek expert advice on the possible Pt IVA consequences.

21 Although note that SA does not have a statutory perpetuity period.

Chapter 11

Taxation of deceased estates

¶11-100 Introduction

The rules relating to deceased estates are complex and there are a number of planning opportunities that can provide a natural lead-in for accountants to play an important role in the taxation affairs of the estate. Good communication between the executor, the financial adviser – especially about cost-base data – and the accountant can result in significant savings to the estate and underlying trusts.

This chapter discusses the responsibilities of the legal personal representative (LPR). The LPR is the executor or administrator of the estate. An estate has an administrator if there was no will – or there was a will but it did not successfully appoint an executor.

We will also discuss the peculiar taxation rules that apply to deceased estates – especially the CGT and main residence rules – and the taxation of life interest estates.[1]

¶11-105 Responsibility for tax returns

Taxation legislation imposes a number of responsibilities on the LPR which, if not properly understood, can result in the LPR incurring personal liabilities.

The LPR is responsible for finalising the taxation affairs of the deceased. This includes lodging taxation returns on behalf of the deceased:

- for each completed financial year in which the deceased was, at their date of death, required to lodge a tax return but had not done so;
- from the 1 July immediately preceding their death to the date of their death – this is known as the "date of death tax return".

The LPR must also lodge a taxation return for the estate for the period from the date of death up to the date that administration of the estate was finalised.

If any trusts are created, the trustee of the trust is responsible for lodging taxation returns for the trust.

Liability of legal personal representative

Until the early 1990s, the ATO issued a taxation clearance notice which provided an LPR with comfort that the ATO was satisfied that all returns had been properly completed and lodged. The ATO no longer issues such notices – this arguably places greater onus on the LPR to satisfy themselves that the deceased's taxation affairs are in order. If assets have been distributed to beneficiaries and a shortfall arises as a result of a taxation liability, the LPR may be liable for some or all of the shortfall – unless the beneficiaries are willing to make the necessary payment. LPRs can protect themselves by making enquiries of the Commissioner before distributing assets of the estate – see PS LA 2006/11.

1 For a comprehensive analysis see Bernard Marks, *Trusts & Estates: Taxation and Practice*, 2nd ed, The Tax Institute, 2009, ch 36. Available online and in print (see www.trustsandestates.com.au).

Tip

If the LPR is distributing estate assets and there is any doubt, they may wish to obtain an indemnity from the beneficiaries to protect themselves. Of course, an indemnity does not assure the LPR of protection. The LPR should also keep evidence of the steps they took to enable them to reasonably conclude that the deceased's taxation affairs were in order.

¶11-110 Date of death tax return

Tax rates

The deceased receives the benefit of the normal taxation rates in the period from the 1 July immediately preceding their death to the date of their death.

Business income

If the deceased operated a business on a cash or accruals basis, the same basis should be applied when determining what income should be included in the date of death tax return.

Trading stock

If the deceased held trading stock, the market value of such stock must be included as assessable income in the date of death tax return – unless the LPR makes an election. An election can only be made:

- within the required timeframe – usually the date of lodgment of the date of death return;[2] and
- if the LPR carries on a business using that trading stock.[3]

If an election is made, the market value of trading stock is ignored and the closing value[4] of trading stock as at the date of death is included instead.[5] If the trading stock involves certain crops or trees,[6] the LPR may elect to include a nil amount for stock in the date of death tax return.

If an election is made, the person on whom the trading stock devolves is treated as having acquired it for the amount included in the date of death tax return – that is, either the closing value or nil as applicable.[7]

2 S 70-105(7) ITAA97. Note that the ATO may allow an election to be made later.

3 S 70-105(5) ITAA97.

4 S 70-105(3) ITAA97.

5 S 70-105(3) ITAA97.

6 S 70-85 ITAA97.

7 S 70-105(6) ITAA97.

Special rules apply to partnership income that held trading stock.[8]

Gifts that trigger a disposal for CGT

If a post-CGT asset passes under a will to a tax-exempt entity, a complying superannuation entity or a foreign resident, CGT event K3 will occur (subject to the exceptions discussed below) and any resulting capital gain or loss should be included in the deceased's date of death taxation return.[9] However, any capital gain or capital loss will be disregarded in certain circumstances, for example:

- there is no disposal for gifts of taxable Australian property to a foreign resident. Taxable Australian property includes direct or indirect interests in Australian real property (see ¶17-110 for more details); and
- a disposal to a tax-exempt entity will be ignored if the entity has DGR status or if the gift is made under the Cultural Bequest Program (see below and ¶11-120).[10]

This results in:

- a capital gain – if the market value of the asset on the day the person died is more than the cost base of the asset; or
- a capital loss – if the market value is less than the asset's reduced cost base.

Any capital gains or losses must be included in the date of death return.

This brings us to an important issue that should be raised with the willmaker at the time their will is drafted – who should pay any tax arising from the disposal?

Example

Hao dies leaving a will that bequeaths his share portfolio – valued at $500,000 – to his brother, Lei and the residue of his estate to his sister, Yang. Yang is an Australian resident but Lei is not. Because of the cost base of the shares, $75,000 in CGT is payable for the shares bequeathed to Lei.

In the absence of a provision in the will that directs otherwise, the tax is payable from the residue of the estate. This means that Yang would effectively pay the tax arising from the disposal of shares to Lei.

Note that legislation to remove the availability of the 50% CGT discount for non-resident and temporary resident individuals received royal assent in 2013 (see ¶17-115 for more details).

8 S 70-100 ITAA97.

9 S 104-215 ITAA97.

10 S 855-15 ITAA97.

Deductions for cultural gifts

If the deceased has made a testamentary gift – other than of land or buildings – under the Cultural Bequests Program,[11] a deduction may be claimed in the estate tax return.

For the value of the gift to be deductible:

- the recipient must be an entity referred to in s 30-230(2) ITAA97. This section includes bodies such as public art galleries, museums and libraries;
- the recipient – or an operating entity of the recipient – must be endorsed as a deductible gift recipient under Subdiv 30-BA ITAA97; and
- at the time of death, there must be in force a certificate from the Minister of Communications and the Arts, approving the gift and specifying its value.

Deductions for gifts to other charities

The unavailability of deductions for gifts to charities with DGR Status gives rise to tax planning tensions.

Example

Frank wishes to make a legacy of $100,000 to the RSPCA. Because of his deteriorating health, he knows that he only has a year or so left. His assets include a $3m share portfolio and his income exceeds $200,000 – so he is taxed at the top rate.

His lawyer informs him that he will not get any deduction whatsoever if he makes the gift through his will. So Frank decides to gift $50,000 in this financial year and the remaining $50,000 in the next financial year. By doing this, the RSPCA gets its donation sooner and Frank receives deductions for the donations.

Example

Sheila has assets of $1m. She wishes to leave a 25% share of her estate to each of her three sons and to Diabetes Australia.

Should Sheila instead leave one-third to each of her children and express a wish that they donate 25% to Diabetes Australia – and claim a deduction for the donation? However, this gives rise to a Pt IVA consideration. Also, Sheila's children may not be as benevolent as she hoped.

Other deductions

In addition to the usual amounts that would have been claimable as deductions by the deceased, the LPR is able to claim for the expense of preparing the date of death return – a concession given because it is the last return for the deceased personally.

11 Refer Subdiv 30-D ITAA97.

Unapplied capital losses

Any unapplied capital losses held by the deceased are lost as they cannot be utilised in the date of death return.

Tip

If possible, consider crystallising capital gains before death to use up any unapplied capital losses. If acting as a person's attorney, always be mindful of their CGT position so that any tax-effective opportunities are not lost.

¶11-115 Estate tax return

Income during estate administration

The first estate return covers the period from the deceased's date of death to the end of the financial year.

The estate will only be taxed at normal individual rates under s 99 ITAA36 if the ATO considers that s 99A would be unreasonable.

The ATO will usually apply the s 99 rates if the end of the income year is less than three years from the date of death, provided administration of the estate has not been completed.

An estate will generally be deemed to have been fully administered once all of the liabilities have been ascertained. It therefore, follows that:

- an estate can be fully administered, and the beneficiaries presently entitled to the income from it, even if the LPR continues to hold the assets; and
- it is possible for present entitlement to arise for part of the estate only.

Example

Olga dies leaving a $2m estate. During the administration process, her LPR was confident that most of the liabilities had been identified, but was awaiting confirmation of some amounts that were likely to be about $50,000 – but could be higher.

The LPR decided to distribute $1m to the sole beneficiary and retain the remaining funds until the exact liabilities had been ascertained.

In these circumstances, the beneficiary is presently entitled to the $1m – and so is liable for tax on future earnings on this sum – but is not presently entitled to the assets retained by the LPR.

In the year that an estate becomes fully administered, the beneficiaries would normally be assessed on all of that year's income. However, the ATO says, in IT 2622, that – provided there is evidence of the income and apportionment process – they will accept a request by the LPR and beneficiaries to apportion income between:

- the LPR – for income to the date the estate was fully administered; and
- the beneficiaries – for income from that date.

Apportionment on a time basis only is not acceptable.

The estate is not liable to pay the Medicare levy.

Deductions

If the whole deduction for a cultural bequest cannot be utilised in the date of death tax return, the excess may be deducted in the first estate tax return.[12]

¶11-120 Capital gains tax

CGT and death

The general rule is that gifts under a will or laws of intestacy do not amount to a disposal for CGT purposes. However, gifts made to an exempt entity, a complying superannuation entity or a foreign resident (see ¶11-110) will be a disposal for CGT purposes.[13]

Trap

Where a gift is made to a tax-advantaged entity, any CGT will ordinarily be payable by the remainder beneficiaries. Willmakers may wish to consider including a provision in the will, making the gift conditional on the tax-advantaged beneficiary paying any CGT.

The cost base that applies to the LPR or the beneficiary is set out in s 128-15(4) ITAA97. If the deceased died before 21 September 1999, an alternative indexation method may be selected to calculate the capital gain. Section 128-15(4) can be summarised as follows:

12 S 30-230(6) ITAA97.

13 S 128-10 ITAA97.

Table 1

Description of asset	CGT treatment
Pre-CGT asset acquired by the deceased	Acquired by the LPR or beneficiary on date of death for market value as at date of death
Post-CGT asset acquired by the deceased	Acquired by the LPR or beneficiary on date of death for cost base or reduced cost base as at date of death
Trading stock	See ¶11-110
Main residence	See ¶11-110

The ATO will, subject to the operation of CGT event K3, disregard any capital gain or loss that arises when an asset owned by a person passes to the ultimate beneficiary of a trust created under the deceased's will – see PS LA 2003/12.

Adjustments to cost base

Two sections in the ITAA97 provide scope for adjustments to the CGT cost base of assets.

Under s 128-15, a beneficiary can include, in the cost base or reduced cost base, expenditure that the LPR would have been able to include at the time the asset passed to the beneficiary.

Under s 110-25, adjustments may be available where expenses have been incurred in establishing, defending or preserving title to an asset. This appears to include legal costs incurred in proving the will. The ATO has published several interpretative decisions on this topic, two of which are summarised as follows:

Table 2

ATO reference	Issue	Details	Decision
ID 2001/729	Do legal costs incurred by the executor in confirming the validity of the will form part of the cost base under s 110-25(6)?	Costs related to proving will in solemn form following a challenge to the will's validity	Yes
ID 2001/730	Do legal costs incurred by the executor to defend a claim for control of the estate form part of the cost base under s 110-25(6)?	Costs related to family provision claim for control of the estate	Yes

Gifts to certain tax-exempt entities

A capital gain or loss is disregarded if it is from a testamentary gift made to a Cultural Bequests Program – or it would have been deductible under s 30-15 ITAA97.

Gifts to tax-exempt entities that are not deductible gift recipients will still trigger a disposal for CGT purposes. The exact means of dealing with transfers to non-deductible gift recipients under a will, therefore need to be considered.

Example

Evonne wishes to make a will bequeathing $10,000 worth of her ANZ shares to the ABC Tennis Club and gifting a legacy of $10,000 cash to the National Heart Foundation.

As the ABC Tennis Club is not a deductible gift recipient, Evonne will be deemed to have disposed of her ANZ shares immediately before her death. This will probably be a bad thing, although the consequences will depend on factors such as the cost base of her shares and the extent to which Evonne had any accrued capital losses.

Evonne would probably be better off if she bequeathed the cash to the ABC Tennis Club and the shares to the National Heart Foundation. Under this scenario, any capital gain on the deemed disposal of the shares to the National Heart Foundation would be disregarded.

Main residence rules

The rules that relate to the tax treatment of main residences and deceased estates are particularly complex. Section 118-105 ITAA97 has a diagram showing how the main residence rules work and, frankly, once tax legislation starts displaying diagrams you know you're in trouble! The following information provides a brief summary of these rules for deceased estates.

Full exemption

You may be entitled to either a full exemption under s 118-195 or a partial exemption under s 118-200.

For a pre-CGT dwelling, a gain or loss will be disregarded if you are a beneficiary – or the LPR – and you dispose of the dwelling within two years of the deceased's date of death.

The gain or loss will also be disregarded if – from the deceased's death to the date the dwelling was disposed of – it was the main residence of one or more of the following:

- the deceased's spouse – other than a spouse living permanently apart from the deceased;
- a person who had the right to occupy the dwelling under the will;
- the original beneficiary of the dwelling under the deceased's will.

Tip

The requirements for the dwelling to be the residence of the relevant individual from date of death are not to be strictly interpreted. The ATO will have regard to what is practical in the circumstances under s 118-135 ITAA97. For example, if a beneficiary is not able to move into the dwelling until probate has been granted then the dwelling may still be regarded as the main residence of the beneficiary from date of death – see ID 2007/128.

The rules allow for more than one pre-CGT dwelling to attract the full exemption – regardless of whether either is their main residence.

Example

Shelly owns two pre-CGT dwellings, one in Sydney and one in Melbourne. She lives in Noosa with her husband Leo and they have a son, Max, who lives in Sydney. Shelly dies and in her will devises the Melbourne dwelling to Leo and gives Max a right of occupancy to the Sydney dwelling. If, directly after Shelly's death, Leo returns to Melbourne and uses the Melbourne dwelling as his main residence and Max uses the Sydney dwelling as his main residence, the exemption will be available for both dwellings.

For a post-CGT dwelling, a gain or loss will be disregarded if you are a beneficiary or the LPR and:

- just before the deceased's death, the dwelling was the deceased's main residence and was not being used for income-producing purposes;
- you dispose of the dwelling within two years of the deceased's date of death.

The gain or loss will also be disregarded if – from the deceased's death the dwelling was disposed of – it was the main residence of one or more of the following:

- the deceased's spouse – other than a spouse living permanently apart from the deceased;
- a person who had the right to occupy the residence under the will;
- the original beneficiary of the dwelling under the deceased's will.

Tip

The key phrase is "just before the deceased's death". It is possible for the exemption to be available for a post-CGT property that the deceased rented out for a number of years, provided that just before the deceased's death the dwelling was the deceased's main residence and was not being used for income-producing purposes.

Partial exemption

Under s 118-200 ITAA97, a partial exemption is available if you are a beneficiary or the LPR and s 118-195 does not apply. The capital gain or capital loss is calculated according to the following formula:

Calculation

$$\text{Capital gain or loss} = \frac{\text{Non-main residence days}}{\text{Total days}}$$

For a pre-CGT dwelling, the non-main residence days are the number of days from the date of death to the date when ownership ended and the dwelling was not the main residence of either:

- the deceased's spouse – other than a spouse living permanently apart from the deceased;
- a person who had the right to occupy the residence under the will; or
- the original beneficiary of the dwelling under the deceased's will.

However, if the dwelling was the deceased's main residence just before death and was not being used for income-producing purposes, any non-main residence days before the deceased's death are ignored.

The total days are the number of days from the date of death until the disposal.

Example

Ron died on 1 January 2005. His will devised a pre-CGT dwelling to his son, Richard. Richard rented out the dwelling for one year and then used it as his main residence from 1 January 2006 until he sold it on 1 January 2008 (730 days) for a gain of $200,000. Total days are 1,095.

Richard is entitled to a partial exemption. His capital gain would be calculated as follows:

$$\$200{,}000 \times \frac{365}{1{,}095} = \$66{,}666$$

For a post-CGT dwelling, the non-main residence days are the number of days during which the dwelling was not the deceased's main residence, and the number of days from the date of death to when ownership ended in which the dwelling was not the main residence of either:

- the deceased's spouse – other than a spouse living permanently apart from the deceased;
- a person who had the right to occupy the residence under the will; or
- the original beneficiary of the dwelling under the deceased's will.

However, if the dwelling was the deceased's main residence just before death and not being used for income-producing purposes, any non-main residence days before the deceased's death are ignored.

The total days are the number of days from the deceased's date of acquisition to disposal by the beneficiary or the LPR.

Example

Ron died on 1 January 2005. His will devised a post-CGT dwelling to his son, Richard. Ron had purchased the dwelling on 1 January 1998 for $300,000 and always rented it out. Richard rented out the dwelling for one year and then lived in it from 1 January 2006 until he sold it on 1 January 2008 for a gain of $200,000. Non-main residence days are 2,920. Total days are 3,650.

Richard is entitled to a partial exemption. His capital gain would be calculated as follows:

$$\$200{,}000 \times \frac{2{,}920}{3{,}650} = \$160{,}000$$

Main residence and life interest estates

The main residence exemption in s 118-110 cannot disregard a capital gain or loss that a life interest owner makes from the ending of their interest – even if that interest entitled them to occupy a property – because CGT event E6 is not an event that attracts the main residence exemption.[14]

Joint tenancies

If an asset is held by two or more joint tenants – and one joint tenant dies – then their interest in the asset passes to the surviving joint tenant or joint tenants.

For CGT purposes, each surviving joint tenant is taken to have acquired their share of the deceased's joint tenant's interest on the date of the death of the deceased joint tenant.

Subdivision 118-B – incorporating ss 118-195 and 118-200 among others – applies to a surviving joint tenant as if the ownership interest of the deceased passed to the surviving joint tenant as a beneficiary in a deceased estate. This means that a surviving joint tenant may be entitled to the main residence exemption.

If a pre-CGT asset is held by joint tenants and one joint tenant dies, their interest is valued at market value on the date of death.

If a post-CGT asset is held by joint tenants and one joint tenant dies, their interest is valued at their cost base as at the date of death.

14 See s 118-110(2)(a) ITAA97 and IT 2006/14.

Life interest estates

Since the introduction of the CGT rules in 1985, determining the taxation consequences of creating and terminating – whether voluntarily or otherwise – a life interest has caused significant problems. Without question, the legislation was drafted without regard to such interests. As a result, tax professionals, LPRs and the ATO have been in the unsatisfactory position of having to interpret how the law will apply in circumstances that it was not designed for.

The main problems are the uncertain treatment for CGT purposes of events such as:

- the death of the life tenant;
- the voluntary relinquishment of the life tenancy for no consideration;
- the voluntary relinquishment of the life tenancy for consideration – such as taking some of the estate assets outright while the remainder of the beneficiaries take the remaining assets; and
- whether the outcomes would be different if the remainder beneficiaries were deductible gift recipients.

IT 2006/14 provides some guidance to these questions. The ruling distinguishes between life and remainder interests in property held on trust (referred to as equitable interests) and life and remainder interests in land that are not held on trust (referred to as legal interests).

Chapter 17

Taxation of non-resident estates

¶17-100 Introduction

This chapter considers the Australian taxation issues for Australian resident beneficiaries of a non-resident deceased estate or testamentary trust. Some of these issues are different to those that would arise if the deceased estate or testamentary trust were an Australian resident. Deceased estates and testamentary trusts are both types of trusts. In this chapter they will be referred to collectively as "estate trusts".

¶17-105 When will an estate trust be non-resident?

The residency of an estate trust is determined separately for each income year. An estate trust will be non-resident for a particular income year if:

- none of its trustees are Australian tax residents at any time during the income year; and
- it is not centrally managed and controlled in Australia at any time during the income year.

Australian tax residency

Individual trustees

The trustee of an estate trust who is an individual will be an Australian tax resident for an income year if:

- they reside in Australia according to the ordinary meaning of "reside";
- their domicile is in Australia, unless the ATO is satisfied that their permanent place of abode is outside Australia;
- they have been in Australia, continuously or intermittently, during more than 183 days in any income year – unless the Commissioner of Taxation is satisfied that their permanent place of abode is outside Australia and they do not intend to take up residence in Australia;
- they are deemed to be a resident in connection with various Commonwealth superannuation schemes.

Company trustees

The trustee of an estate trust that is a company will be an Australian tax resident for an income year if:

- the company is incorporated in Australia; or
- the company carries on business in Australia – and either its central management and control is in Australia or its voting power is controlled by shareholders who are residents of Australia.

Place of central management and control

An estate trust will be centrally managed and controlled in Australia if decisions about the management of its affairs are made in Australia. It is possible for an estate trust to be centrally managed and controlled in Australia, even if the trustee is not an Australian resident.

For example, a non-resident trustee of an estate trust may manage the affairs of the estate trust in accordance with directions provided by the beneficiaries who are Australian residents. In this case, the estate trust would be centrally managed and controlled in Australia – even though its trustee is a non-resident.

Example

Harry has lived in New Zealand all his life and dies leaving two adult children, Sally and Ken. Ken lives in New Zealand and Sally lives in Australia.

Harry appoints Sally and Ken as joint executors of his estate.

Harry's estate will be an Australian resident trust because one of the executors (ie trustees) is Sally who is an Australian tax resident.

Example

Molly has lived in Australia all her life and dies leaving one adult child, Jane, who is not an Australian tax resident. Jane is the sole executor of Molly's estate and exercises all of her duties in New Zealand.

Molly's estate will therefore be a non-resident estate.

Deceased's residency and asset location not relevant

The residency status of the deceased before death – and the location of assets of the estate trust – are not relevant to the residency of the estate trust. It is, therefore, theoretically possible for an estate trust established by an Australian tax resident for assets wholly located in Australia to be a non-resident estate trust. This could be the case where a non-resident executor is appointed and the estate is wholly managed and controlled outside of Australia throughout the administration of the estate.

¶17-110 Who is taxed?

It will generally be the trustee or a beneficiary of a non-resident estate trust who will be taxed. Deciding who will be taxed depends on a number of factors including:

- the source of the amount;
- whether the amount is income or a capital gain;
- whether the amount has been distributed to a beneficiary; and
- the rights of beneficiaries under the will or testamentary trust.

At times, the analysis of who gets taxed on what can be very complex. We have divided the analysis into two timeframes:

- the accumulation phase – where the trustee does not distribute or provide benefits to any beneficiaries; and
- the distribution phase – when the trustee provides benefits or makes distributions to beneficiaries.

Accumulation phase – taxation of the trustee

In the accumulation phase, it is useful to consider the taxation of the trustee first and then the taxation of any beneficiaries.

What is taxed to the trustee?

During the accumulation phase, the trustee will be required to include the types of income that any non-resident would be required to include in their assessable income. These amounts would be:

- Australia-sourced income; and
- capital gains from taxable Australian property.

Source of income

The taxation of income of a non-resident estate trust will be affected by whether the income is sourced in Australia. Rules about source are found both in statutory provisions and common law.

A number of provisions in Australia's taxation legislation deem certain amounts of income to be sourced in Australia. Examples include certain interest, dividends and royalties under the withholding tax provisions. If an amount is not specifically designated in Australia's taxation legislation as being Australia-sourced, common law source rules must be taken into account.

At common law, the overarching principle is whether as a hard practical matter of fact an amount of income is Australia-sourced. The starting point is to consider what links the income may have with Australia, such as:

- whether the asset generating the income is located in Australia;
- whether services generating the income were performed in Australia;
- whether documents for the relevant amount were negotiated and/or executed in Australia; and
- whether the funds were paid from an Australian bank account.

Taxable Australian property

The taxation of a capital gain of a non-resident estate trust will be affected by whether the gain is from taxable Australian property (TAP). In broad terms, TAP is defined as:

- direct and indirect interests in Australian real property;
- direct and indirect interests in Australian mining, quarrying or prospecting rights;
- an asset that has been used at any time in carrying on a business via a permanent establishment in Australia;

- an option over one of the above; or
- an asset subject to an election by an individual taxpayer to disregard a capital gain upon ceasing Australian taxation residency.

What rate of tax applies?

Any Australia-sourced income or capital gains from TAP would be included in the non-resident trustee's Australian assessable income under either s 99 or 99A ITAA36. The default position is that such amounts would be taxed under s 99A. Under s 99A, all of the assessable income of the non-resident trust would be subject to tax at the top marginal tax rate, without the Medicare levy.

However, if the trust is established under a will, the Commissioner has a discretion to apply s 99 instead. If s 99 applies, the ordinary non-resident individual marginal tax rates would apply – because the trustee of the estate trust is a non-resident. Both deceased estates and testamentary trusts should come within the ambit of this discretion. The circumstances in which the Commissioner usually applies s 99 to a deceased estate are discussed below.

Double taxation agreements

The application of Australian taxation to the trustee is subject to the operation of any relevant double taxation agreements.

For example, if the trustee of a non-resident estate trust is a resident of a jurisdiction with which Australia has a double taxation agreement, the terms of that agreement may allocate taxing rights over certain amounts (such as trading profits) to the country of residency only – this would preclude Australia from being able to tax such amounts.

If other countries are involved with an estate trust – that is, because of the residency of the trustee or the source of a particular amount of income – you need to find out if Australia has a double taxation agreement with that country. If so, that agreement should be reviewed to see whether it limits Australia's ability to subject certain amounts to taxation.

Accumulation phase – taxation of beneficiaries

Although no distributions or benefits may be provided from the non-resident trust to Australian resident beneficiaries, it is possible that certain income and gains could be attributed back to Australian resident beneficiaries.

From the 2010-11 income year, this attribution occurs via the operation of three possible taxing regimes. These are:

- the transferor trust rules; and
- the controlled foreign company (CFC) rules.

For the 2009-10 and earlier income years, the foreign investment fund (FIF) and deemed present entitlement rules could also have application.

The transferor trust, FAF and CFC regimes are aimed at countering tax avoidance, so their application to estate trusts is quite limited. In particular, the transferor trust and CFC rules will not apply in situations where:

- the deceased estate/testamentary trust has been established by the operation of a will; and
- no Australian resident has, or is deemed to have, transferred property or services to the trust.

A detailed analysis of the operation of these regimes is beyond the scope of this guide. However, if there have been direct or indirect transfers of property or services to the estate trust, or beneficiaries have an interest in the estate trust, these three regimes should all be carefully considered.[1]

Example

Jack and Jill are Australian resident beneficiaries of their father's non-resident estate. Jill is a lawyer and, although she is not administering the estate, she has provided legal services to the estate free of charge. This is likely be considered as a transfer under the transferor trust rules, so Jill will need to consider the application of the transferor trust and CFC regimes to her particular circumstances.

Example

Louise is an Australian resident beneficiary of her mother's non-resident testamentary trust. The trust has some liquidity problems so Louise organises for a friend overseas to provide funds to the estate – to ensure that none of the capital assets are sold. Louise reimburses her friend for the expenditure.

Although Louise has not made a direct transfer of funds to the estate, she will be deemed to have made a transfer via her arrangement with her offshore friend. Louise will therefore need to consider the application of the transferor trust and CFC regimes to her particular circumstances.

Distribution phase

During the distribution phase, it is generally the beneficiaries of a non-resident estate trust who will be taxed on distributions. Exceptions to this would include distributions made to beneficiaries under a legal disability. These are the same type of exceptions that would apply to situations where a trustee is taxed instead of a trust beneficiary on normal trust distributions.

1 The government has announced a rewrite of the CFC rules and proposed certain amendments to the transferor trust rules. However, at the time of writing, none of these changes had been legislated and no firm start date for the amendments had been announced.

Assuming that the relevant beneficiaries are adults with full legal capacity, the taxation burden will lie on the beneficiaries to whom distributions are made. However, in certain circumstances, it is possible that the accruals rules could still apply so that beneficiaries are taxed disproportionately to their distributions.

The accruals rules are essentially anti-avoidance provisions intended to tax amounts that might not otherwise be taxed, so it is appropriate to look at these rules last.

When determining the taxation liabilities of beneficiaries it is best to analyse them in the following order:

- taxation of current year income to which beneficiaries are presently entitled – this will include present entitlement during the income year and within two months of the end of the income year;
- taxation of other distributions or deemed distributions – this will include primary taxation and certain penalty taxation; and
- accruals rules.

Taxation of current year income to which beneficiaries are presently entitled

Under s 97 ITAA36, the assessable income of an Australian resident beneficiary will include that share of the income of a trust estate to which they are presently entitled. Section 98 will assess the trustee if a resident beneficiary has a vested and indefeasible interest – see s 95A(2). You need to consider whether any beneficiary is presently entitled to a share of the income of the deceased estate.[2] This depends on the stage of administration of the estate.

Under IT 2622, a present entitlement will not generally arise until the estate has been fully administered. This is when all debts are paid or provisioned and the amount of the residue is ascertained. However, a present entitlement may also arise if some income is actually paid to a beneficiary before administration is completed. Where administration is completed during a year, the beneficiaries are deemed presently entitled for the whole income unless the Commissioner has agreed to a request for apportionment, in which case part will be assessed to the LPR – see ¶11-105.

Example

Amy and Jonathan are Australian resident beneficiaries of their mother's non-resident estate. Amy is to receive a house and Jonathan is to receive a share portfolio, with the residue to be divided equally. As at the end of the relevant income year, the residue has not been determined and no distributions have been made. Therefore, neither Amy nor Jonathan will be presently entitled to the income of their mother's estate and s 97 will not apply.

In the following tax year the residue is determined and all the assets of the estate are distributed to Amy and Jonathan. Amy and Jonathan will both be presently entitled to a share of the income of the estate in that tax year. Part of the income may be assessed to the LPR if a request to apportion is successful.

2 The application of the proposed streaming rules should also be considered.

Taxation of other distributions

In addition to taxing the current year income of the estate, the ATO will also seek to tax any income or gains that have been derived in previous income years.

Under s 99B, when a beneficiary receives a distribution or an amount is applied for their benefit from an estate trust, the beneficiary will be required to include the relevant amount – less specific exclusions – as assessable income.

An amount will be deemed to have been applied for the benefit of a beneficiary if:

- the amount has been directly or indirectly re-invested, accumulated or capitalised or otherwise dealt with such that it will, at a future time, benefit the beneficiary;
- the derivation of the amount has operated to increase the value to the beneficiary of any property or rights of any kind held by or for the benefit of the beneficiary;
- the beneficiary has received or become entitled to receive any benefit – including a loan or a repayment, in whole or in part, of a loan or any other payment of any kind – provided directly or indirectly out of that amount or out of property or money that was available due to the derivation of the amount;
- the beneficiary has power, by means of the exercise of any power of appointment or revocation or otherwise, to obtain, whether with or without the consent of any other person, the beneficial enjoyment of the amount; and
- the beneficiary has directly or indirectly assigned their interest in the amount to another person or is able, in any manner whatsoever, whether directly or indirectly, to control the application of that interest.

The scope of what might be considered to be a distribution under s 99B is extremely broad. Common instances where amounts could unwittingly be caught are if:

- a loan is provided from the estate trust to an Australian resident beneficiary;
- a guarantee is provided from the estate trust for the benefit of an Australian resident beneficiary; or
- the terms of the estate trust mean that an Australian resident beneficiary has the ability to obtain the benefit of an amount held by the estate trust.

Once the inclusionary amounts have been determined, you then need to see whether certain portions of this can be carved out. The amounts that can be carved out include:

- the corpus of the estate trust – not including amounts that would have been taxed if derived by an Australian tax resident;
- amounts assessed to an Australian tax resident beneficiary under s 97;
- amounts assessed to a trustee under s 99 or 99A;
- amounts not taxable if derived by a resident; and
- amounts assessed under transferor trust rules.

Example

James is an Australian resident beneficiary of his uncle's non-resident estate. James has never received a distribution from the estate; however, he did borrow money from the estate at an arm's length rate of interest.

The full amount of the loan will be assessable to James under s 99B ITAA36 unless he can demonstrate that one of the exclusions mentioned above applies.

Example

Amanda is an Australian resident beneficiary of her mother's non-resident estate. The only asset of the estate is a New Zealand bank account. The balance of this bank account when Amanda's mother died was AUD 900,000 and during the administration of the estate it derived income of AUD 100,000.

Amanda was considered to be presently entitled to income of AUD 70,000 and included this income in her assessable income under s 97 in the tax year prior to any distributions.

In the following tax year the estate is finalised and Amanda receives a distribution of AUD 1m.

The full amount of this distribution will be included in Amanda's assessable income less specific exclusions. In these circumstances the exclusions would include:

- AUD 900,000 – being the corpus of the estate
- AUD 70,000 – being the amount assessed to an Australian resident beneficiary under s 97 ITAA36.

Therefore, Amanda will only be required to include AUD 30,000 in her assessable income under s 99B as a result of the distribution.

Penalty taxation

Australian resident beneficiaries can sometimes defer Australian taxation by deferring distributions from a non-resident estate trust, so there is a provision that applies penalties to distributions that are unduly delayed.

Section 102AAM ITAA36 assesses an Australian resident beneficiary with additional tax. This is like an interest charge for assessable distributions received by a beneficiary from a non-resident trust estate that is:

- included in the assessable income of a resident taxpayer under s 99B; and
- not considered to have been comparably taxed by a listed country – that is, the United Kingdom, the United States, New Zealand, France, Germany, Japan or Canada.

Beneficiaries of an "estate of a deceased person" – who may otherwise have been assessable under s 99B – are exempt from the interest charge if the amounts in question are paid to or applied for the beneficiary within three years of the death of the deceased. However, since the wording of the exception only covers the estate of a deceased person, testamentary trusts will not qualify for this concession.

The calculation of the interest charged under s 102AAM is a complex calculation performed on an annual basis to correctly mirror an interest charge.

Accruals taxation

The transferor trust and CFC regimes – if applicable – can apply even if 100% of the income has been distributed. This might occur, for example, where an Australian tax resident is to be attributed under the transferor trust rules and trust distributions are made to non-resident individuals who are not resident in any "listed" jurisdiction.[3]

Checklist for applying rules

When explaining how non-resident deceased estates and testamentary trusts and their beneficiaries may be taxed, we split the taxation analysis into two phases – the accumulation phase and the distributions phase.

However, there will obviously be situations that do not fit this precise model. The following list outlines the most appropriate order to apply the various rules to the taxation of trustees and beneficiaries of non-resident estate trusts:

- beneficiaries under s 97 – looks at current year income;
- trustees under s 98 – essentially the same issue as s 97 for beneficiaries under legal disability;
- trustees under s 99 or 99A – looks at current year income and has carve-outs for s 97;
- accruals rules – looks at current year income and has carve-outs for other taxation under ss 97 and 99 or 99A;
- s 99B – distributions of previous year income with carve-outs for previous year Australian taxation and some other offshore taxation; and
- s 102AAM – only looks at applying additional tax to certain amounts taxed under s 99B.

Cost base on assets distributed in specie

When an Australian resident beneficiary acquires an asset from the estate of a deceased person who is a non-resident, the cost base rules are largely the same as if they had received the distribution from a deceased Australian resident.

However, there will be a difference if there is a distribution of an asset which is not taxable Australian property and is not trading stock. If this type of asset was distributed from the estate of an Australian resident, the first element of the beneficiary's cost base would be the deceased's cost base in the asset. However, if the distribution was from a non-resident the first element of the beneficiary's cost base would be the market value of the asset at the deceased's death.

3 Canada, the United Kingdom, the United States, Japan, France, New Zealand and Germany.

¶17-115 Other non-resident issues

Legislation to remove the availability of the 50% CGT discount for non-resident and temporary resident individuals received royal assent in 2013. The 50% CGT discount was previously available to any individual deriving a taxable capital gain on the disposal of an asset held for more than 12 months, regardless of residency.

The amendments apply to discount capital gains included in the assessable income of an individual, irrespective of whether the CGT asset producing the gain was owned directly by the individual or held indirectly by a trust.

The amendments also reduce the discount percentage applicable to a discount capital gain made after 8 May 2012 by a trustee that is taxed under s 98 ITAA36 in respect of an individual beneficiary who was a foreign resident or temporary resident for some or all of the period that the CGT asset was held. In circumstances where a trustee is taxed under s 98, the discount percentage will be worked out on the basis that the individual beneficiary made the gain.

Temporary residents and non-residents will still be entitled to a discount on capital gains accrued prior to 8 May 2012, provided they choose to obtain a market valuation for their assets as at that date. However, individuals who do not have a market valuation will be ineligible for the CGT discount on pre-announcement gains. This is regardless of whether the individual made the discount capital gain directly or as a result of being a beneficiary of a trust.

It should be noted that, while foreign residents and temporary residents are only subject to CGT in relation to taxable Australian property (TAP), the definition of TAP not only includes land in Australia (whether held directly or indirectly), but also any other asset that an individual who was an Australian resident has elected to defer the taxing point on when ceasing to be an Australian resident.

What does this mean for the beneficiaries of deceased estates?

Based on the explanatory memorandum to the legislation, it would seem that a beneficiary who becomes entitled to a capital gain after 8 May 2012 (for example, on 30 June 2012) will be caught by these changes if they were a foreign or temporary resident on or after that date – even if the capital gain was from an asset that was sold by the trust before that date.

The changes will also apply to any resident taxpayer who inherits TAP on or after 8 May 2012 from someone who was a foreign or temporary resident during the period that they held the asset.

Where all, or a significant portion, of the capital gain accrued prior to 8 May 2012, it is likely to be beneficial to obtain an independent market valuation of the asset at that date to maximise access to the 50% CGT discount. However, this may become more difficult (and costly) as time passes. As such, it may be prudent to consider obtaining valuations of assets held now in anticipation of a capital gain being derived in the future.

Further complications will arise where the capital gain has originated in a deceased estate in which the individual is one of a number of beneficiaries. In these cases, it may be difficult, if not impossible, to obtain this information from the trustee.

These changes may also affect those individuals who depart Australia, cease residency for a number of years and then return to Australia shortly before they die. If the individual holds real estate which is subject to CGT (for example, an investment property or family home which only qualifies for a partial main residence exemption), the 50% CGT discount will be reduced on the ultimate sale of the property by either the estate or a beneficiary who inherits the property.

Trustees, especially trustees who are assessed under ss 98 and 99 ITAA36 , will need to give consideration to:

- the discount percentage of any beneficiaries to ensure that the trustee withholds sufficient amounts in relation to any distributions;
- obtaining market valuations as at 8 May 2012 of all of the CGT assets (in the case of non-fixed trusts) or all assets that constitute TAP (in the case of a fixed trust); and
- the provision of detailed distribution statements to beneficiaries setting out:
  - the acquisition date of all CGT assets disposed of and their date of disposal in order to determine the discount testing period; and
  - the market valuation of all of the relevant CGT assets as at 8 May 2012.

Chapter 18

Overview of business succession planning

¶18-100 Introduction

This chapter introduces the topic of business succession planning. It will concentrate on the role of the adviser and the issues that the adviser and their clients should consider when addressing business succession planning.

References to "patriarch" are intended to be references to the mother, father or other family member who has primary control over a particular business that has become the subject of a succession plan.

As with all information in this guide, it is important to remember that these chapters set out the law in general terms that cannot take into account everyone's circumstances. It is difficult to imagine anyone entering into a business succession without obtaining advice from one or more advisers.

The role of advisers is particularly important with business succession and invariably more than one adviser will need to be consulted. It will often be necessary for the advisers to share information in order to help their mutual client implement a successful business succession plan.

¶18-105 What is business succession planning?

Although there is no universally accepted definition of "business succession planning", it can perhaps be described as planning for the transition in the management and/or ownership of a business.

Particularly in the small to medium enterprise and closely held business market space, business succession planning is likely to have implications for estate planning – who gets what and when – if the owner or controller of certain assets dies. However, business succession issues can be quite separate from estate planning issues. For example, there might be a plan for passing control of the running of a business – or its ownership – during the lifetime of the creator of a business, but he or she might not have settled the terms of his or her will.

There is sometimes a tendency to focus on planning for what might happen if, for example, the owner of a business dies or retires. However, it is far more likely that owners or managers will become disabled or suffer severe illness during their working lives than die – that's why total or permanent disablement and trauma cover is so much more expensive than death cover. We should, therefore, remember to consider the impact of disability and illness when preparing succession plans.

Tip

Remember to plan for disability (eg stroke, heart attack etc) as this is often more likely to occur than death, during our working lives.

Chapter 19 deals with buy-sell agreements – that is, agreements between the proprietors of closely held businesses for the transfer of equity in the event of, for example, death, trauma or total or permanent

disablement (TPD). The transfer of equity due to such an unplanned event is typically financed by insurance.

In this chapter, we will consider some issues that might be more relevant to a smaller family business. In other instances, we might refer to a professional services firm or – in the case of a large family group – a family office. What is perhaps most interesting is the frequency with which many of the issues cross the boundaries between such organisations.

Finally, before we consider the many technical and human issues, a word of caution. Be very careful to establish at the start exactly who your client is. It can be the patriarch, the trustee of a trust or the managing partner of a firm – but it should not be, say, "a family". There will almost inevitably be some conflicts of interest, regardless of comments like "I want everyone to be treated fairly or equally" or "I want to be very open" or "I want the family to agree".

Trap

Remember to identify who your client is. It should be an individual, not a whole family, if a conflict of interest is to be avoided.

¶18-110 A multidisciplinary approach – the facilitator

Effective and efficient business succession planning generally requires a multidisciplinary approach. It is likely to involve accountants and lawyers and – when insurance and wealth creation or management are involved – financial advisers. If the plan includes a business sale or initial public offering (IPO) there might be further specialists involved such as valuers, corporate financial advisers, underwriters, remuneration specialists and bankers. Others might be involved if the proposed successors in the operation of the business need coaching or mentoring.

Whenever a number of advisers come together to work on a particular project, it is important that one person is appointed to manage the project. This person need not be the source of all knowledge. However, they should act as a facilitator and bring the necessary resources to bear on a timely basis, keep the project moving along according to an agreed timetable, and assist with decision-making – particularly if difficult legal, commercial or personal issues arise.

¶18-115 A dynamic process

One of the responsibilities of the facilitator is to ensure that each of the specialists is fully briefed at the start of the project and they continue to have all the information they need as issues develop.

Further important information will often surface as the project unfolds. This may happen because facts become clearer, misunderstandings are clarified, the law and circumstances change, or one of the advisers recommends a new route to avoid a problem or achieve a better outcome.

You might change the original broad plan a number of times in response to issues identified by the various advisers.

Then, when the plan is settled and any documents are finally signed, it is important to be able to continue to identify issues that might impact the plan, either positively or negatively. Just as it is important that businesses are able to change their operating and other plans and respond quickly to changing circumstances, it is important that business succession plans can change on a timely basis.

As a result, preparing business succession plans should be seen as a dynamic process. We agree to a plan – but also recognise the need to keep coming back and reviewing and perhaps modifying the plan.

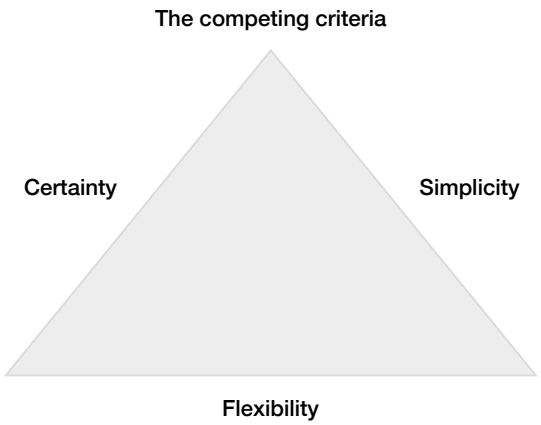
Tip

There should be one person responsible for bringing all of the parties together (see ¶18-110) and they should also be responsible for reviewing the plan as the law or circumstances change.

¶18-120 What can be realistically achieved?

It can help to start the process with a particular objective very clearly in everyone's mind. For example, the older daughter will take over the running of the business in five years and when her mother dies the ownership will be split equally between the children. Unfortunately, circumstances sometimes change. For example, one of the children could become bankrupt, they may be considering divorce, or the older daughter may become disinterested or incapable of running the business. This is a reminder of the dynamic nature of the process.

It is sometimes helpful to test our business succession plans against three criteria – certainty, simplicity and flexibility. We may often be able to achieve a high degree of any two of these characteristics, but realistically we may face considerable difficulty achieving a high degree of all three.



For instance, in the previous example, appointing the older daughter to run the business in five years and dividing the assets equally between the children on the mother's death is simple and has a degree of certainty. However, it isn't flexible. It doesn't deal with the possible divorce, bankruptcy, disinterest or competency issues raised.

Although we should always strive for excellence, there are practical limits on our ability to foresee what the future might hold and how any contingencies might be dealt with. It is often important to temper expectations with a touch of realism about what can be achieved.

¶18-125 Why plan?

The benefits of business succession planning will depend on the precise circumstances in each case, but they could include:

- preserving and generating family wealth – including protection from creditors, spendthrift family members and estranged or divorced spouses;
- minimising disharmony between family members – particularly if they have different views about what should become of the family's assets;
- minimising the impact of tax;
- encouraging the personal growth of family members – particularly those charged with management roles; and
- funding retirement.

¶18-130 How and where do I start?

There is no single place to start – but you need to get a clear statement from the owner or controller of the assets about what they would like to achieve.

This might be as simple as "I would like my eldest son to take over as CEO by a particular date and the business to be sold or floated within three years. Out of the proceeds, I would like the family's mortgages paid off and the trusts that hold most of the wealth managed for the benefit of my wife and myself during our lifetime and then for our children equally."

Tip

Get a simple and accurate statement from your client as to what is to be achieved. Then, test each proposition against that objective.

A number of the following issues may need to be addressed by various specialists concurrently rather than sequentially; otherwise the planning might take an inordinate amount of time. This is one of the reasons the role of the facilitator is so important.

It may also be efficient to get all of the advisers and at least the owners of the business together, both at the start of the project and then periodically. This can help clarify facts, work out what is realistically achievable and by when, and avoid specialists considering issues unnecessarily.

Some of the factual information to be gathered and issues to be considered by the family members and the relevant specialists are likely to include the following:

Table 1: Non-exhaustive checklist – documents and information to gather

Asset ownership	Who owns what assets? What is the market value as well as the carrying value of the assets? What is their CGT cost base and are they pre- or post-CGT assets? Get a copy of the accounts and tax returns. What loans and capital advances have been made to related parties? These might be taken into account when considering who gets what assets. Who has the right to use assets and on what basis – for example, non-arm's length rentals, asset sales or management assistance? What does the future hold for the business? Get a copy of any business plans
Structure	Get copies of trust deeds, company constitutions, shareholder agreements, up-to-date company searches etc
People	Who works in the business and what are their roles? Perform a realistic skills assessment. What are the plans for the executives and family members and what are their financial, marital and health positions? Performing a realistic skills assessment of the adult children, let alone the parents, can be problematic. Also, what are people's expectations and what promises have been made? It is sometimes useful to get a feel for where the key relationships are or are not – for example, with key staff or suppliers or customers. A sense of the lifestyles and work ethics of the key players can also be important
Goals	What is to be achieved, by whom and by when?
Financing	How is the plan to be funded, for example by insurance, savings, trade sale, vendor finance, asset transfer on death or debt forgiveness?

Due diligence	This analysis is not unlike doing a due diligence as part of a sales transaction. The same sorts of issues that help establish the value of the entity and the basis of that value – for example, market position, asset ownership and availability, technology, individual skills and barriers to entry – may be very important
Estate planning	How does this fit in with the estate planning?
Family constitution	If there is a family constitution, how do these plans fit with the constitution?
Pre- and post-nuptial agreements	Are there such agreements in existence and what is their impact?

Once this information is provided to the various specialists, a broad outline of one or more ways forward is likely to emerge quite quickly. There will, however, be a considerable amount of more detailed work.

¶18-135 Documenting a business succession plan

The existing documents that may need to be reviewed and amended – and how the business succession plan is documented – will depend on the precise details of the plan.

Buy-sell agreements – that is, agreements for the transfer of equity in the event of death, trauma or TPD – and how they might be documented are dealt with in chapter 19. These agreements are typically entered into between unrelated parties and in closely held businesses.

A non-exhaustive checklist of other documents that might be reviewed, amended or prepared include:

Table 2: Non-exhaustive checklist – documents to review, amend or prepare

Company constitutions	These might need to be amended to deal with the rights of the shareholders to buy or sell shares, the company's ability to issue, redeem or cancel shares and on what basis, the need for shareholder approval, voting rights in relation to the appointment and termination of directors or other decisions
Trust deeds	If the trust is a discretionary trust (that is, the trustee has a discretion to distribute income or capital) consideration should be given to who the trustee will be and who the shareholders and directors of a corporate trustee might be. It is also important to determine who the appointor, guardian or protector of the trust is now and who it might be in the future, particularly in the event of either death or disability The appointor typically has the power to remove the trustee and appoint a new trustee. They may also have certain reserved powers – for example, their consent might be required before capital is distributed or loans are made to beneficiaries

Trust deeds (cont)	The role of any guardian or protector will also be set out in the trust deed Consideration should also be given to who any default beneficiaries are. These are the beneficiaries who become entitled to any income or capital that the trustee fails to effectively appoint (distribute) to a beneficiary by the relevant date – such as by year end or the vesting date of the trust When reviewing discretionary trust deeds, pay particular attention to limitations on who the income and capital beneficiaries are – especially any excluded classes of people and limits on the number of generations who might be eligible. For example, grandchildren may be the last generation of eligible or notional settlors and the trustee may be excluded. Also check the rules for adding and deleting beneficiaries
Shareholder/ unitholder/ partnership agreements	Each of these agreements is likely to deal with the transfer of equity or the issue or redemption of interests. They must be reviewed to check their fit with the business succession plan
Deeds of family arrangement/ family constitution	This type of document might be prepared to reflect the parties' wishes about how the family's affairs will be managed in the future. Specialist advice is needed about whether such a deed would be enforceable in a particular situation. A key question is whether it would be found to be contrary to public policy – see, for example, *Lieberman v Morris* (1944) 69 CLR 69 and *Barns v Barns* (2003) 214 CLR 169
Letters of wishes	This is an estate planning tool that may affect business succession planning. There might be issues associated with enforceability at law – it might represent little more than a wish. On the other hand, it might reflect the wishes of the donor (of a parcel of wealth) that can appropriately be taken into account in, for example, guiding a trustee when exercising a discretion
Options	Put and call options might be granted to protect the ability of parties to buy or sell assets at certain prices at certain times
Resolutions	Trustees might resolve to distribute income or capital, or directors might resolve to declare dividends or issue, redeem or cancel shares
Financing	Transfers of equity and lifestyle might need to be funded. This should often be documented as if the parties were at arm's length. Financing is considered further in chapter 20
Insurance	This can be an important method of financing the transfer of equity and the settling of debts, particularly in the buy-sell context (see chapter 19)
CGT rollovers	It is common to find that CGT rollover relief is sought on the transfer of assets, and this can require various notices It is very common in discretionary trusts to want to divide assets among family members. To avoid CGT on a transfer of assets out of a trust to a beneficiary, you might split the trust or clone the trust and transfer assets to the cloned trust, CGT-free. This issue is dealt with in more detail at ¶18-140
Duty	Check whether the instruments to be prepared are dutiable in each jurisdiction and whether you are required to bring a document into existence
Tax returns	Consider how these will be affected

People-related issues	These might include documenting employee share schemes or other performance plans, or preparing goals, personal development plans and performance evaluation guidelines While all of the documents should be reviewed from a tax, regulatory and legal perspective, the relationship aspects cannot be overlooked
Related party transactions	It is important to find out what related party or non-arm's length transactions exist. Even in larger groups it is unusual to find formal documentation for things like rent, intra-group sales, management fees etc. However, as assets are divided or decisions are made about who keeps what, this can be essential
Pre- and post-nuptial agreements	How might such agreements impact your plans?

Documentation and family dynamics

Relationship issues can profoundly affect the documentation of the plan. Some practitioners suggest we should assume that dysfunctional relationships are the norm, rather than the exception. Although this may overstate the position, it is a useful reminder that business succession planning can be a very different process to:

- a conventional sale of business, performance evaluation or planning with arm's length employees; or
- preparing a will or estate plan that people, other than the willmaker, might not see until after the willmaker's death.

An example of how family issues may affect business succession planning and its documentation arose when a father did not want his adult sons to see or sign the proposed family constitution or consolidated balance sheet – because he felt that one son would pressure the family to access assets earlier than the father intended. In another case, a father prepared a plan that meant very little of the family wealth would be available to his adult children, even after his death, until they were close to middle age. The father was concerned about his children living off the wealth that he had created, rather than working and generating wealth themselves. He was also concerned about in-laws accessing this wealth.

Similarly, it is common to find that some family members will be more talented than others and that some are more materialistic, domineering or have a greater expectation of entitlement.

These examples illustrate that it will not always be the case that the family – however broadly that description might apply – will openly discuss and be content with the value of the relevant assets, who should access them and when, who should control the assets, who should work in the business and in what roles, and what their remuneration should be.

Some practitioners suggest that those who work hard and add value should be rewarded. Perhaps this proposition goes to the heart of an issue to be resolved. There might be some, like the son who works the farm, who feel entitled to a greater share of the family wealth because they work in the business

and there might be others who feel entitled to an equal share of the family wealth by virtue of their birthright.

It is important to recognise that these issues will arise with many families. Although it is not guaranteed, the risks and tensions may be reduced if the principles agreed upon are well documented and related party remuneration is benchmarked against external organisations.

At ¶18-105 we looked at the importance of clearly establishing who your client is – that is, the patriarch or the business entity, but not the whole family. Then, at ¶18-125, we considered why we should plan. In particular, there is the possible preservation of family wealth, the minimisation of disharmony and the encouragement of personal growth.

Perhaps the next question is, who should buy into the business succession plan? On one hand there is sometimes a desire for a degree of confidentiality. On the other hand, without buy-in by the key stakeholders the plan might not work. The information that is passed across, and when and how the plan is sold to the key stakeholders, is critical – but it must be determined on a case-by-case basis.

It is only once these human relationship issues are understood that the business succession plan can be settled. These issues will affect the type of documentation to be prepared as well as what information is to be made available to which parties and when.

¶18-136 When do I finish?

It is common to find that new information comes to light and that circumstances change, or they are about to change. We therefore have to ask whether we should keep amending draft plans and defer signing the required documents.

Perhaps a useful rule of thumb is that once you have a practical, workmanlike plan, execute it. This should be on the basis that this is a dynamic process and as circumstances change, as they invariably do, the plan will be revisited. In the meantime, there is a documented way forward at the earliest feasible time.

It follows that a timetable and/or triggers for a review should be agreed upfront. Triggers might include issues such as a death, divorce, ill health, insolvency, significant economic developments etc.

Tip

Consider implementing the plan once it is practical and workmanlike. Agree a timetable and the triggers for review, such as divorce, ill health, or significant economic changes.

¶18-140 Tax issues

The tax issues that could arise out of a plan will only be limited by the precise details of the plan.

In chapter 19 – which deals with buy-sell agreements – a myriad of income tax, CGT, FBT, GST and duty issues are considered.

Given the almost unlimited ways that a business succession plan can be constructed, the following is only a very general outline of some of the tax issues that could arise.

It is sometimes useful to think of business succession tax issues in terms of disposal of assets issues and remuneration of people issues.

CGT on disposal of assets

Pre- versus post-CGT assets

If there is a disposal of assets there may be a CGT or income tax liability. For example, if real estate, plant, shares or units are transferred to successors, there will be a CGT event and a gain or loss may arise.

If shares or other assets that were acquired pre-CGT – that is, before 20 September 1985 – are disposed of, CGT can still arise due to CGT event K6 happening under s 104-230 ITAA97 or there could be implications under Div 149 ITAA97.

If you dispose of shares or units that you acquired pre-CGT, you may – under CGT event K6 – be subject to tax on some of the sale proceeds. This provision is triggered if the market value of post-CGT assets of the company or trust is at least 75% of the net value of the company or trust. If so, very broadly, a capital gain will arise equal to the amount of the sale proceeds (of the shares or units) that represents the increase in value in the post-CGT assets of the company or trust.

It is very easy to breach the 75% test because we compare 100% of the market value of post-CGT assets with 75% of the net value of the company or trust.

Trap

If you are disposing of pre-CGT shares or units, CGT could still apply due to CGT event K6.

Then there is Div 149 ITAA97. Ignoring the many amendments and the public entity rules, the pre-CGT assets of the company or unit trust will be treated as post-CGT assets when there is no longer continuity in majority underlying ownership. For example, if Kevin and Julie have each owned 50% of the shares in Aust Pty Ltd since 1979, but Kevin sells his shares in February 2008, there would be no continuity of majority underlying interest in the company's pre-CGT assets. They would, therefore, be taken to have been acquired at their market value in February 2008.

If there has been a change in shareholding or unitholding, or there are post-CGT assets in the company or trust, CGT event K6 and Div 149 ITAA97 may apply.

Trap

Pre-CGT assets could become post-CGT assets, unless there has been a continuity of majority underlying ownership (see Div 149 ITAA97).

Timing

If we contract now to dispose of assets in the future, say on the happening of a given event, a CGT event may happen now – at the time of signing the contract – not later when the transfer occurs. This is so even though there is no transfer until the trigger event occurs – see CGT event A1 and s 104-10(3(a) ITAA97. For example, if Kevin agrees to sell assets to his son on his retirement, the disposal would generally be taken to occur at the time of contracting – that is, now, not in five years when he retires. This is usually a highly undesirable outcome.

Trap

CGT events often happen as of the date that you enter into a contract, not later when the transfer occurs (see s 104-10(3)(a) ITAA97).

Some possible ways to avoid this problem are discussed in chapter 19. One alternative is for the parties to agree to have a trigger event, such as Kevin's retirement, as a condition precedent to the formation of the contract – rather than entering into a simple mandatory contract now for the transfer of assets/equity later. There will then be no disposal for CGT purposes until the trigger event, such as retirement, occurs. Another alternative is to use put and call options. Here, the parties can compel each other to buy and sell the assets in the future if either of them exercises their option.

Tip

Consider transferring assets pursuant to put and call options, for example, so as to defer the date that a disposal occurs for CGT purposes.

Avoiding the disposal of assets

If there is no CGT event then there will be no CGT liability. However, there may be income tax on, for example, the transfer of trading stock or depreciable assets. This is considered in more detail below.

Valuable assets are often held in trusts. If the trust is a fixed or unit trust, there may be a disposal for CGT purposes regardless of whether you transfer the units or the trust assets. If so, you might try to defer the disposal of either the units or the assets for as long as possible, subject of course to the possible impact of asset value movements.

If the relevant assets are held in a discretionary trust, there are at least three alternatives to a straight transfer of assets by the trustee. These alternatives are splitting or cloning the discretionary trust or transferring control of the trust to one or more members of the next generation. They are important because even if the trustee distributed these assets in specie to a beneficiary under a corpus distribution power in the trust deed, there would still be a CGT event unless there is a specific exclusion. It is also likely that the market value substitution rules in ss 112-20 and 116-30 ITAA97 would apply. If so, the trustee would be taken to have disposed of the assets at their market value and the beneficiary would be taken to have acquired them at that value. Be aware, these provisions can be quite complex.

The market value substitution rules often come as a surprise to some families. They see them as imposing a type of gift tax when they have given away their assets to the next generation.

Should beneficiaries inherit or buy assets from the executor?

A further issue to consider is whether a beneficiary should inherit (business) assets and therefore acquire a CGT cost base equal to their market value at the date of death if they were pre-CGT assets of the deceased, or the cost base of the assets to the deceased if they were post-CGT assets of the deceased.

An alternative is to provide in the business succession plan, and in the will of each relevant party, the flexibility for the potential beneficiary to buy some or all of the assets from the executor and to inherit (a share of) the resulting remaining cash. Where there is an as yet unrealised taxable capital gain to be made on the business assets, a sale to a beneficiary might result in another party sharing some of the CGT burden or even offsetting some or all of the capital gain against capital losses in the estate.

Trust splitting and cloning

The terms "splitting" and "cloning" are sometimes used interchangeably, but they mean quite different things. These terms are not defined in the tax law.

Trust splitting involves the appointment of separate trustees over different assets within (supposedly) a single trust. It is argued that no new trust is created. Instead, it is argued that a single trust can have different trustees over different assets.

Whether it is possible to have only one trust in such a situation is a matter on which opinions appear to be divided. It follows that if you wish to go down this path, specific specialist advice should be sought.

Trap

If it is possible to split a trust (and for there still to be only one trust), consider:

(1) how income might be taxed to each beneficiary under Div 6 ITAA36; and

(2) whether assets "controlled" by one trustee might be available to creditors of another trustee.

Trust cloning involves the creation of a nearly identical trust – hence the word clone. Assets such as some of the shares in a family company might be transferred out of the original trust into the new trust.

The trust cloning opportunity had been considered by, for example, many families wanting to divide assets held in family discretionary trusts between members of the next generation. This was especially the case where assets were to be transferred before the death of the father or mother.

Following the passage of the *Tax Laws Amendment (2009 Measures No. 6) Act*, the door has effectively been closed on trust cloning for discretionary trusts (see ¶14-135).

Transferring control of discretionary trusts

If control of a discretionary trust is passed to, for example, members of the next generation of a family – rather than cloning the trust or transferring assets out of the trust to members of that next generation – there should be no CGT event.

An obvious question then is – how can that be done? Unfortunately, the answer can be very complex. This issue is dealt with in more detail in ¶20-105.

CGT small business relief

It might be that the timing of the transfer of interests in a business is influenced by the CGT small business relief rules in Div 152 ITAA97. For example, a family might decide to transfer equity, or assets, while values are depressed during a time of economic difficulty, so as to satisfy the $6,000,000 net asset value (NAV) ceiling.

The NAV ceiling might also impact in another way. For instance, parents might make gifts to their adult children earlier than they otherwise might, so that they no longer own such assets and they therefore come within the $6,000,000 NAV ceiling. They might also consider superannuation contributions and upgrading their home.

Other tax issues on the transfer of assets

A non-exhaustive checklist of some of the other tax issues that could arise on the transfer of assets to the next generation are listed in the following table.

Table 3: Non-exhaustive checklist – other tax issues to consider

Dividends	The definition of a dividend in s 6(1) ITAA36 includes the distribution of money or property
Div 7A deemed dividends	The transfer of property to a shareholder or associate of a shareholder, or sometimes an ex-shareholder, can be a payment under the deemed dividend rules in s 109C(3)(c) in Div 7A ITAA36
Trading stock	A transfer of trading stock, other than in the ordinary course of business, might be taken to occur at market value under s 70-90 ITAA97
Depreciable assets	An assessable amount may be taken to arise under the various capital allowance rules
Stamp duty	Could arise on the transfer of property, not just real property. Also, if you are transferring shares or units, you need to consider the land rich rules
FBT	Could arise when assets are transferred to employees or associates and the transfer is in any way related to their employment. If the transfer is a family-related matter – even if the party is an employee or associate – FBT may not apply (see *Slade Bloodstock v C of T* [2007] FCA FC 173)
Bad debts	If trade debts are transferred, the acquirer would not be entitled to a deduction for any bad debts as they would not have returned the amount as income (see s 25-35(1)(a) ITAA97)
Bad debts and tax losses	If shares are transferred and the company wishes to deduct losses or bad debts, it may not be able to satisfy the complex recoupment/deduction tests – see, particularly, Div 165 ITAA97
GST	If a business that is registered, or is required to be registered, for GST transfers assets that are not financial supplies and the going concern exemption does not apply, there may be a taxable supply that is subject to GST
Interest deductions	If there are borrowings in the old entity, will interest costs continue to be deductible? If the old entity borrows to make income or capital payments, will the interest be deductible? If the new entity borrows to buy the assets, will any interest cost be deductible? These issues are covered in more detail in ¶20-125
Family trust distribution tax	Has the distributing trust made a family trust election or interposed entity election? If so, is the transferee within the family group and will they need to make a family trust and/or interposed entity election?
International issues	If assets are being brought into or taken out of the Australian tax net, there may be deemed acquisitions or disposals for CGT purposes. There could also be income tax issues if, say, an Australian resident or beneficiary of a trust becomes entitled to capital from a trust that has been previously untaxed in Australia – see, for example, s 99B ITAA36. Specialist advice should be sought on international issues
Work in progress (WIP)	If the business/practice brings WIP to account, remember that there are now statutory rules in ss 15-50 and 25-95 ITAA97 that bring to account income receipts by exiting partners and allow deductions for payments made by the old partnership

There may also be issues that could arise in relation to superannuation or non-resident entities, assets or individuals. Specialist advice should be sought on the specific aspects of each case.

Redemption, cancellation or buyback of shares or units

A business succession plan might include the redemption, cancellation or buyback of shares or units to effectively pass ownership and control to the next generation of owners. If so, the specific rules dealing with these transactions and ATO pronouncements – such as PS LA 2007/9 on share buybacks – need to be considered.

Demergers

If a private company owns a variety of assets that the family would like to split between more than one company, demerger relief might be considered.

Figure 1 shows a before and after example.

Figure 1

If demerger relief applies, Div 125 ITAA97 might avoid CGT on the CGT event and s 44(4) ITAA36 might avoid income tax on any distribution to the shareholders.

However, according to the ATO, demerger relief will not often be available due to the application of s 45B ITAA36. The ATO's views may be found in PS LA 2005/21. In the example in Figure 1, if the demerger occurred to facilitate the more efficient running of the businesses, demerger relief may be available. On the other hand, if the demerger occurred to facilitate a sale by one of the shareholders, the anti-avoidance rule in s 45B would apply. Demergers to facilitate the more efficient running of businesses in the mid-market are relatively rare. They are more likely to be considered as part of an exit strategy.

Demerger relief is, therefore, rare in business succession planning scenarios – at least when it is designed as part of an exit strategy for one or more of the shareholders.

Exotic and other equity interests

A patriarch may want to issue shares or units to family members, perhaps at a nominal value, to give them a share of the business.

If the family member is an employee, the employee share scheme (ESS) rules in Div 13A ITAA36 might apply if shares or options are issued at a discount to market value. These rules do not require particular documentation or even offers to a number of employees – they can apply to the issue of shares to a single employee.

If there are units rather than shares issued, the FBT rules may apply rather than the ESS rules.

If equity is issued at other than market value, the CGT value shifting rules also need to be considered.

Alternatively, the directors might decide to issue bonus shares or shares of a particular class to family members. For example, they might not have voting rights or they might have preferential (or reduced) rights to income or capital.

The tax implications of these arrangements will depend on the precise facts, but the following rules may apply:

- dividend streaming – s 45 ITAA36;
- dividend and capital benefit streaming – s 45A ITAA36;
- the benchmark franking rule – Div 203, especially s 203-25 ITAA97;
- the linked distribution rules – Divs 170 and 204 ITAA97;
- franking credit streaming – s 204-30 ITAA97 and s 177EA ITAA36;
- value shifting – Divs 723, 725, 727 and 140 (that can have a residual effect) ITAA97;
- debt/equity rules – Div 974 ITAA97; and
- the general anti-avoidance rules – Pt IVA ITAA36.

In other words, if you currently have or are considering issuing other than ordinary shares, take particular care and consider seeking specific specialist advice on issues such as the above.

Stamp duty

The stamp duty implications will depend on the details of the arrangement and the law in the relevant state or territory. You should seek specialist advice but, as a general guide, remember that:

- there can be duty on security or lending documents;
- duty can arise on the transfer of property, not just real property;
- property can include goodwill, even when it is not disclosed in the accounts;
- goodwill might exist in a jurisdiction in which you trade, even if, for example, your factory is elsewhere;
- duty could arise on the transfer of shares or units under the land rich rules, if the company or trust owns substantial real estate;
- if you are amending a trust deed, there may be a resettlement that might result in a duty liability; and
- there are exemptions from duty in the relevant jurisdictions.

GST

The GST implications of a business succession plan will, of course, depend on the precise details of the plan.

However, as a general guide, you should consider whether there is a supply by an enterprise that is registered or required to be registered and whether any exemptions might apply – for example, for certain financial supplies.

Remember that the term supply is defined very broadly. It includes not only the supply of goods and services but also advice, the grant and surrender of rights, the entry into or release from obligations to do anything, to refrain or to tolerate an act or situation.

Also, keep in mind that the going concern exemption which some people might feel inclined to rely upon without delving into the intricacies, can be very complex and difficult to satisfy.

It follows that specialist GST advice can be very important.

Chapter 21

Interaction between family law and estate planning

¶21-100 Introduction

This chapter will examine generally some of the ways in which family law can impact on estate planning.

It should be noted that family law proceedings relate not only to marriages but also to de facto (including same-sex) relationships.

A court may make an order dividing property of a de facto relationship where the period of the relationship is at least two years. In addition, an order may be made regardless of the length of the relationship in circumstances where there is a child of the relationship, where the party seeking the order has made a (financial or non financial contribution) and it would be unjust if no order was made or if the relationship was registered under state or territory law.[1]

There are three key reasons this chapter has been added to the 2011 edition.

First, there appears (from the author's experience at least) to be an increase in the number of estates where family law proceedings are on foot at the time of death of one of the parties. This may simply be a reflection of the growing number of divorces. It may, however, also be the case that where a couple are estranged and one of them is terminally ill, the other has been advised that their prospects of receiving a share of the property pool is likely to be greater under family court proceedings (commenced before death) compared to a post-death claim against the deceased's estate under testator family maintenance (family provision) rules.

Second, clients are increasingly concerned that their child's inheritance (whether received or prospective) may be the subject of a court order in the event the child's relationship breaks down. This leads to clients seeking advice on will-drafting strategies to limit the likelihood of an inheritance becoming the subject of a court order.

Third, clients are increasingly interested in the use of binding financial agreements – both as between themselves and their partner and also between the clients' child and their respective partner.

This chapter sets out general principles only. A typical family law matter will involve many complex issues and will of course be decided on its own facts, including the circumstances of the parties and having regard to the law, not all of which is covered in this chapter.

¶21-105 How does a court divide property?

The approach that courts generally adopt when dividing property of the marriage or de facto relationship ("the property pool") was set out in the case of *Hickey & Hickey & Attorney-General for the Commonwealth of Australia*[2] where it set out four interrelated steps:

1 See ss 4AA and 90SB of the *Family Law Act 1975*. Note also that in some jurisdictions it is possible to register a relationship.

2 [2003] FamCA 395 at [39].

- first, the court should make findings as to the identity and value of property, liabilities and financial resources of the parties at the date of the hearing;
- second, the court should identify and assess the (financial and non-financial) contributions of the parties as a percentage of the net value of the property. Note that non-financial contributions include the contribution of one party as the "homemaker";
- third, the court should identify and assess the relevant matters in certain sections[3] of the *Family Law Act* (such as the earning capacity of the parties, and, to the extent relevant, the age, financial resources and child-minding responsibilities of the parties) and determine the adjustment (if any) that should be made to the contribution-based entitlements of the parties established at step 2;
- fourth, the court should consider the effect of those findings and determination and resolve what order is just and equitable in all the circumstances of the case.

(Note, the term "financial resource" in step 1. Property that is a "financial resource" does not form part of the "property pool" which the court divides between the parties. However, a "financial resource" can be taken into account when the court undertakes the third step.)

After going through the four steps, the court will divide the assets based on the financial and non-financial contributions made by the parties and their future needs. The court can effect this division in either of two ways: an asset-by-asset approach or a global asset approach.[4] The global approach is more convenient and may be preferred for that reason, especially where one party has made a significant contribution as a homemaker. In shorter marriages however the asset-by-asset approach may be preferred.

¶21-110 How does a court adjust for "financial resources"?

As stated above, assets that are only "financial resources" of a party cannot be divided between the parties but may influence the division of the property pool.

3 That is, matters referred to in s 79(4)(d), (e), (f) and (g) ("the other factors"), including, because of s 79(4)(e), the matters referred to in s 75(2) so far as they are relevant.

4 In an asset-by-asset approach, the court deals with each asset separately. In a global asset approach, the court pools the assets and then makes one split – eg 60/40.

Example

Andrew and his wife Molly are separating. They have $1m in matrimonial assets, being a house property, investments and motor vehicles.

In addition, Andrew and his two siblings are trustees of a testamentary trust established under the will of his late father. The trust has assets valued at $2m. The beneficiaries include the three siblings and their families, and distributions from the trust have historically been made on a needs basis - ie not automatically, one third to each family.

In these circumstances, it is likely that the court would regard Andrew as having an interest in the trust that is a financial resource but not matrimonial property.

The court *might*, for example, say "Instead of dividing the matrimonial property equally between Andrew and Molly we take into account the $2m testamentary trust which has some value as a financial resource to Andrew, and direct that the matrimonial property be divided $650,000 to Molly and $350,000 to Andrew".

¶21-115 Family law proceedings versus claim against estate

Returning to the situation described in the introduction, where a couple are estranged and one is terminally ill, there are three reasons one partner might consider commencing family law proceedings prior to the death of the terminally ill partner:

- first, the party instigating proceedings under family law might be awarded a greater share of the property pool under a family law settlement than they would if they simply made a claim against their deceased partner's estate;
- second, if the terminally ill partner held money in a superannuation fund (as is usually the case) the family court may allocate part or all of the superannuation interest to the other partner.[5] In contrast, if a superannuation death benefit was paid directly to individuals and not to the member's estate, that superannuation would be beyond the reach of any claim made against the estate; and
- third, if the terminally ill partner controlled a family trust (as is often the case) there is a possibility that the family court would regard the assets of the trust as either:
  - a financial resource of the terminally ill partner, which may result in the other partner being allocated a greater share of the property pool; or
  - part of the property pool, which would then be the subject of the court order.

¶21-120 Is inherited property at risk in family court proceedings?

An inheritance received during the marriage will invariably form part of the pool of property that a court can divide between the parties.

5 Under s 90MC of the *Family Law Act 1975* a superannuation interest is treated as property.

The leading authority for this is *Bonnici and Bonnici*.[6] In this case, the husband received two inheritances shortly prior to the end of what was a 21-year marriage. He argued that the inheritances should fall outside of the divisible property pool. The husband argued that the inheritance should fall into a category of assets protected from distribution, but the court rejected this argument.

Similarly, in *Dashwood & Bennett*[7] the parties had been married for nearly thirty years before separating in 2008. In late 2007 the wife's mother died and the wife eventually received an inheritance of just under $150,000. Referring to *Bonnici*, the court said:[8]

> "There is no dispute that the wife's inheritance should be treated as property rather than simply a financial resource available to her."

However, an inheritance received after separation but before trial may or may not be included in the property pool.[9] If it is not included in the property pool, the division of the pool will usually be adjusted taking the inheritance into account as a "financial resource".

¶21-125 Factors influencing whether inherited property will be divided

Having established, then, that inherited assets (prior to separation, at least) will form part of the property pool that may be divided, the next question is whether an inheritance will actually be divided.

As noted at ¶21-105, the court may deal with property on an asset-by-asset approach or by a global approach. While these approaches may lead to different results for the treatment of inherited assets, the final position of the parties will often be similar, regardless of which approach is taken. Keeping an inheritance separate from other property may increase the likelihood of the inherited property being retained by the recipient spouse, provided there are sufficient other assets to enable a just division of the total property pool between the parties.

Whether the benefit of an inheritance will be shared between the parties or retained by the recipient spouse will depend on a range of factors referred to in the third and fourth steps referred to in ¶21-105. Some of the likely important factors are:

- how recently was the inheritance received – as a general rule, the longer the duration of the relationship the less likely the court will be inclined to allocate a greater portion to the party who received the inheritance;

6 (1992) FLC ¶92-272.

7 [2011] FMCAfam 93.

8 At 72.

9 See, for example, *GWH & PGH* [2005] FamCA 388.

- the size of the inheritance as against the total asset pool; and
- the contribution (if any) of the parties to the inheritance.[10]

Example

Phil and Kim have been married for two years. They do not have children, they both work full time, have kept their assets separate and have contributed equally to expenses. Phil's mother died nine months ago and left him an inheritance of $1m which has now been paid to him and which he has deposited in an account in his own name.

Phil and Kim have now decided to divorce.

Phil's inheritance will form part of the property that may be divided.

In these circumstances, it is likely that the court would regard Phil as being entitled to retain all, or the vast majority, of his inheritance. As the inheritance was segregated, this would probably be done on an asset-by-asset basis.

Example

Ali and Yung have been married for 15 years. They have three children. Yung has been the primary income earner for the duration of their marriage as they started a family shortly after they were married. Ali gave up her promising career as a lawyer to care for the children, perform all home duties and enable Yung to advance his career. Yung's mother died 10 years ago and left him an inheritance of $1m which was used to pay off their mortgage. They have few assets other than their house property.

Ali and Yung have now decided to divorce.

Yung's inheritance will form part of the property that may be divided.

In these circumstances, it is very likely that Yung would *not* retain the benefit of the vast majority of his inheritance.

¶21-130 Are future inheritances at risk in family court proceedings?

While property belonging to, say, a parent of one of the parties cannot be the subject of a court order, it is the case that the division of the pool of assets between the parties can be adjusted to take into account the likelihood that one party will receive an inheritance.

10 For example, in *James and James* (1978) FLC ¶90-487, where the wife had contributed by working on the husband's parents property which the husband ultimately inherited.

One of the early cases dealing with this possibility is *White v Tulloch*.[11] The court said:[12]

> "The answer is ultimately a question of fact and degree … In a case where the testator had already made a will favourable to the party but no longer had testamentary capacity and there was evidence of his or her likely impending death in circumstances where there may be a significant estate, and where there was a connection to s.75(2) factors, it would be shutting one's eyes to realities to treat that as irrelevant. On the other hand, the bald assertion that one of the parties has an elderly relative who has property and is or is likely to benefit that party is so speculative that it would be inappropriate to contemplate it as relevant in a s.79 determination, it being too remote to affect the justice and equity of the case in any worthwhile way."

By giving the example of a testator who "no longer had testamentary capacity", the court in *Tulloch* appeared to tread conservatively around the issue of prospective inheritances. Recent cases suggest that courts are increasingly willing to bring prospective inheritances into account.

For example, in *De Angelis and De Angelis*,[13] the court said:[14]

> "The discussion by the Full Court in *White and Tulloch v. White* (1995) 19 Fam LR 696 of this question of the treatment of anticipated inheritances in property settlement proceedings indicates that there is no absolute rule and that each case will depend on its own facts. However, we think it important to remember that the Court is required in exercising the jurisdiction under s.79 of the *Family Law Act 1975* to accord justice and equity to both parties. The question therefore has to be asked whether, in the present case, it would be just and equitable to the husband for the Court to have ignored the probability that, in what could well be very short period of time (given the ages of her aunt and mother), the wife could well be the owner of two properties having a combined value of almost the same amount as the value of the parties' property currently available for distribution, and particularly in circumstances where the husband had been found to have done substantial improvement and maintenance work on both properties?
>
> We consider that it would have been unjust to the husband to ignore this matter *even if it was categorised only as a possibility and not a probability*." (emphasis added)

As noted in ¶21-100, each case must be determined on its own facts. Currently, however, whether a court will take a prospective inheritance into account will most likely depend on matters such as:

- the likelihood of the party receiving the inheritance;
- when the inheritance could reasonably be expected to be received;
- the amount of the likely inheritance; and
- the needs of the parties.

11 (1995) FLC ¶92-641.

12 At 51.

13 (2003) FLC ¶93-133.

14 At 95 and 96.

¶21-135 Binding financial agreements

A binding financial agreement (BFA) is a written agreement entered into by two people which sets out what is to happen to some or all of their property (including, if they wish, prospective inheritances) in the event of their separation.

While BFAs are sometimes referred to as "pre-nuptial" agreements, that term is misleading as a couple can enter into a BFA before, during or after the relationship.[15]

As the effect of the BFA is to override the court's ability to deal with property of a relationship, strict rules apply and these must be adhered to when making a BFA.

For example, before signing a BFA, each party must have received independent legal advice from a legal practitioner about the effect of the agreement on the rights of that party and about the advantages and disadvantages, at the time that the advice was provided, to that party of making the agreement.

A BFA can be set aside in certain circumstances, including:[16]

- where the BFA was obtained by fraud (including non-disclosure of a material matter);
- where a party entered into the BFA for the purpose of defrauding creditors or a person who is a de facto of either of one of the parties;
- the BFA is void or unenforceable;
- in the circumstances that have arisen since the BFA was made it is impracticable for the BFA or a part of the BFA to be carried out;
- a payment flag is operating under Pt VIIIB on a superannuation interest covered by the BFA and there is no reasonable likelihood that the operation of the flag will be terminated by a flag-lifting agreement under that Part; or
- the BFA covers at least one superannuation interest that is an unsplittable interest for the purposes of Pt VIIIB.

¶21-140 Strategies to address family law concerns

The above discussion identifies a number of ways in which family law might have an adverse impact on their estate planning.

The following table summarises these strategies and these are expanded on in the following text in this chapter.

15 Ss 90B, 90C, 90D (if married) and 90UB, 90UC and 90UD (if de facto) of the *Family Law Act 1975*.

16 These and other circumstances are listed in s 90K of the *Family Law Act 1975*.

	Concern	Possible strategy
(1)	My partner might instigate family law proceedings shortly before my death	Enter into a BFA now
(2)	My partner might make a TFM claim against my estate	Enter into a BFA now and, perhaps, include intentions as to what should happen in event of death
(3)	My former partner might make a claim against my estate	Negotiate in settlement
(4)	My gift in my will to child A might end up going to child A's ex-partner	Request child A and partner to enter into a BFA
		Set up a testamentary trust for child A and descendants with (truly) independent trustees
		Set up a single testamentary trust for children A, B and C and all their descendants with A, B and C as trustees
		Set up a life interest trust for child A with child A's children to receive the capital (query if this gives child A enough provision)
		By-pass child A and set up trust(s) for child A's children (same query)
		Give child A a small amount and remainder to a trust for child A's children (same query)
(5)	I'm settling my divorce but expect my spouse will receive a significant inheritance in the near future	Negotiate a periodic maintenance payment to spouse instead of a lump sum capitalised payment

Family court proceedings commenced before death

If a couple is concerned that either of them might, prior to death of either of them, commence family law proceedings that would then disrupt their estate planning, they could consider entering into a BFA.

It might be appropriate to also consider supporting the BFA with a mutual will arrangement – see ¶8-160.

TFM claims by partner

A BFA will not usually contract out the right of one party to make a testator family maintenance (TFM) claim against the other's estate.

However, when deciding whether a person in their will has made adequate provision for another, it is open to the court to take into account the terms of a BFA (or a deed of similar effect), to the extent the court considers this to be relevant.

In *Kozak v Matthews*[17] the parties entered into a deed that effectively said one partner had no right to the house that was registered in the other partner's name. The registered owner died, and the surviving partner made a claim against the deceased partner's estate. In assessing this claim, the judge took the deed into account when deciding whether provision made in the deceased's will was adequate in all the circumstances. The decision of the judge was affirmed on appeal.

Similarly, in *Hills v Chalk & Ors*[18] the husband asked the court to order that he could bring a claim for additional provision from his wife's estate even though the statutory period for making the claim had expired. The Court of Appeal of the Supreme Court of Queensland said:[19]

> "The strength of a pre-nuptial agreement as one of the relevant factors must of course vary from case to case: in this case, the brief summary of the evidence I have given suggests that this pre-nuptial agreement provides considerable support for the view that the provision in the will was 'adequate' for the 'proper' maintenance and support of the respondent."

Based on the above decisions, parties might receive some protection from TFM applications if they refer in the BFA to their intentions in the event of their deaths. It is submitted that any such references should be drafted carefully to avoid the BFA being deemed to be an informal will or codicil.

TFM claims by former partner

It should be remembered that the law in Victoria does not prevent a former partner from making a claim against the other partner's estate – see chapter 12.

In other jurisdictions, a former spouse is able to make a claim against a deceased's estate– see Table 1 at ¶12-110.

If the possibility of a TFM claim by a former partner is a concern, any family law settlement should, to the extent possible, be negotiated to carve out the other party's right to make a TFM claim.

Binding financial agreements for a beneficiary

If a willmaker is concerned that their gift to a beneficiary will be at risk in the event the beneficiary suffers a relationship breakdown, the willmaker may wish to consider talking to the beneficiary and suggest that he or she and their partner should enter into a BFA. This may be a difficult conversation, for obvious reasons.

However, where significant assets are involved it can be a very important conversation. It is also an area where the willmaker's adviser can become involved and add value as a "neutral" party. The presence of an adviser (or counsellor) may help change the beneficiary's reaction from:

17 [2007] QCA 296.

18 [2008] QCA 159.

19 At 209.

- "You've never liked my partner and now you're telling me not to trust him/her too!"

to:

- "This is a prudent asset protection issue and a BFA has been suggested by the independent adviser as a solution which people commonly use."

Testamentary trust with independent trustees

A willmaker concerned that an inheritance (or prospective inheritance) might be taken into account in a property settlement could consider the use of a testamentary trust with independent trustees.

In *Ward & Ward*[20] the husband was one of three siblings. His mother, a widow, had made a will leaving a one-third share of her estate to each sibling, absolutely. Two days before the husband and his wife separated, the husband's mother amended her will and instead of giving him a one-third share of the estate absolutely the one-third share was to pass to a testamentary trust, the beneficiaries of which were the husband and his two children and the trustees of which were the husband's sister and the mother's solicitor. The husband admitted under cross-examination that the purpose of the change was to put the inheritance out of reach of his wife. The mother died in 2003 and the family law case came before the court in 2004.

The court said that the trust assets would not be brought into the marital property pool, but were a financial resource:[21]

> "In *Bonnici*, the inheritance had vested. This is not the case here. I am satisfied that the creation of the testamentary trust was for the purposes, acknowledged by the husband, to put it out of the reach of the wife. Certainly he has achieved that in a control sense. The wife cannot assert any right to alter the husband's contingent interest in the trust.
>
> I am satisfied that it is likely on the balance of probabilities that the husband will receive the whole of the entitlement of the testamentary trust personally. Once final orders are made then any vesting of an interest in the trust will be 'beyond the reach of the wife'. I expect it will vest for the husband's full benefit.
>
> The contingent interest represents at this time a financial resource."

As the court considered the assets in the testamentary trust to be a financial resource of the husband, it was able to increase the wife's share of the property pool to reflect the benefit of the "inheritance".

It would have been interesting to see what the court would have done in *Ward* if the inheritance paid to the testamentary trust was significant and there were insufficient assets in the property pool to make a "just" adjustment. It would surely have been tempted to classify the assets of the trust as part of the property pool, especially as it would be reasonable to expect the trustees to follow the direction of the husband. The result might be different again, however, if the trustees were truly independent.

20 [2004] FMCAfam 193.

21 At [31] to [33].

Single testamentary trust for multiple "primary beneficiaries"

A willmaker could consider setting up a single testamentary trust for children A, B and C and all their descendants with A, B and C as trustees – see example at ¶5-115.

Life interest trust

A willmaker could consider structuring the testamentary trust as a life interest trust whereby:

- child A and his children are entitled to the income of the trust, at the discretion of the trustee;
- the children of child A, as they attain x years of age, receive the capital of the trust.

By-pass child

A willmaker concerned about the possibility of a child suffering a relationship breakdown could consider by-passing the child and instead establish one or more trusts for the willmaker's grandchildren.

Child and grandchildren trusts

A willmaker could also consider a nominal trust for the child and one or more trusts for the willmaker's grandchildren.

Adjusting a family law settlement

If a client is getting divorced and it is likely that their partner will come into a significant inheritance in the not too distant future, it might be in your client's best interests to push for periodic maintenance payments instead of a lump sum capitalised payment. Then, if the partner subsequently receives the significant inheritance, the obligation to continue the maintenance payments may fall away.

Chapter 15

Dealing with superannuation

¶15-100 Introduction

Since the introduction of the *Superannuation Industry (Supervision) Act 1993* (SISA), superannuation has become one of the most important wealth generation vehicles for most Australians. It will continue to hold an important place in the future as a result of the additional tax incentives offered from 1 July 2007.

In particular, the abolition of the compulsory cashing rules and the abolition of tax on benefits paid after the superannuation fund member's 60th birthday means that the treatment of superannuation upon death is a major issue for clients of financial planners, accountants and lawyers.

The ability to provide comprehensive strategic advice on superannuation will help advisers strengthen their relationships with clients and limit the likelihood of disgruntled clients seeking advice elsewhere. The financial consequences of not receiving the correct advice can be significant to the client.

This chapter provides a thorough analysis of the superannuation planning opportunities in the event of death and incapacity. We look at the relevant legislation and demonstrate solutions through the use of detailed examples and troubleshooting strategies.

¶15-101 Superannuation and incapacity

A person's incapacity will give rise to important succession and estate planning opportunities and strategies.

Incapacity and taxation

In chapter 2, we discussed the important role that an attorney or guardian can play in making financial decisions on behalf of an incapacitated person. The following example demonstrates how significant taxation savings can result from an attorney cashing a superannuation benefit immediately prior to a member's death. This strategy arises because tax will be payable on death benefits paid to persons who are not dependants for tax purposes (see ¶15-145 and the Appendix to this chapter).

Example

Helen is a widow aged 65 years and no longer has capacity. She has three daughters, the eldest of whom is her attorney under an enduring power of attorney. One of Helen's assets is an interest in a superannuation fund, consisting entirely of a taxed component, valued at $750,000.

Helen's only beneficiaries are her three children, none of whom are tax dependants.

If Helen died with the money still in the superannuation fund then the death benefit is paid to her children from her superannuation fund, it would be taxed at 16.5%.

Helen is close to death. Her attorney decides to withdraw her benefit which is done tax-free. Helen dies one week later. The $750,000 forms part of her estate and is then distributed to the beneficiaries named in her will, being her three daughters.

Example (cont)

If at the time of Helen's death the $750,000 was still held in her superannuation fund then, upon withdrawal tax of $123,750 would have been paid as the benefit was not paid to a tax dependant. By withdrawing the whole benefit shortly before Helen's death, the attorney has saved this amount.

Note, for a further discussion of this strategy – including risks – and a description of terms such as "taxed component", see ¶15-145.

In 2008, the SISA was amended to permit a member's benefit to be withdrawn where the member is suffering a "terminal medical condition" which is defined in the SISA to exist where:

- two registered medical practitioners certify that the member suffers from an illness, or has incurred an injury, that is likely to result in the death of the person within a period (the certification period) that ends not more than 12 months after the date of the certification;
- at least one of the registered medical practitioners is a specialist practising in an area related to the illness or injury suffered by the person; and
- for each of the certificates, the certification period has not ended.

Benefits withdrawn because of a terminal medical condition are received tax-free.[1] The terminal medical condition provision therefore expands the opportunity for benefits to be withdrawn in a tax-effective manner.

Example

Tyler is 35 years old and, following a terrible accident, is in a coma and is not expected to live more than a month. He has no tax dependants.

It may be possible for his attorney or guardian to request the trustee of his superannuation fund to cash his benefit on the basis that Tyler suffers from a terminal medical condition, in which case the benefit will be received tax-free.

In contrast, if Tyler's benefit had not been withdrawn prior to his death and a death benefit had been paid to a non-dependant for tax purposes – for example, his parents – then tax would have been payable in respect of the death benefit.

Incapacity and binding death benefit nominations (BDBNs)

Where a person has lost capacity, their attorney (or, in some cases, a guardian) will usually have full control over the person's financial affairs including their superannuation. This gives rise to several important questions including:

1 S 303-10 ITAA97.

- if the member has satisfied a condition of release (eg is aged over 60), does the attorney have the necessary knowledge to make important decisions such as whether to cash part or all of the benefit?
- does the attorney have the integrity and skill to take responsibility for the investment of what might be a significant sum of money?
- can the attorney confirm a BDBN or revoke or make a new BDBN?
- can the attorney take some other action that enables them to effectively revoke a BDBN or make a new BDBN?

We will discuss these in turn.

As seen at ¶2-110, an attorney will have significant powers including, depending on the age and health of the incapacitated person, the power to cash all of their superannuation benefits. Once benefits are cashed, the attorney would receive the proceeds and in most cases there would be little day-to-day supervision over how the attorney applies these proceeds. The following example serves as a reminder that it is essential to choose attorneys wisely, to consider appointing two people to act jointly and, in some cases, to consider appointing an independent party such as an accountant, financial adviser, lawyer or trustee company.

Example

Doris, aged 65, lives in Hobart. She has four children but only one, Sue, lives in Hobart and so Doris appoints Sue as her attorney under an enduring financial power of attorney.

Doris loses capacity and Sue takes over the management of her financial affairs which includes Doris's superannuation interests, valued at $1m.

Sue discovers that she is able to cash all or part of her mother's superannuation. Reasoning that she is really doing quite a lot of unpaid work for her mother, and believing also that her mother really did like her much more than her siblings, Sue starts cashing her mother's superannuation benefit and spending more and more time down at the local pokies tavern.

When Doris dies two years later, Sue has spent all of the superannuation, her siblings were left with little financial recourse, and the pokies tavern now has a rooftop garden.

It is unclear whether an attorney or guardian is able to make a new BDBN or revoke a BDBN – the favoured view is that this is not possible.

It is also unclear whether an attorney is able to keep alive a BDBN by exercising the member's right to confirm the nomination and therefore refresh its operation for a further three years, as members are permitted to do under the *Superannuation Industry (Supervision) Regulations 1994* (SISR).[2] It appears that some superannuation funds permit an attorney to refresh a BDBN in this way. It will usually depend on the fund's trust deed and the attitude of the trustee. The inclusion of a clause in a power

2 Reg 6.17A(5) SISR.

of attorney stating that the attorney can confirm a BDBN may be helpful, although not necessarily determinative.

It may be possible for an attorney to take other action that has the effect of revoking a BDBN or making a new BDBN, such as moving the member's benefit from one superannuation fund to another. Whether such action is possible or appropriate will depend on the circumstances.

Example

Bruno, who has $200,000 in his SMSF, has lost capacity and his son, Ant, is his sole attorney.

Ant discovers that Bruno has made a non-lapsing BDBN that directs his superannuation to Ant's two sisters (40% each) and to Ant (20%).

Ant knows that Bruno's will will leave his estate to the two sisters (25% each) and to Ant (50%).

Ant uses his power as attorney to close Bruno's SMSF and roll over his benefits to a public offer superannuation fund, the rules of which provide that any death benefit be paid to the member's (Bruno's) estate.

While transactions entered into by an attorney for their own benefit will usually be able to be unwound, or challenged to remove the benefit from the attorney, this assumes that the disadvantaged parties are aware of the offending transactions.

Incapacity and SMSFs

It is a requirement of self-managed superannuation funds (SMSFs) that each member of the SMSF be a trustee, or a director of the corporate trustee, of the SMSF. Section 17A of the SISA sets out an exception to this requirement. Under s 17A(3)(b)(ii), a person who holds an enduring power of attorney granted by a member may be a trustee, or a director of the corporate trustee, in place of that member without causing the SMSF to breach the legislation. See ¶2-110 for more details.

¶15-105 What is a superannuation death benefit?

A superannuation death benefit is a benefit received by an individual due to the death of another person. The benefit may come from:

- a superannuation fund;
- a retirement savings account;
- an approved deposit fund; or
- an annuity purchased with superannuation moneys.

A superannuation death benefit does not include a payment by an employer following the death of an employee. This type of payment, known as a death benefit termination payment, is treated differently to a superannuation death benefit for taxation purposes.

For details on the treatment of employer death benefits, refer to ¶15-155.

Likewise, the proceeds of a life insurance policy paid to a beneficiary are not treated as a superannuation death benefit, unless the owner of the policy was the trustee of a superannuation fund and the proceeds were paid to a beneficiary by the trustee as a result of the death of a member of the superannuation fund.

For details on the treatment of proceeds of a life insurance policy owned by an individual, refer to ¶19-115.

¶15-110 Who can receive a superannuation death benefit?

The range of people eligible to receive a superannuation death benefit is limited. Restrictions are imposed upon the superannuation fund by legislation and the trust deed. To be eligible to receive a death benefit, a person must fall within the legislative confines. In addition, it is necessary to ensure that the trust deed does not exclude the person from being a beneficiary. It is important to note that if a person is eligible to be a beneficiary under legislation but not under the fund's trust deed they are not eligible to be a beneficiary.

Once the class of potential recipients has been identified, the actual recipients may be determined as a result of a binding death benefit nomination or, where a binding death benefit nomination does not exist, following the exercise of trustee discretion.

Restrictions imposed by legislation

The SISA generally limits beneficiaries to one or more of the following:

- a dependant of the member, as defined in the SISA;
- the member's legal personal representative (LPR) – that is, the executor or administrator of the member's estate.

If there is no-one who falls into these two categories, the beneficiary may be any individual or individuals nominated by the trustee.

The SISA defines a dependant as including:

- the spouse of the member;
- any child of the member; or
- any person with whom the member has an interdependency relationship.[3]

Because the definition is inclusive, persons other than a spouse, child or interdependent can be regarded as a dependant. For example, a person may be regarded as a dependant if they were financially dependent on the deceased (see below).

3 S 10 SISA.

Who is a spouse?

A spouse includes an individual who, whether or not legally married to the member, lives with the member on a genuine domestic basis as the member's husband or wife.[4] The definition of "spouse" in the SISA was amended with effect from 1 July 2008 and now includes:

- a de facto partner of the member (whether same-sex or a different sex), and
- a person (whether same-sex or a different sex) with whom the member is in a relationship that is registered under the law of a state or territory; for example, Victoria, Tasmania and the ACT have prescribed legislation for registering relationships.

A de facto partner is generally regarded to be a person who, although not legally married to the member, lives with the member on a genuine domestic basis in a relationship as a couple.

Who is a child?

A child is defined to include an adopted child, a stepchild or an ex-nuptial child of the member. It does not include a grandchild of the member unless that grandchild had been adopted by the member although the grandchild may be a financial dependant (see below).

It is important to note that if a stepchild has not been formally adopted by the deceased member, they will only be treated as a stepchild while the child's natural parent is still alive. From 1 July 2008 the definition of child in the SISA was broadened so that it now includes all children of a spouse and anyone who is a child as defined in family law legislation. The effect of the amendment is that the definition of child now includes a child of a couple even though only one parent is a biological parent, capturing children born from surrogacy procedures and a child of an opposite sex or same-sex de facto by a former relationship. The definition of "child" includes:

- an adopted child, a stepchild or an ex-nuptial child of the deceased;
- a child of the person's spouse (regardless of whether that spouse is married to, or a de facto of, the member; and
- someone who is a child of the person within the meaning of the *Family Law Act 1975*.

Under the *Family Law Act 1975*, a child includes situations where:

- a child is born through artificial conception;
- a child born through a surrogacy arrangement; and
- a child is a child of a de facto partner through artificial conception, surrogacy or adoption.

Where a donor has provided genetic material for a birth by artificial conception, the child produced is not a child of the donor.

4 S 995-1(1)I ITAA97.

Who is an interdependent?

Two people, whether or not related by family, are considered to have an interdependency relationship if they satisfy all of the following:

- they have a close personal relationship;
- they live together (unless unable to because of a disability);
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.[5]

The SISR state that the following circumstances of the relationship between the deceased and the person in question (to the extent relevant) should be considered when determining whether a close personal relationship exists:[6]

- the duration of the relationship;
- whether or not a sexual relationship exists;
- the ownership, use and acquisition of property;
- the degree of mutual commitment to a shared life;
- the care and support of children;
- the reputation and public aspects of the relationship (such as whether the relationship is publicly acknowledged);
- the degree of emotional support;
- the extent to which the relationship is one of mere convenience; and
- any evidence suggesting that the parties intended the relationship to be permanent.

If two people, whether or not related by family, have a close personal relationship but do not satisfy some or all of the other requirements of interdependency – because one or both suffer from a physical, intellectual or psychiatric disability or because they are temporarily living apart – then they will still be deemed to have an interdependency relationship.[7]

Examples of interdependency relationships may include two siblings living together or an adult child who lives with and cares for an ageing parent on a long-term basis. A student who is living with parents while finishing their studies would not generally be considered to be in an interdependency relationship with those parents, however, that student may still meet the definition of a financial dependant – see below.

5 S 10A SISA.

6 Reg 1.04AAAA(2) SISR.

7 Reg 1.04AAAA(3) and (4) SISR.

The terms "domestic support" and "personal care" are not expressly defined in the SISA. However, the SISR list the following as examples of "care":[8]

- significant care provided for the other person when he or she is unwell; and
- significant care provided for the other person when he or she is suffering emotionally.

Importantly, in listing those examples, the regulations refer to those examples as being "care normally provided in a close personal relationship rather than by a friend or flatmate".

Who is a financial dependant?

A person is also regarded as a dependant if they were financially dependent on the deceased member. This means that they must generally have relied upon the financial support of the member to maintain their usual standard of living just before the member's death. However circumstances prior to date of death may also be relevant when determining financial dependency.[9] It is possible for "financial dependency" to arise from many different types of relationships. For example, a mother has been deemed to be financially dependent on her deceased son[10] (they lived together and the son made financial contributions as well as undertook responsibility for repairs and gave other support), as have friends.[11]

Determining who is a dependant will not always be straightforward and is impacted by regular changes to SIS and interpretations by the courts. Care must be taken when advising clients, remembering that the broadening of the definition of dependant may suit some clients but may be a concern to others.

See the table in the Appendix to this chapter for a summary of who is a dependant for the SISA purposes.

Restrictions imposed by the trust deed

A superannuation fund is a trust that is governed not only by the relevant legislation, but also by rules in the fund's trust deed.

The trust deed can restrict who the superannuation death benefit is paid to – for example, it may state that a death benefit must go to a spouse where the spouse survived the deceased. Trust deeds for older funds should be studied carefully as some of the death benefit provisions are usually narrower than in most modern deeds – for example, the definition of dependant may be restricted to a married spouse and children of the marriage.

A strategy that is gaining in popularity is the use of a self-managed superannuation fund (SMSF) trust deed to make sure that a superannuation death benefit is paid to certain people.

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8 Reg 1.04AAAA(2) SISR.

9 *Noel v Cook* [2004] FCA 479.

10 *Malek v FCT* (1999) 99 ATC 2294.

11 *Noel v Cook* [2004] FCA 479.

Example

Martin held $500,000 in his self-managed superannuation fund.

He knew that on his death there was likely to be a dispute between his two children over the benefit. He wanted his daughter, Alice, to receive the whole benefit because she had looked after him for many years. Martin could – subject to the amending power in the trust deed allowing him – amend the trust deed so that on his death the trustee was compelled to pay his death benefit to Alice.

Binding death benefit nominations

A BDBN can be used to direct the trustee to pay a member's superannuation death benefit to the person or persons nominated.[12] The fund's governing rules must allow the trustee to accept a BDBN. Special rules apply for SMSFs – see ¶15-120.

The main advantage of a BDBN is that it gives a degree of certainty to the member and the intended beneficiaries. For example, the nomination is not subject to a challenge to the Superannuation Complaints Tribunal. In addition, if dependants are nominated (as distinct from the member's legal personal representative) the benefit won't be paid to the deceased member's estate and so would not be at risk of a claim against the estate.

For a nomination to be binding it must satisfy all of the following conditions:

- it must be in writing;
- all the beneficiaries nominated must have been dependants of the member just before the member's death or the LPR of the member;
- the nomination must clearly state the proportion payable to each beneficiary and the total of all proportions must equal 100% of the death benefit;
- it must be signed and dated by the member in the presence of two witnesses. These witnesses must be over 18 years of age and must not be nominated beneficiaries;
- the nomination must contain a declaration signed and dated by the witnesses stating that the nomination was signed by the member in their presence;
- the nomination must have been signed, confirmed or updated within the previous three years – or a shorter period if specified in the trust deed. This three-year period starts at the time that the nomination was last signed, confirmed or updated.[13]

If all of these conditions are met, the trustee is required to act in accordance with the BDBN for any death benefits that may be available when a member dies.

12 S 59 SISA.

13 Reg 6.17A SISR.

If – at the date of the member's death – any of these conditions are not met, the nomination will be invalid and the trustee will act as if the nomination did not exist.

There are a number of reasons why a nomination may be invalid at the date of the member's death. The most likely reasons are that:

- the nomination had not been signed, confirmed or updated in the three years before the member's death. It is vital to remember that BDBNs must be reviewed by the member at least every three years;
- not all of the people named as a beneficiary on the nomination were the member's dependants and/or LPR just before the member's death – for example, one of the beneficiaries dies before the member.

Trap

The rules governing the execution of BDBNs in reg 6.17A SISR appear to be onerous in that they do not include a "saving" provision, ie they do not include a separate rule that allows a document to be recognised as a BDBN even though the rules were not strictly adhered to. (Note that not all BDBNs must comply with reg 6.17A.) For example, they require the BDBN to be dated not only by the member, but also by each of the two independent witnesses. It would therefore seem that a BDBN will be invalid where it was signed by the member and witnesses in each other's presence and dated by the member only.

This can be contrasted with legislation dealing with wills which includes a "saving" provision enabling a will to be recognised as valid even if the formal execution requirements are not met. For example, a will may, in some circumstances, be valid even though it was not witnessed or dated.

Even if great care has been taken in drafting and reviewing the BDBN, circumstances surrounding the death of the member may cause the nomination to become invalid.

Example

A husband and wife each provide their trustee with a BDBN.

Each has nominated that their death benefit is to be paid to each other.

A few years later, the couple are in a car accident in which the husband dies and then the wife dies a few days later from her injuries.

What is the effect on each BDBN?

As the wife was still alive at the time of her husband's death, it may be that the husband's BDBN will be valid and must be paid to the wife's estate.

Contrast this to a situation where the fund was a public offer fund and there was no BDBN. The fund trustee made a preliminary decision to distribute the death benefit to the wife who then died before the death benefit was paid. In that case, the wife would have ceased to be a dependent as defined under superannuation law and it may not be possible for the death benefit to be paid to her estate (see, for example, the discussion in *Webb v Teeling*[14]). Remember, it is always necessary to consider any relevant clauses within her fund's trust deed.

14 [2009] FCA 1094.

The rules relating to BDBNs can be complex where a member takes a pension and has nominated a reversionary pensioner. For example, in the case of market linked and allocated pensions, where the reversionary pension beneficiary dies having survived the primary pensioner the superannuation death benefit would usually be paid to a death benefit dependant, or the legal personal representative, of the reversionary pension beneficiary. Depending on all of the circumstances, this may mean that a person who was a death benefit dependant of the primary pensioner only — that is, not a death benefit dependant of the reversionary pension beneficiary — is unable to receive a death benefit following the death of the reversionary pensioner.

It is important to note that BDBNs have some limitations. For example:

- for asset protection reasons, a nominated beneficiary may not want to receive a death benefit directly;
- there is always the risk that the nomination will cease to be appropriate because of a change in circumstances, although the three-year lapsing rule reduces the likelihood of this being the case;
- the BDBN may be overridden in the following circumstances:
  - where a family law payment flag has been made in regard to the member's benefit;[15]
  - where a family law splitting order has been made in regard to the member's benefit;[16]
  - where the trustee is subject to a court order, or aware that the member is subject to a court order, restraining or prohibiting payment in accordance with the notice;[17]
- in New South Wales, if the BDBN can be overridden by a notional estate order (see ¶12-125).

Trap

Be aware that, just as a will can be challenged – for example, on the grounds that there was undue influence or the willmaker lacked capacity – so too might a BDBN be challenged.

If there is a real risk of a BDBN being challenged, you should consult a lawyer with appropriate experience to discuss how the risks can be reduced or eliminated.

Non-lapsing nominations

It has recently become common for superannuation funds to permit members to make "non-lapsing nominations". The concept involves the trustee permitting the member to make a binding direction as to whom death benefits are to be paid. As the trustee no longer has discretion in regard to the payment of death benefits, the usual death benefit nominations rules – including the three-year lapsing rule – do not apply.

15 Under s 90ML(4) of the *Family Law Act 1975* – see reg 6.17AA SISR.

16 Under s 90MU(1) of the *Family Law Act 1975* – see reg 6.17AA SISR.

17 Reg 6.17A SISR. Note that for the purpose of this regulation, "court" means a court exercising its jurisdiction under the SISA.

Typically a non-lapsing nomination would need to:

- be in writing;
- be signed by the member in the presence of two competent witnesses;
- be dated; and
- nominate only beneficiaries who are "dependants" as defined in the SISA and the relevant trust deed.

Trustee discretion

If there is no BDBN and no direction in the trust deed, the trustee may use its discretion to determine who will be the beneficiary of a superannuation death benefit. However, this discretion must be properly exercised. (See chapter 16 for a more detailed discussion on death benefit payments and disputes.)

The trustee must first identify the potential beneficiaries. This requires the trustee to consider any restrictions in the trust deed – for example, the trust deed may contain a definition of dependant which is narrower than that in the SISA.

The trustee must then take into account reasonable matters which include, but are not limited to:

- information regarding the circumstances of the eligible dependants;
- the merits of paying all or part of the benefit to the deceased's estate – assuming that it is an eligible beneficiary;
- any indication of intent provided by the member, including a non-binding death benefit nomination or directions in the will;
- the extent to which a potential beneficiary may receive proceeds from the deceased member's estate.

Often the decision facing the trustee is a difficult one. This is particularly the case where there are both minors and adults who are eligible beneficiaries, or a second spouse and children from the first marriage.

¶15-115 Superannuation Complaints Tribunal

The Superannuation Complaints Tribunal (SCT) is an independent tribunal established by the federal government to deal with certain complaints regarding superannuation funds, annuities and retirement savings accounts. However, its jurisdiction does not extend to SMSFs (see below). A comprehensive description of the SCT's role is set out in chapter 16.

A beneficiary or potential beneficiary may apply to the SCT for a review of the trustee's decision if they feel that they have unfairly missed out on receiving a superannuation death benefit or that the proportion of the death benefit they are to receive should be greater.

A complaint generally cannot be made where the proposed decision was made pursuant to a direction in the fund's trust deed, or as the result of a BDBN.

The SCT has the power to:

- order the trustees to review its proposed decision; and
- confirm the decision of the trustees.

An application to the SCT for the review of a trustee decision must be lodged within 28 days of the trustee's decision.

The SCT's jurisdiction does not extend to decisions made by trustees of SMSFs or certain exempt public sector superannuation schemes.

¶15-120 Issues for self-managed superannuation funds

The SCT's inability to act in SMSF cases can make SMSFs a valuable tool in ensuring that a person's death benefits are paid in the manner desired by that person.

Control of SMSF following incapacity

The rules governing SMSFs require each member to be a trustee or director of the company acting as trustee. Where a member becomes incapacitated, it may be possible for the member's attorney to act in the member's place – see ¶2-110.

Control of SMSF following death

If the decision as to who receives death benefits is to be made by the remaining trustee/s of the SMSF, then the danger is that the trustee/s might decide to pay benefits in a manner that does not accord with the deceased member's wishes.

Example

The case of *Katz v Grossman*[17] is a good example. In that case, the fund member was the father and he and his daughter were the trustees. The father had made a non-binding nomination expressing the wish that his death benefit be divided equally between his daughter and son. Following the father's death his daughter appointed her husband as a co-trustee and they then together resolved to pay the whole of the father's death benefit to the daughter. It was necessary for the son to bring action in the New South Wales Supreme Court in an attempt to protect his position.

It is vital, therefore, that clients understand the problems that can arise in regard to distribution of superannuation death benefits and the strategies they can implement to prevent these problems from occurring. The two most common strategies that give certainty are BDBNs which are properly made (see below) and trust deed direction.

18 [2005] NSWSC 934.

Members intending for their executor (legal personal representative) to represent them after death should ensure that this is not prohibited by the trust deed.

Death benefit nominations

Many in the superannuation industry are of the view that an SMSF member, if permitted by the SMSF's deed, can make a BDBN without the need to update or refresh the nomination every three years as required by s 59(1A) SISA and reg 6.17A SISR. This view is supported by the ATO in its Self Managed Superannuation Fund Determination 2008/3. It should be noted that the ATO's view does not have the effect of legislation. The case of *Donovan v Donovan*[19] serves as a warning to SMSF members and trustees who assume that an SMSF fund member can make a binding nomination in accordance with the SMSF's deed, without having regard to the requirements imposed by s 59(1A) SISR (see ¶15-110). In *Donovan* the court considered whether a letter from a fund member expressing a "wish" that his death benefit be paid to his LPR was binding on the trustee. The court held that it was not binding as the letter referred only to a "wish". However, the judge (Fryberg J) went on to consider whether the trust deed for this fund required a binding death benefit nomination be made in accordance with the requirements of reg 6.17A SISR.

Clause 11.4(b) of the deed said:

> "A member may make a binding death benefit nomination in the form required to satisfy the Statutory Requirements."

It was argued that the definition of "Statutory Requirements" did not capture the requirements of reg 6.17A. The judge disagreed saying that the words in the definition were of general import only and that it is quite plain that the words in cl 11.4(b) signify that a nomination be in the form prescribed by reg 6.17A. The judge then said:

> "The legislation governing superannuation in Australia is notoriously convoluted … It is very easy for trustees and members to make a mistake about the requirements applicable in their particular case. It is very understandable that a deed should specify a requirement in effect to comply with the form described in regulation 16.7A(6) out of an abundance of caution. The alternative would be to require the trustees or the member to take legal advice about whether or not the binding death benefit provisions in SIS apply to SMSFs and to run the risk that their advice might turn out to be incorrect. Such an approach is uncommercial and unlikely. Interestingly, requiring conformity with that regulation also eliminates any argument about whether the disposition is a testamentary disposition which fails to meet the requirements of a Will."

It would also be wise to remember that any dispute that arises with an SMSF death benefit will most likely be bitter, personal and fought out in the courts where the opinions of the superannuation industry and the ATO might be relevant but will not be determinative.

19 [2009] QSC 26.

A BDBN would not be binding if it nominates a person who is not eligible to be a beneficiary under the SISA. A document drafted as a BDBN will also not be binding if the SMSF's deed does not contain a clause permitting the trustees to accept an instruction under a valid BDBN.

Liquidity of assets

It is not uncommon for a member to die leaving the trustee of the SMSF having to grapple with how to pay out the deceased member's benefit when the asset(s) of the fund are mostly or wholly illiquid.

While it is a requirement under the SISA that a trustee have regard to liquidity when making investments,[20] the fact is that liquidity in the event of death of a member is not at the front of mind of the trustee when they are setting the investment strategy or making individual investment decisions. Examples of types of investments that may cause liquidity problems are business real property and geared "instalment warrant" investments.

The result can be that the SMSF is reliant on new members entering the fund or existing members making significant contributions (which may be difficult under the new contribution rules) in order to finance a death benefit payment, or the trustee having to make an in specie distribution.

¶15-125 How can a superannuation death benefit be paid?

A death benefit from a superannuation fund can, subject to the trust deed of the fund, be paid as either a lump sum, an income stream, or a combination of both.

However, if the death benefit is paid on or after 1 July 2007 to a person who is not a dependant for tax purposes – including an LPR – the death benefit must be paid as a lump sum.

A dependant for tax purposes, generally known as a "tax dependant", is limited to:

- the spouse of the deceased;
- a child of the deceased who was under 18 years of age at the date of the deceased's death; and
- any person who was either financially dependent on the member or was in an interdependency relationship with the member just before the member's death.[21]

If a death benefit income stream is paid to a child of the deceased under 18, the income stream must be commuted – that is, the assets supporting the pension must be converted into a lump sum – before the child reaches 25 years of age, unless the child is deemed to be permanently disabled.

20 S 52(2)(f) SISA.

21 S 310-195 ITAA97.

Trap

The form in which a death benefit can be paid may be further restricted by the superannuation fund's trust deed.

It is important that you understand any restrictions before advising a client on estate planning strategies for their superannuation benefits.

Child death benefits

The restrictions on the form in which death benefits can be paid to certain classes of beneficiaries can cause some interesting situations to arise, particularly in relation to children.

Example

After Tom's death, the trustee noted that he had provided them with a BDBN leaving his superannuation death benefit to his three children in equal shares.

The youngest child was 17 years of age at the time of payment and, under law, can receive the death benefit as either a pension or a lump sum. However, if the death benefit is paid as a pension, it must be commuted before the child's 25th birthday – unless he or she is deemed to be permanently disabled at that time.

Tom's second child was 18 years of age. He was living away from home, employed and not considered to be financially dependent upon his father. He could not receive a death benefit pension, but instead must receive his death benefit in the form of a lump sum.

Tom's eldest child was 25 years of age and a full-time student who was financially dependent upon Tom. As a result, the death benefit can only be paid as a lump sum. However, if the beneficiary was not Tom's child, for example, if it was a financially dependent nephew, then the death benefit could be paid as a pension regardless of the beneficiary's age.

Another issue that can confront parents is whether a child who receives a death benefit will have the maturity to properly manage a potentially large amount of money. As a death benefit is unrestricted and non-preserved, there is nothing to stop a child from commuting a pension death benefit as a cash lump sum. Some safety net may be available until the child attains legal capacity at 18 years of age, as before this time it is generally required that a guardian requests the withdrawal be made on the child's behalf. However, once the child reaches 18, they will have the ability to commute a pension unless such a commutation is restricted by the trust deed.

Troubleshooting strategy

If a parent is concerned that a child may not be sufficiently mature to manage a superannuation death benefit at age 18, it may be appropriate to draft a clause within the superannuation fund's trust deed that will restrict the ability for a death benefit pension to be commuted until a later date – for example, until the child is 25 years of age.

When inserting such a clause, remember that if the pension was paid before the child's 25th birthday, the commutation must occur before the child reaches 25 years of age – unless they are deemed to be permanently disabled under the *Disability Services Act 1986*.

This strategy is often known in the industry as the "sex, drugs and rock and roll" strategy – referring to the possibility that large funds received by a child may be used for less than desirable purposes!

This type of strategy may also be appropriate if an adult beneficiary is not financially competent, or may be subject to a divorce, negligence or bankruptcy claim at some time in the future.

In these circumstances, a suitable lawyer should be consulted to determine how and to what extent protection can be built into the trust deed.

Grandchild death benefits

It should also be noted that where a child beneficiary is not a child of the deceased – for example a grandchild receiving a benefit as a financial dependant of their deceased grandparent – then subject to the trust deed and other matters the pension may be able to continue past the child's 25th birthday, ie the requirement to commute may not apply.

¶15-130 Commutation of death benefit pensions

There are times when the beneficiary of a death benefit pension may wish to commute that pension to a lump sum benefit – by converting the assets supporting the pension to a lump sum.

For that commutation to be treated as a superannuation death benefit, the payment must be made before the later of:

- six months from the date of the deceased's death; or
- three months from the date that probate has been granted on the deceased's estate, or letters of administration have been issued.[22]

This period is generally known as the "six month/three month" period. It can be extended if the payment of the benefit is delayed because of legal action over entitlement to the benefit, or because of reasonable delays in the process of identifying and making initial contact with the potential recipients of the benefit.

22 S 307-5 ITAA97.

In such instances, the period can be extended by six months from the date that legal action ceases, or from the date that the initial contact with the potential recipients occurs.

If a benefit is paid to a beneficiary of the deceased member outside this period, the benefit will not be taxed as a death benefit. It will be taxed as if the beneficiary had received the benefit as a result of being a member of the fund.

It is important to note that a death benefit cannot be rolled over.

Troubleshooting strategy

There will often be cases where the beneficiary of a death benefit wants to keep the benefit in an accumulation account – either in the fund from which the death benefit was paid or in another superannuation or rollover fund.

There are two possible ways that this outcome can be achieved:

(1) The benefit could be received as a lump sum death benefit and re-contributed by the beneficiary back into their superannuation accumulation account.

However, this may mean that the benefit becomes subject to taxation if it is paid to a beneficiary who is not a tax dependant and is under 60 years of age. In addition, the contribution:

- will count towards the beneficiary's contribution cap;
- will be preserved;
- can only occur if the beneficiary is eligible to contribute to a superannuation fund – that is, they are under 65 years of age, or under 75 years and 28 days of age and have been gainfully employed for at least 40 hours in a consecutive 30-day period since the previous 1 July (inclusive).

(2) If the death benefit has been paid as an income stream, the beneficiary may choose to commute and roll over the benefit into an accumulation account or another pension after the end of the six month/three month period – subject to any restrictions imposed by the superannuation fund's trust deed.

As the commutation has occurred outside of the six month/three month period, the commutation will not be treated as a death benefit, so no restriction on rolling over the benefit will apply.

This second strategy eliminates any issues in relation to lump sum tax, contribution eligibility, contribution caps and preservation – but is only available if a death benefit pension has been paid. This means it will not be available, for example, if the beneficiary is an adult child of the deceased and was not financially dependent or in an interdependency relationship with the deceased immediately before their death.

The commutation of a death benefit pension that was paid to a child, who at the date the benefit was paid was under 18 years of age, will not be treated as a lump sum death benefit provided:

- they are under 25 when they receive the commutation;
- the commutation takes place because they turned 25 years of age; or
- they are considered to be permanently disabled under the *Disability Services Act 1986* when they receive the benefit.

Instead, the commutation will be received tax-free as non-assessable, non-exempt income.

¶15-135 Preservation status of death benefits

The death of a member of a superannuation fund is a condition of release for superannuation purposes.[23]

As a result, the death benefit will become unrestricted non-preserved and will remain so in the hands of a beneficiary of a pension death benefit – a reversionary beneficiary – regardless of the beneficiary's age or employment status.

¶15-140 How is a superannuation death benefit funded?

A death benefit is generally funded from one or more of the following sources:

- the deceased's accumulated superannuation benefits;
- insurance proceeds received by the trustee as a result of the death of the member;
- a deduction available to the trustee under the "anti-detriment provisions"; or
- consolidated revenue, in the case of an unfunded government fund or scheme.

A superannuation trustee can also use a temporary borrowing to fund the payment of a death benefit. However, such borrowings can only occur if the period of borrowing does not exceed 90 days and the amount borrowed does not exceed 10% of the value of assets of the fund.

Anti-detriment provisions

Before 1 July 1988, deductible contributions were not included in the assessable income of a superannuation fund – that is, they were not subject to contributions tax. In addition, no tax was payable on lump sum death benefits paid to a dependant as the result of a member's death.

To offset the contributions tax that now applies to a deductible contribution, the fund trustee may be able to claim – as a deduction – an amount representing the amount of taxable contributions made to the deceased member's account that were subject to contributions tax.

However, this deduction can only be claimed by the trustee if:

- the trustee pays the death benefit as a lump sum to a person who was the spouse, former spouse or child[24] of the deceased at the time of the payment; or
- the trustee has increased the lump sum paid to one or more of these beneficiaries so that the amount of the lump sum is the amount that the fund would have paid, had not contributions tax been charged to the deceased member's account.[25]

23 Reg 6.21 SISR.

24 "Child" includes an adult child of the deceased member – see ID 2010/1.

25 S 295-485 ITAA97.

Trap

The use of anti-detriment provisions can cause problems for some small superannuation funds such as SMSFs.

Because the trustee must pay the lump sum benefit – including the increase representing the tax benefit – before the tax benefit is received, a small superannuation fund may experience cash-flow difficulties if the anti-detriment provisions are used.

Future service deductions

A superannuation fund is also able to claim a deduction if it makes a payment to a member whose employment has terminated due to death or disability.[26] The deduction which the fund receives is based on the future service of the member up to their retirement date. However, the deduction is only available if the fund elects not to claim a deduction in the payment year for insurance premiums under s 295-465(4). The election applies to future years, "unless the Commissioner decides that it should not". Therefore, this deduction is more attractive to SMSFs than to other funds.

¶15-145 Tax treatment of death benefits

The discussion in this chapter is generally confined to taxed superannuation funds. If the death benefit is being paid from an untaxed superannuation fund, specialist advice should be sought.

The tax treatment of a death benefit will generally depend on three things:

- whether the recipient is a dependant for tax purposes – note that this is different to being a dependant for the SISA purposes as discussed at ¶15-105;
- the components of the death benefit; and
- whether the death benefit is paid as a lump sum or a pension.

A person will be a dependant for tax purposes (referred to as a "death benefits dependant") if they are:[27]

- the member's spouse;
- the member's child aged less than 18;
- a person with whom the member had an interdependency relationship;[28]
- any other person who was a dependant (and so may include financial dependants).

See the table in the Appendix to this chapter for a summary of who is a dependant for tax purposes.

26 S 295-470 ITAA97.

27 S 302-195 ITAA97.

28 The ITAA97 contains its own definition of "interdependency relationship". It is very similar, but not identical, to the definition of that term in s 10A SISA.

A superannuation death benefit can consist of two components – a tax-free component and a taxable component. This is the case regardless of the funding sources or whether the benefit is paid as a lump sum or pension.

The taxable component is split into two elements – a taxed element and an untaxed element.[29]

The death benefit will contain an untaxed element if:

- the benefit is paid as a lump sum;
- the trustee has claimed a deduction for death insurance for the deceased member; and
- the member is aged less than their normal retirement age, for example, age 65.

It will also contain an untaxed element if the lump sum or pension is paid from an untaxed fund such as the Commonwealth Superannuation Scheme.

Lump sum death benefits

If a lump sum death benefit is paid, the rate of tax which will apply to the taxed component will depend upon whether the beneficiary is tax-dependant, and the amount of each element that forms part of the taxed component.

Beneficiary	Tax-free component	Taxable component*	
		Element taxed	Element untaxed
Dependant[30]	Tax-free	Tax-free	Tax-free
Non-dependant[31]	Tax-free	16.5%	31.5%

* Includes Medicare levy.

* Note that when a superannuation fund has claimed (or intends to claim) a deduction for insurance premiums, an element untaxed will be included in the fund of the taxable component of the lump sum benefit. See as support ID 2010/76.

If the death benefit is paid to the deceased's LPR, the taxation treatment will depend on what the LPR does with it.

To the extent that the death benefit is paid to a death benefits dependant of the deceased, it will be taxed as if it were paid to a dependant.[32] This gives rise to a significant planning opportunity (refer to ¶4-140) and so a person may wish to make a will:

- that directs superannuation to be paid to beneficiaries who are death benefits dependants of the deceased;
- that creates a trust, the beneficiaries of which are limited to death benefits dependants.

29 S 307-290 ITAA97.

30 S 302-60 ITAA97.

31 Ss 302-140 to 302-145 ITAA97.

32 S 302-60 ITAA97.

However, to the extent that a benefit is paid to a non-death benefits dependant it will be taxed as if it were paid to a non-dependant. This might be the result where the benefit is paid to a discretionary testamentary trust which has a number of beneficiaries, only some of which would qualify as a death benefits dependant.

Defence Force and police personnel

If a lump sum death benefit is payable to a beneficiary who is a non-dependant for tax purposes – as the result of the death of a member of the Australian Defence Force, Australian Federal Police or a state or territory police force killed in the line of duty – the benefit will not be subject to tax.[33]

Terminal medical condition benefits

If a member of a superannuation fund receives a lump sum benefit prior to their death as the result of a diagnosis of a terminal medical condition, they will not be subject to tax on any part of that benefit.[34]

Calculating the untaxed element of a death benefit

The amount of taxable component – untaxed element of a lump sum death benefit paid from a taxed source is calculated as follows:[35]

Step 1: Work out the tax-free component

The tax-free component of the death benefit paid from the accumulation phase will equal the amount of the death benefit payment, multiplied by the tax-free proportion of the deceased member's benefits immediately before the benefit is paid.

Step 2: Taxable component – taxed element

Calculate the amount of the total death benefit that proportionally relates to the period from the start of the member's service period to the date of their death, using the formula:

Calculation

$$\frac{\text{(Lump sum death benefit x Service days) – Tax-free component}}{\text{Total days}}$$

33 S 302-195(2) ITAA97.

34 S 303-10 SISA.

35 S 307-290 ITAA97.

Service days equals the total days from the start of the member's service period to the date of their death (inclusive).

Total days equals the total number of days from the start of the member's eligible service period to the date of the member's normal retirement date, usually their 65th birthday (inclusive).

The result will equal the taxable component – taxed element of the lump sum benefit, unless the result of the formula is less than zero. If the result is less than zero, the amount of the taxable component – taxed element will be nil.

Step 3: Taxable component – untaxed element

The taxable component – untaxed element equals the taxable component less the amount worked out in Step 2.

Example

Peter, who was born on 12 February 1955, had an eligible service period start date of 1 July 1980. He died on 25 September 2007 while still a member of his superannuation fund.

After his death, the trustees of his fund decide to pay a lump sum death benefit of $800,000 to his son. This is funded from Peter's accumulated account balance and the insurance proceeds from a life policy that the trustees had taken out on Peter's life.

As Peter had accumulated $350,000 of tax-free component in his account before his death, the taxable components of the death benefit paid to his son would be calculated as follows.

Step 1:

Tax-free component is $350,000. Therefore, the total taxable components, both taxed element and untaxed element, will be $450,000.

Step 2:

The number of days that Peter had accrued in his eligible service period before his death was 10,130, and the number of days between the date of his death and the date at which he would have reached his normal retirement age (ie age 65) was 4,523.

Therefore, his taxable component – taxed element would be:

$$\$800{,}000 \times \frac{10{,}130}{(10{,}130 + 4{,}523)} - \$350{,}000 = \$203{,}061$$

Step 3:

The remaining amount of the taxable component will be the taxable component – untaxed element:

$450,000 – $203,061 = $246,939.

Reducing tax payable by non-dependent beneficiaries

Choosing where to place insurance

It is interesting to note that the smaller the proportion of the service period until normal retirement date that occurred before the member's death, the less of the taxable component that will be taxed as an untaxed element at the higher rate of 31.5%, including Medicare levy.

Troubleshooting strategy

If a client is considering applying for insurance within a superannuation fund and has more than one fund with different eligible service period start dates, it can be beneficial to place the insurance within the fund with the earliest start date.

This will ensure that a larger proportion of the taxable component of any death benefit will be treated as a taxed element, rather than an untaxed element. This will reduce the tax payable by any non-dependent beneficiary of a lump sum death benefit.

Remember that if you are considering replacing a client's insurance policy in order to take advantage of this strategy, it is important to ensure that the new policy is in place before cancelling the old to ensure your client does not end up uninsured!

Re-contribution strategy

As a tax-free component will not be taxable when paid to a non-dependent beneficiary, increasing the proportion of tax-free component in a member's account before their death will reduce the taxable component and, therefore, the tax payable by a non-dependent beneficiary.

Strategy

Provided that the member of a superannuation fund is still eligible to contribute to a superannuation fund and is over the age of 60, the taxable component with the appropriate portion of tax-free component can be withdrawn by the member and re-contributed back into a superannuation fund as a non-concessional component – without incurring any lump sum or contributions tax.

As non-concessional components form part of the tax-free component, this strategy reduces the amount of taxable component that is taxable in the hands of a non-dependent beneficiary.

However, before undertaking this strategy, it is important to ensure that any non-concessional contribution made will not be in excess of the member's non-concessional contributions cap. Excess non-concessional contributions are taxed at 48.5%.

The member may also incur expenses in relation to the sale or transfer of assets required to fund the withdrawal. This can include a CGT liability – unless the sale or transfer is made using only assets that are supporting a pension.

Pre-death withdrawals

The payment of a lump sum death benefit to a non-dependent beneficiary can often lead to the generation of a tax liability.

In contrast, if a member withdraws a lump sum from their superannuation fund after they reach 60 years of age, the whole amount of the lump sum benefit is not subject to tax – provided the benefit is not paid from an untaxed superannuation fund.

Strategy

Pre-death withdrawals can result in significant tax savings. Assuming that this strategy would only be used where death was imminent, it reinforces the importance of having a valid enduring financial power of attorney in place.

Example:

Jenny is over 60 years of age and has a superannuation benefit of $500,000, consisting entirely of a taxed component.

Her only beneficiary is her son Bill, aged 40, who is not a tax dependant.

If the death benefit is paid to Bill, it would be taxed at 16.5%.

If instead Jenny was to withdraw the amount as a lump sum shortly before her death, the amount could pass to Bill under Jenny's will tax-free. This would result in a tax saving of $83,500.

If Jenny was unable to effect the withdrawal because she did not have legal capacity, Bill could, provided he held an enduring power of attorney.

This strategy does, however, have some potential disadvantages, including:

(1) benefits are withdrawn prematurely from the concessionally taxed superannuation environment – what if Jenny has a miraculous recovery and lives for 20 more years?

(2) the strategy must be implemented before the member's death and it is not always possible to know when a member is approaching death;

(3) if the withdrawn benefit is not gifted to the beneficiary before the death of the member, it will form part of the deceased's estate – so it may be at risk of a claim made against the estate; and

(4) it assumes that the member's estate will not be pursued by creditors after the withdrawal.

Differential allocation to beneficiaries

Another option may be available where the member has both tax dependent and non-tax dependent beneficiaries. In such cases it might be possible to direct the superannuation death benefit to tax dependants and gift other property to non-tax dependants.

Strategy

Streaming superannuation benefits to tax dependants can result in significant tax savings.

Example:

Gregor is 52 years of age. His superannuation benefit is valued at $400,000, consisting entirely of a taxed component.

His two children are a son Jhari, aged 25, who is not a tax dependant, and a daughter Anna, aged 16.

If the death benefit is paid equally to Jhari and Anna then tax at 16.5% would be payable in respect of Jhari's share and Anna's share would be tax-free.

If Gregor had sufficient wealth, he could leave the whole of his superannuation to Anna and via his will leave an equivalent gift to Jhari. Anna would take the superannuation tax-free.

This strategy does, however, have some potential disadvantages, including:

(1) it assumes that the member's estate will have enough funds to equalise the distribution; and

(2) it generally means that the tax dependent child will be able to demand the benefit at the age of 18. In contrast, a testamentary trust with vesting at a later age might offer protection that outweighs the tax savings.

Death benefit pensions

The tax treatment of a death benefit pension will depend on the age of the deceased at the date of their death and – if the deceased was under 60 years of age – the age of the beneficiary.[36]

Age of deceased at date of death	Age of recipient at date of pension payment	Tax-free component	Taxable component	
			Applies if the beneficiary is a dependant or the reversionary pension commenced to be paid before 1 July 2007	
			Taxed element	Untaxed element
Under age 60	Under age 60	Tax-free	MTR less a 15% offset	MTR*
	60 and above	Tax-free	Tax-free	MTR less 10% offset*
60 and above	Any age	Tax-free	Tax-free	MTR less 10% offset*

* plus Medicare levy

36 Ss 302-65 to 302-90 ITAA97.

If the marginal tax rate (MTR) of the beneficiary is less than the rates shown, the tax on the taxable component will reduce to the MTR of the beneficiary.

If the taxable component – taxed element of the income received by the beneficiary is initially subject to tax because both the deceased and the beneficiary are under 60 years of age, any amount of this component will be tax-free once the beneficiary reaches 60 years of age.

However, if the income stream containing this taxed element is rolled over and used to purchase another income stream, the beneficiary will lose the ability to claim the 15% tax offset until they have reached their preservation age. This is because the new income stream did not commence as the result of the death of another person – the nexus to death has been broken.

Non-dependent beneficiaries

A death benefit pension cannot commence to be paid on or after 1 July 2007 to a beneficiary who was not dependent on the deceased member for tax purposes.[37]

If the death benefit pension paid to a tax non-dependant commenced before this date, the pension will be taxed as if it is being paid to a dependent beneficiary.

¶15-150 Contribution quarantining

Before 1 July 2007, it was often possible to reduce the tax payable on death benefits paid to multiple beneficiaries by directing different components to different death benefits.

For example, benefits paid as a lump sum to a beneficiary who was not a dependant for tax purposes – and who would therefore, be taxed on certain components – could include a greater share of the tax-free components.

Components that were subject to tax in the hands of a non-dependant would be directed to beneficiaries who were dependants for tax purposes – as they would not be subject to tax on any death benefit paid.

Since 1 July 2007, it is no longer possible to segregate components in this way if all of the components form one superannuation interest – for example, belong to the one superannuation product or SMSF. The proportion of tax-free and taxable component of any benefit payable from a superannuation fund must be in proportion to:

- the proportion of tax-free and taxable component that existed in the fund immediately before the payment of the benefit – if the benefit was paid from an accumulation account;
- the proportion of tax-free and taxable component that existed in the fund at the commencement of the pension – if the death benefit is paid from the deceased member's pension.

37 Reg 6.21(2A) SISR in conjunction with reg 6.21(2) SISR.

To some extent this proportioning rule may be overcome in respect to future contributions by contributing, that is, "quarantining", future non-concessional contributions in a separate superannuation fund to those containing taxable components, or to which concessional contributions will be made.

Troubleshooting strategy

Elizabeth, aged 63, has a company superannuation fund in which she has accumulated $600,000 of taxable component.

In the lead-up to her retirement at age 65, she would like to make a total of $500,000 of non-concessional contributions to superannuation.

Elizabeth has nominated her husband and her son as beneficiaries of any superannuation benefit following her death. Her son is unlikely to be considered a dependent beneficiary at that time.

If she was to make the non-concessional contributions to her existing superannuation fund, any death benefit paid must consist of both tax-free and taxable components. Although tax-free to her husband, the taxable component of a death benefit paid to her son would be taxable.

If instead she was to contribute the non-concessional contributions to a separate fund to which her son was a beneficiary, the son may be able to receive a death benefit that includes a large amount of tax-free component.

This quarantining strategy may not, however, be perfect, as any investment earnings generated from the non-concessional contributions which are not supporting a pension will be treated as a taxable component.

Capital gains tax on the disposal of pension assets

The disposal of assets such as shares and property that are being used to support a pension will not currently generate a tax liability.[38] As at June 2013, the government had announced (though the changes are not yet law) that, from 1 July 2014, earnings on pension assets will be tax-free up to $100,000 a year for each individual, with pension earnings above $100,000 to be taxed at 15%. It is expected that transitional arrangements will apply for assets purchased before 1 July 2014 to ensure that those who have such assets have 10 years to decide whether to restructure their superannuation holdings, before CGT applies.

If the pension reverts upon the death of a primary pensioner, the assets supporting the pension remain in "pension phase".

Further, with the introduction of the *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013*, if a pensioner dies and no reversionary pensioner exists, the tax exemption for earnings on assets supporting pensions will continue following the death of the pensioner until the deceased pensioner's benefits have been paid out of the fund (subject to the benefits being cashed as soon as practicable). This supersedes both the Commissioner's preliminary view expressed in a draft

38 See Subdiv 295-F ITAA97.

ruling (TR 2011/D3) and his view in an interpretative decision (ID 2004/688) that, if a pensioner dies and no reversionary pensioner exists, there is no pension so that when assets are sold or transferred in specie to support a death benefit payment, any assessable capital gains on the sale of assets to fund lump sum death benefits will be taxed at the rate of 15% in the accumulation phase.

The recently clarified tax exemption excludes payments received from life insurance proceeds and anti-detriment payments.

The operation of the proportioning rule also applies to such death benefits so that the tax-free proportion of that pension can be used when calculating the tax components of those benefits.

It remains to be seen whether the announced $100,000 cap set to apply on earnings on pension assets from 1 July 2014 will apply on earnings on assets supporting pensions following the death of a pensioner.

Strategy (subject to $100,000 cap applying)

If death benefits payable on the death of a member consist of both lump sum and pension death benefits, a trustee may be able to reduce the impact of CGT by segregating assets that have higher unrealised assessable capital gains.

Ideally, assets that have less accumulated unrealised capital gains may then be those sold or transferred to fund the lump sum death benefits, minimising the amount of realised capital gains subject to tax.

However, tax should not be the only consideration when selecting assets to be sold to fund a lump sum death benefit. The long-term performance of available assets should also be considered when selecting assets to remain in the fund.

Example (taken from the explanatory statement to the *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013*)

Harold was a member of a complying superannuation fund who was receiving a superannuation income stream immediately before his death on 1 February 2013. When the income stream commenced, the value of the superannuation interest from which it was paid (the relevant interest) was $100,000, of which the tax-free component was $20,000 (20% of the value) and the taxable component was $80,000 (80% of the value).

The income stream did not automatically revert to another person on Harold's death and no amounts were added to the relevant interest on or after his death.

The trustee of the fund determined that the entire value of the deceased member's benefits in the fund (being the value of the relevant interest) would be paid as a single lump sum to the deceased's adult child, Emma. The lump sum death benefit, in the amount of $75,000, was paid on 20 July 2013 using only an amount from the relevant interest. The fund did not increase the lump sum death benefit by an anti-detriment increase amount and the benefit was not to any extent attributable to an insurance-related amount paid or arising on or after the deceased's death.

The lump sum death benefit of $75,000 consists of a tax-free component of $15,000 (20% of the amount of the benefit) and a taxable component of $60,000 (the remainder of the benefit).

Example (taken from the explanatory statement to the *Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013*) (cont)

If the trustee of the fund had added $10,000 to the relevant interest to fund an anti-detriment increase of that amount in the payment to Emma, the lump sum death benefit of $85,000 would consist of a tax-free component of $15,000 (20% of the amount of the benefit as reduced by the $10,000 anti-detriment increase) and a taxable component of $70,000 (the remainder of the benefit).

Refreshing the cost base

There will be instances when all expected beneficiaries will be non-dependants for tax purposes and will have to receive a death benefit in the form of a lump sum.

In these circumstances consideration should be given to whether the impact of CGT can be reduced. The following strategy appears to have been quite popular, however, as noted below the ATO's views on "wash sale" arrangements at the relevant time must be considered.

Strategy

If a member of a superannuation fund has commenced a pension, consider whether assets being used to support the pension should be sold and used to purchase the same or another asset from time to time. This strategy is known as "refreshing".

Capital gains generated by pension assets are not taxable in the hands of the trustee. When the new asset is purchased with the proceeds of the sale, the cost base of the new asset will equal the purchase price plus any other capital expenses associated with the purchase of the new asset.

By selling assets that are supporting a pension and have increased in value – and then using the proceeds to purchase new assets – the cost base of the pension assets will generally increase if the asset was sold at a profit. This will in turn reduce any capital gains that may be assessable when those assets revert back to the accumulation phase before the payment of a lump sum death benefit.

Before implementing a refreshing strategy, several important points should be considered:

- the tax treatment of an asset in the future should not be the only consideration when determining whether an asset is sold;
- the sale and repurchase of an asset will not be recognised if the transaction is merely a paper transaction. There must be a genuine change in beneficial ownership and both the sale and repurchase of the asset must always be made on an arm's length basis. This may expose the asset to the risk of changes in market value between the time of sale and repurchase; and
- to increase the likelihood that the transaction will not be subject to the anti-detriment provisions of Pt IVA, a potential beneficiary should not play any part in these transactions.[39]

39 Refer to TR 2008/1 and TA 2008/7.

Commuting a death benefit pension

As discussed at ¶15-130, if a beneficiary who is a dependant for tax purposes would like to receive a death benefit as a lump sum, the impact of CGT can sometimes be removed by using the six month/three month rule.[40]

40 S 307-5 ITAA97

Strategy

Income and realised capital gains produced by the assets supporting the pension are treated as non-assessable, non-exempt income. As a result, no CGT will be paid by the trustee upon the sale of assets used to support the death benefit pension.

In addition, the pension will be treated as a death benefit, and not subject to any lump sum tax, as long as it is commuted by the beneficiary – who is a dependant for tax purposes – within:

- six months from the death of the superannuation member; or
- three months from the date that probate has been granted on the deceased's estate, or letters of administration have been issued.

¶15-155 Employer payments made after the death of an employee

A payment made by an employer after an employee's death forms part of the employee's estate. The beneficiaries of this benefit will generally be determined in accordance with the deceased employee's will.

Accrued annual and long service leave

Employer payments for unused annual leave, leave loading and unused long service leave made after the death of an employee are not subject to tax.

Death benefit termination payments

A benefit paid by an employer for an employee who has died will be treated as a death benefit termination payment – as long as it does not represent either unused annual or unused long service leave.

A death benefit termination payment can consist of one or two components – the tax-free component and the taxable component. The tax-free component comprises the pre-July 1983 segment of the payment and the invalid segment of the payment.[41] The taxable component comprises the balance.[42]

41 S 82-140 ITAA97.

42 S 82-145 ITAA97.

Each component will be taxed depending upon whether the beneficiary is considered to be a dependent or non-dependent beneficiary for tax purposes.[43]

Beneficiary	Tax-free component	Taxable component*
Dependent	Tax-free	First $140,000: Tax-free Excess: 46.5%
Non-dependent	Tax-free	First $140,000: 31.5% Excess: 46.5%

* Includes Medicare levy. The amount of $140,000 is indexed annually from 1 July 2007 (in $5,000 lots).

If the marginal tax rate of the beneficiary is less than the rates shown, the tax on the taxable component will reduce to the marginal tax rate of the beneficiary.

Appendix – SISA and ITAA97 dependency

Relationship with member	Dependent for SISA purposes?	Dependent for tax purposes?
Married to member	Yes	Yes
Lived with member as a de facto	Yes (even if same sex)	Yes (even if same sex)
In a relationship with member that is registered under a state/territory law that was prescribed for s 22B *Acts Interpretation Act 1901*	Yes (even if same sex)	Yes (even if same sex)
Child under 18	Yes	Yes
Child over 18 financially dependent	Yes	Yes
Child over 18 who is financially independent	Yes	No (unless interdependent)
Parent	No (unless financial dependent or interdependent)	No (unless financial dependent or interdependent)
Grandchild	No (unless financial dependent or interdependent)	No (unless financial dependent or interdependent)
Friend	No (unless financial dependent or interdependent)	No (unless financial dependent or interdependent)
Charity	No	n/a

43 Ss 82-65 to 82-70 ITAA97.

Note

(1) Beneficiaries of any anti-detriment benefit are further restricted to a spouse, former spouse or child of the member – see ¶15-140.

(2) Non-SISA dependants can receive a benefit in very limited circumstances – see ¶15-110.

Chapter 22

Ten estate planning strategies

¶22-100 Introduction

This chapter sets out some common client scenarios which you as an adviser might encounter. I have identified issues that you should raise and discuss with your client and where relevant I have suggested answers and commented on these issues and included tables illustrating the solution.

Of course, each strategy is a generalisation and many of your clients will require variations – slight or major – before the estate plan can be said to truly reflect their wishes and needs.

This chapter shows that an estate plan is more than just making a will and power of attorney. Much of the work is extracting information from your clients and running through various scenarios to make sure that their estate plan truly reflects their wishes.

For ease of reference, I will use broadly the same characters in each strategy, although their circumstances change as set out in the introduction to each strategy. I have limited discussion to wills, apart from the final two strategies that deal with superannuation. In practice, you would routinely discuss financial powers of attorney, medical powers and guardianship with your clients also.

Your clients are (with thanks to *Modern Family*!):

Phil and Claire – married with three children, Haley, Alex and Luke.

Jay and Gloria – married (second time around for Jay) and have living with them Gloria's son Manny. Jay has two adult children by a previous marriage – Claire and Mitchell.

Mitchell and Cameron – same-sex relationship with daughter Lily.

¶22-105 Strategy 1: the nuclear family

Setting the scene:

- Phil and Claire are married.
- Their children Haley, Alex and Luke are all minors.
- Phil and Claire assets are all jointly held and include a house, bank accounts and motor vehicles – total value $500,000.
- Phil has $150,000 in a public offer superannuation fund. He has $50,000 life cover through the fund.

Issues for Phil and Claire to consider:

Issue	Options	Instructions
Personal representatives	Who to nominate for the important role of executor and trustee in the event they both die. Consider alternatives	Nominate each other at first instance then Jay and Mitchell jointly as alternatives
	Are executors/trustees to be paid?	No payment
Guardian for children	Consider nominating in the will a guardian for the children	Appoint Jay and Gloria as guardians
	Consider including wishes regarding upbringing, schooling etc	Clients don't want to include wishes, powers or payment
	Consider including powers regarding accommodation for guardians, purchase of motor vehicle etc	
	Will guardians be paid?	
Nominating beneficiaries	Outright gift or via testamentary trust?	To each other outright
What if the other predeceases?	Need for education trust? The children currently have different education needs. For example, Haley has almost completed school; Alex is a couple of years behind her; and Luke a couple of more years behind. Should the wills set up an education fund to pay school expenses to treat beneficiaries more fairly and avoid one person's inheritance (eg Luke's) being eaten up by school/ university fees?	Elect not to set up education trust
	Gift-over to children?	Yes, to children equally
	Outright or testamentary trust?	Outright
	At what age?	At age 21
What if a child predeceases or dies before age 21?	Consider need to provide for grandchildren	If deceased child is survived by a child (or children), that child (or those children equally) to receive, at 21 years, the inheritance the deceased child would have received had they survived and attained 21 years
		If deceased child is not survived by a child or children, the inheritance the deceased child would have received to pass to Phil and Claire's remaining children
What if they all die?	If the family all die together (or no child survives and attains 21 years) who do they want to benefit from their estate?	Half to Phil's siblings, half to Claire's siblings

cont …

Issue	Options	Instructions
Other issues for discussion	Should Phil make a binding nomination/ direction for his superannuation fund? Is there a need to include superannuation proceeds trust and equalisation clause in will?	Discuss with client Clients don't want super trust/ equalisation clauses
	Is Phil's insurance cover adequate? Does he need income protection cover and should this be held personally or in the superannuation fund? Should Claire take out insurance cover?	Discuss with client

Phil's strategy might look like:

Phil dies and …	Personal representative	Custodial guardian	Distribution of estate					
Claire survives	Claire	n/a	Claire					
Claire predeceases and one or more of Haley, Alex and Luke survive and attain 21 years	Jay and Mitchell	Jay and Gloria	⅓ to Haley if she survives and attains 21 years. If not, then:		⅓ to Alex if she survives and attains 21 years. If not, then:		⅓ to Luke if he survives and attains 21 years. If not, then:	
			If Haley leaves a child or children who survive and attain 21 years, to that child or children equally	Otherwise, add to Alex and Luke's shares	If Alex leaves a child or children who survive and attain 21 years, to that child or children equally	Otherwise, add to Haley and Luke's shares	If Luke leaves a child or children who survive and attain 21 years, to that child or children equally	Otherwise, add to Haley and Alex's shares
Claire predeceases and no child or grandchild of Phil's survives and attains 21 years	Jay and Mitchell	Jay and Gloria	½ to Phil's siblings			½ to Claire's siblings		

Note: "survives" means survives willmaker by 30 days; "predeceases" means fails to survive willmaker by 30 days.

¶22-110 Strategy 2: the wealthy nuclear family

Setting the scene:

- Phil and Claire are married.
- Their children Haley, Alex and Luke are all minors.
- All their assets are both solely and jointly held and include a thriving real estate business, a house, bank accounts and motor vehicles - total value $5,000,000.
- Phil has $500,000 in a self-managed superannuation fund. He also has $500,000 life and TPD cover through the fund.

Issues for Phil and Claire to consider:

Issue	Options	Instructions
Personal representatives	Who to nominate for the important role of executor and trustee in the event they both die. Consider alternatives	Nominate each other at first instance then Jay and Mitchell jointly as alternatives
	Are executors/trustees to be paid?	No payment
Guardian for children	Consider nominating in the will a guardian for the children	Appoint Jay and Gloria as guardians
	Consider including wishes regarding upbringing, schooling etc	Clients don't want to include wishes, powers or payment
	Consider including powers regarding accommodation for guardians, purchase of motor vehicle etc	
	Will guardians be paid?	
Nominating beneficiaries	Outright gift to each other or via testamentary trust?	To each other via testamentary trust
What if the other predeceases?	Need for education trust? The children currently have different education needs. For example, Haley has almost completed school; Alex is a couple of years behind her; and Luke a couple of more years behind. Should the wills set up an education fund to pay school expenses to treat beneficiaries more fairly and avoid one person's inheritance (eg Luke's) being eaten up by school/ university fees?	Yes, set up education trust for $500,000 (takes effect before children's testamentary trusts are established) Important to provide vesting date for trust (eg earlier of Luke attaining 23 years or all children ceasing education) and direct what will happened on that date (eg distribute in line with residue as if willmaker had died on vesting date)
	Gift-over to children?	Yes, to children equally
	Outright or testamentary trust?	Testamentary trust (TT)
	At what age?	At age 28

Issue	Options	Instructions
What if a child predeceases or dies before age 28?	Consider need to provide for grandchildren	If deceased child is survived by a child (or children), that child (or those children equally) to receive, via testamentary trust, at 21 years, the inheritance the deceased child would have received, via a testamentary trust, had they survived and attained 21 years If deceased child is not survived by a child or children, the inheritance the deceased child would have received, via a testamentary trust, to pass to the testamentary trusts for Phil and Claire's remaining children
What if they all die?	If the family all die together (or no child survives and attains 28 years or leaves child who attains 21 years) who do they want to benefit from their estate?	Half to Phil's siblings, half to Claire's siblings
Other issues for discussion	Should Phil make a binding nomination/ direction for his superannuation fund? Is there a need to include superannuation proceeds trust and equalisation clause in will?	Discuss with client Yes, include super trust/equalisation clauses
Other issues for discussion	What will happen to the real estate business on Phil's death? Has a strategy been put in place to enable it to continue to operate if Phil died or became incapacitated? Is key-man insurance required? Is there a business partner and should they enter into a buy/sell agreement?	Some issues may or may not be dealt with by will
	Is Phil's insurance cover adequate? Does he need income protection cover and should this be held personally or in the superannuation fund? Should Claire take out insurance cover?	Discuss with client

Phil's strategy might look like:

<table>
<tr><th>Phil dies and …</th><th>Personal representative</th><th>Custodial guardian</th><th colspan="6">Distribution of estate</th></tr>
<tr><td>Claire survives</td><td>Claire</td><td>n/a</td><td colspan="6">Claire</td></tr>
<tr><td rowspan="3">Claire predeceases and one or more of Haley, Alex and Luke survive and attain 28 years</td><td rowspan="3">Jay and Mitchell</td><td rowspan="3">Jay and Gloria</td><td colspan="6">Education trust: $500,000
Terminate on specific date (eg Luke reaching age 23) or event (eg all children ceasing education)
On termination, remaining funds to residue (as if Phil died that day)</td></tr>
<tr><td colspan="2">⅓ of balance to TT for Haley if she survives and attains 28 years. If not, then:</td><td colspan="2">⅓ of balance to TT for Alex if she survives and attains 28 years. If not, then:</td><td colspan="2">⅓ of balance to TT for Luke if he survives and attains 28 years. If not, then:</td></tr>
<tr><td>If Haley leaves a child or children who survive and attain 21 years, to that child or children equally via individual TT(s)</td><td>Otherwise, add to Alex and Luke’s TTs</td><td>If Alex leaves a child or children who survive and attain 21 years, to that child or children equally via individual TT(s)</td><td>Otherwise, add to Haley and Luke’s TTs</td><td>If Luke leaves a child or children who survive and attain 21 years, to that child or children equally via individual TT(s)</td><td>Otherwise, add to Haley and Alex’s TTs</td></tr>
<tr><td>Claire predeceases No child or grandchild of Phil’s survives and attains 28/21 years</td><td>Jay and Mitchell</td><td>Jay and Gloria</td><td colspan="3">½ to Phil’s siblings</td><td colspan="3">½ to Claire’s siblings</td></tr>
</table>

Note: “survives” means survives willmaker by 30 days; “predeceases” means fails to survive willmaker by 30 days.

¶22-115 Strategy 3: problem children

Setting the scene:

- The same as per ¶22-110 except Phil and Claire want a protective trust established for Haley who has a drug problem.
- They establish this with the executors to be the trustees of the trust and Haley not to ever take control of her trust unless trustees determine it is appropriate for her to do so.

Diagrammatically, this could look like ¶22-110 except the trustee(s) of Haley's trust would be the trustee(s) of the estate – Claire if she survives Phil or, if she predeceases, Jay and Mitchell.

¶22-120 Strategy 4: the blended family

Setting the scene:

- Your client is Jay.
- Jay and Gloria are married.
- Jay has two children by his first marriage, Claire and Mitchell, who are now both adults. Gloria has one child, Manny, aged 10, who lives with her and Jay.
- Most assets are held in Jay's name and include a business, a house, bank accounts and motor vehicles - total value $10,000,000.
- Jay has $1,000,000 in a self-managed superannuation fund from which he is drawing a transition to retirement pension. He has no life cover through the fund.

Issues for Jay to consider:

Issue	Options	Comments
Personal representatives	Could Gloria act solely? Preferably nominate two persons and an alternative (perhaps independent)	Gloria and Mitchell with Claire as a further alternative
	Will executors be paid?	No payment
Guardian for Manny	If Gloria and Jay die together, consider nominating in the will a guardian for Manny	Claire and Phil to be guardians
	Consider including wishes regarding upbringing, schooling etc	No wishes, special powers or payment
	Consider including powers regarding accommodation for guardians, purchase of motor vehicle etc	
	Will guardians be paid?	
Nominating beneficiaries	On Jay's death, does he want his estate to go to: ■ Gloria solely or ■ Gloria, Claire and Mitchell or ■ some other option	Estate to be divided between Gloria (50%), Mitchell (25%) and Claire (25%)
	Use testamentary trusts or outright gifts?	Testamentary trusts
What if a beneficiary predeceases?	If any of Gloria, Claire and Mitchell predecease leaving children, do those children receive the share their deceased parent would have received? At what age?	If Gloria predeceases, whole estate to be distributed between Mitchell (40%), Claire (40%) and Manny (at age 25) (20%) via testamentary trusts If Claire, Mitchell or Manny predecease, their share to pass to their children who attain age 25, via testamentary trusts
Further gift-over?	Provision could be made in the event any child of Claire and Mitchell predeceases or dies before age 25 leaving children of their own	Clients don't require
Other issues for discussion	What will happen to the business on Jay's death? Has a strategy been put in place to enable it to continue to operate if he died or became incapacitated? Is key-man insurance required? Is there a business partner and should they enter into a buy/sell agreement?	Discuss with client

Issue	Options	Comments
	Has Jay nominated a reversionary beneficiary to the pension in his superannuation fund? Should Jay make a binding nomination/direction for his superannuation fund?	Jay makes a binding nomination nominating Gloria. If Gloria predeceases then to his estate with the executors able (if Manny is a death benefits dependant) to allocate death benefit to a superannuation will trust for Manny with Claire and Mitchell's share to be adjusted upwards accordingly
	Has Jay been informed about family provision principles, including the possibility of Gloria making a claim for greater provision?	Discuss with client

Jay's strategy might look like:

	Personal representative	Custodial guardian	Distribution of estate					
Gloria survives	Gloria and Mitchell If Mitchell predeceases, Gloria and Claire	N/A	½ to Gloria via TT		¼ to Claire via TT If Claire predeceases, then:		¼ to Mitchell via TT If Mitchell predeceases, then:	
					If Claire leaves a child or children who survive and attain 25 years that child or children equally take Claire's share via individual TT(s)	Otherwise, add to Gloria and Mitchell's shares in same proportions	If Mitchell leaves a child or children who survive and attain 25 years that child or children equally take Claire's share via individual TT(s)	Otherwise, add to Gloria and Claire's shares in same proportions
Gloria predeceases	Mitchell and Claire	Claire and Phil (subject to Manny's father's rights)	1/5 to Manny via TT if he survives and attains 25 years. If not, then:		2/5 to Claire via TT if she survives. If not, then:		2/5 to Mitchell via TT if he survives. If not, then:	
			If Manny leaves a child or children who survive and attain 25 years, that child or children equally take Manny's share via individual TT(s)	Otherwise, add to Claire and Mitchell's shares in same proportions	If Claire leaves a child or children who survive and attain 25 years, that child or children equally take Claire's share via individual TT(s)	Otherwise, add to Manny and Luke's shares in same proportions	If Mitchell leaves a child or children who survive and attain 25 years, that child or children equally take Mitchell's share via individual TT(s)	Otherwise, add to Manny and Claire's shares in same proportion

Note: "survives" means survives willmaker by 30 days; "predeceases" means fails to survive willmaker by 30 days.

¶22-125 Strategy 5: the blended family and life interest

Setting the scene:

As per ¶22-120 (except Jay wants to give Gloria a life interest – see comments below).

Issues for Jay to consider:

Issue	Options	Comments
Personal representatives	Could Gloria act solely? Preferably nominate two persons and an alternative Will executors be paid?	Gloria and Mitchell with Claire as a further alternative No payment
Guardian for Manny	If Gloria and Jay die together, consider nominating in the will a guardian for Manny Consider including wishes regarding upbringing, schooling etc Consider including powers regarding accommodation for guardians, purchase of motor vehicle etc Will guardians be paid?	Claire and Phil to be guardians No wishes, special powers or payment
Nominating beneficiaries	On Jay's death, does he want his estate to go to: ■ Gloria solely or ■ Gloria, Claire and Mitchell or ■ some other option including education trust	No education trust Legacy (not indexed) of $250,000 each to Claire and Mitchell outright (ie not via testamentary trust) Balance in life interest trust (see ¶4-125) with Gloria as life tenant. On death of Gloria (or earlier if she consents) balance of trust to be divided between Mitchell (40%), Claire (40%) and Manny (at age 25) (20%) via testamentary trusts
What if a beneficiary predeceases?	If any of Gloria, Claire and Mitchell predecease leaving children, do those children receive the share their deceased parent would have received? At what age?	If Gloria predeceases, whole estate to be distributed between Mitchell (40%), Claire (40%) and Manny (at age 25) (20%) via testamentary trusts If Claire or Mitchell predecease their legacy to pass (outright) to their children who survive and attain 21 years. If Claire, Mitchell or Manny predecease, their share in remainder to pass to their children who survive and attain age 25, via testamentary trusts

cont …

Issue	Options	Comments
Further gift-over?	Provision could be made in the event Manny or any child of Claire and Mitchell predecease or die leaving children of their own	Client doesn't require
Other issues for discussion	What will happen to the business on Jay's death? Has a strategy been put in place to enable it to continue to operate if he died or became incapacitated? Is key-man insurance required? Is there a business partner and should they enter into a buy/sell agreement?	Discuss with client
	Has Jay nominated a reversionary beneficiary to the pension in his superannuation fund? Should Jay make a binding nomination/direction for his superannuation fund?	Jay makes a binding nomination nominating Gloria. If Gloria predeceases then to his estate with the executors able (if Manny is a death benefits dependant) to allocate death benefit to a superannuation will trust for Manny and Claire and Mitchell's share to be adjusted upwards accordingly
	Has Jay been informed about family provision principles, including the possibility of Gloria making a claim for greater provision?	Discuss with client

Jay's strategy might look like:

<table>
<tr><th></th><th>Personal representative</th><th>Custodial guardian</th><th colspan="6">Distribution of estate</th></tr>
<tr><td>Gloria survives</td><td>Gloria and Mitchell
If Mitchell predeceases, Gloria and Jay</td><td>N/A</td><td colspan="3">$250,000 legacy to Claire if she survives
If Claire predeceases leaving a child or children who survive and attain 21 years than that child or children equally take the legacy</td><td colspan="3">$250,000 legacy to Mitchell if he survives
If Mitchell predeceases leaving a child or children who survive and attain 21 years then that child or children equally take the legacy</td></tr>
<tr><td></td><td></td><td></td><td colspan="6">Balance of estate on life interest trust for Gloria
On Gloria's death (or end of trust) then as per below as if "Gloria predeceases":</td></tr>
<tr><td>Gloria predeceases</td><td>Mitchell and Claire</td><td>Claire and Phil (subject to Manny's father's rights)</td><td colspan="2">1/5 (subject to superannuation equalisation) to Manny via TT if he survives and attains 25 years. If not, then:</td><td colspan="2">2/5 (subject to superannuation equalisation) to Claire via TT if she survives. If not, then:</td><td colspan="2">2/5 (subject to superannuation equalisation) to Mitchell via TT if he survives. If not, then:</td></tr>
<tr><td></td><td></td><td></td><td>If Manny leaves a child or children who survive and attain 25 years, that child or children equally take Manny's share via individual TT(s)</td><td>Otherwise, add to Claire and Mitchell's shares in same proportions</td><td>If Claire leaves a child or children who survive and attain 25 years, that child or children equally take Claire's share via individual TT(s)</td><td>Otherwise, add to Manny and Luke's shares in same proportions</td><td>If Mitchell leaves a child or children who survive and attain 25 years, that child or children equally take Mitchell's share via individual TT(s)</td><td>Otherwise, add to Manny and Claire's shares in same proportions</td></tr>
</table>

Note: "survives" means survives willmaker by 30 days; "predeceases" means fails to survive willmaker by 30 days.

¶22-130 Strategy 6: elderly and single

Setting the scene:

- Jay and Gloria are divorced and Gloria and Manny returned to Columbia after Jay and Gloria reached an amicable property settlement.
- Jay has two children by his first marriage, Claire and Mitchell, both adults.
- Although not as wealthy as he was pre-divorce, Jay has significant assets including a small business, a house, bank accounts and motor vehicles – total value $5,000,000.
- Jay has $1,000,000 in a self-managed superannuation fund from which he is drawing a transition to retirement pension. He has no life cover through the fund.

Issues for Jay to consider:

Issue	Options	Instructions
Personal representative	Who to nominate for the important role of executor and trustee. Preferably nominate two persons and an alternative	Appoint Claire and Mitchell with Phil and Cameron as respective alternatives
	Will executors be paid?	No payment
Nominating beneficiaries	On Jay's death, does he want his estate to go to Claire and Mitchell equally or some other option	Estate to be divided equally between Claire and Mitchell
What if a beneficiary predeceases?	If Claire or Mitchell predecease leaving children, do those children receive the share their deceased parent would have received?	Yes
	At what age?	Age 25
Other issues for discussion	What will happen to the business on Jay's death? Has a strategy been put in place to enable it to continue to operate if he died or became incapacitated? Is key-man insurance required? Is there a business partner and should they enter into a buy/sell agreement?	Discuss with client
	Has Jay nominated a reversionary beneficiary to the pension in his superannuation fund? Should Jay make a binding nomination/direction for his superannuation fund?	Jay makes a binding nomination nominating his estate

¶22-135 Strategy 7: same-sex couple

Setting the scene:

- Mitchell and his partner Cameron live together with their daughter Lily.
- They are modestly wealthy, although this might change over time (and Mitchell may receive a substantial inheritance from his father Jay).

Issues for Mitchell and Cameron to consider:

Issue	Options	Instructions
Personal representative	Who to nominate for the important role of executor and trustee in the event they both die. Consider alternatives Will executors be paid?	Appoint each other Claire and Phil alternatives No payment
Guardian for Lily	Who will act as Lily's guardian? Consider wishes regarding schooling, upbringing etc Consider including powers regarding accommodation for guardians, purchase of motor vehicle etc Will guardians be paid?	Claire and Phil to be guardians No specific wishes, payment etc
Nominating beneficiaries	Do they want to gift everything to each other or make provision for Lily as well?	Lesser of $200,000 or 50% of estate to Lily at age 21 Balance to each other
What if a beneficiary predeceases?	If the other or Lily predeceases?	If the other predeceases, all to Lily but at age 25 If Lily predeceases or does not reach 25 years of age, all to the other
What if they all die (or Lily survives but does not attain 25 and has no children)		Distribute 50% to Claire, the remaining 50% equally to Haley, Alex, Luke and Manny at 21 years

¶22-140 Strategy 8: dealing with the family trust

Setting the scene:

- Jay has a family trust which holds assets valued at $5m.
- Jay is the sole trustee and appointor of the trust.
- On his death he would like the trust to principally benefit Gloria and Manny along also with Claire and Mitchell.

Issues for Jay to consider:

Question	Options	Issues to discuss
Who to succeed Jay as trustee and appointor	Could appoint Gloria, Claire and Mitchell If Gloria died, would be relying on Claire and Mitchell to "do the right thing" by Manny. Would they? Consider independent trustee Perhaps a good case for a letter of wishes to guide the trustees	Check trust deed and amend if necessary
Take some other action to compel distributions?	Is it viable to direct that trust is to be wound up on Jay's death and assets distributed to certain persons (or to his estate?)	Sale or transfer of assets will be a disposal for CGT purposes – will this be an issue?
	Can the deed be amended (or a resolution made) to stream distributions post his death?	Will this give rise to a resettlement? Will it put each beneficiary's entitlement at risk of family law claim?
	Can the trust be split?	Will this give rise to a resettlement? Will it put each beneficiary's entitlement at risk of family law claim?

¶22-145 Strategy 9: dealing with public offer superannuation interest

Setting the scene:

- Jay has $1m in a public offer superannuation fund plus insurance cover for a further $1m.
- He would like the benefit to be divided between Gloria (60%), Claire (20%) and Mitchell (20%).

Issues for Jay to consider:

Issue	Options	Comments
Without a binding nomination, the trustee would most likely give much more of the death benefit to Gloria/ Manny than Mitchell or Claire	If Jay wants Claire and Mitchell to benefit, he should make a binding nomination or give a binding direction	Consider risk of three-year lapsing rule. For example, if Jay was incapacitated for years before his death Is a binding direction an option?
Can he make a nomination nominating Gloria, Claire and Mitchell all as beneficiaries	Yes, as they are all "dependants" as defined under the SISA However, only Gloria would be a death benefit dependant (for tax purposes) and this may mean tax is payable on that part of the benefit paid to Claire and Mitchell	Consider leaving all super to Gloria and equalising distributions via family trust. Equalisation possible by will, but depends on estate assets being sufficient and also subject to claims – eg by Gloria Manny would be a dependant (as a financial dependant) – does this give planning opportunities?
What if Jay made a binding nomination but one of the nominees died before him?	It depends on the rules governing the nomination Assume Gloria had died, could Jay make a new nomination appointing Manny, Claire and Mitchell all as beneficiaries?	Important to check with the fund trustee On Gloria's death, Manny would cease to be Jay's stepchild and so would no longer fall within the "child" category in the definition of "dependant" in SISA. Manny may, however, be an SISA dependant if he was financially dependent on Jay
Problems with binding nominations	Jay's will establishes a testamentary trust for Mitchell because asset protection is important given Mitchell's occupation as a lawyer	But nominating Mitchell as a beneficiary in a binding nomination exposes Mitchell in the event he is being sued at the time of Jay's death
What happens if Jay loses capacity?	Has Jay made an enduring power of attorney?	Who has Jay appointed as attorney? Does he understand his attorney/s may withdraw his money from his superannuation fund prior to his death (or roll it over into another superannuation fund) and this would render any binding nomination useless?
Are pensions an option?	Gloria and Manny (until 25 years of age) could receive a pension	Discuss with client Project and compare financial outcomes

¶22-150 Strategy 10: dealing with a self-managed superannuation fund

Setting the scene:

- Jay is the sole member of a self-managed superannuation fund.
- The fund has assets of $1m plus insurance cover for a further $1m.
- Jay is the sole director of the company acting as trustee of the fund.

Issues for Jay to consider include all of the issues listed in strategy 9 plus the following:

Issue	Options	Comments
Who will make the decision regarding the distribution of the death benefit?	Jay must consider who to leave the shares in his trustee company to	Important to check: ■ the trust deed to see what it says on death of a member ■ the company constitution Remember *Katz v Grossman*-type problems[1]
Does Jay want more certainty regarding death benefit recipients?	Does the fund permit non-lapsing directions or nominations? Is an option to amend the deed and compel the trustee to pay the benefit to certain persons/LPR?	Consider court's remarks in *Donovan v Donovan*[2] regarding non-lapsing nominations What if a nominee predeceases?
What tax issues arise on death?	Selling assets or transferring assets out of the fund would generally be a disposal for CGT purposes. Stamp duty and possibly GST issues might also arise	Consider also tax issues based on death benefit dependant status of recipient - see strategy 9
Does fund have any borrowings?	If the fund has borrowed to purchase an asset, what will this mean in the event the fund is wound up?	
Are disputes likely?	If Jay is really concerned about the ability of his successors to properly deal with and divide his superannuation, he could consider moving part of his superannuation benefit to a new fund and deal with both superannuation Interests separately	May have CGT consequences But may be simpler to divide super between two funds (60% and 40%) or three funds (60/20/20)

1 [2005] NSWSC 934. See ¶15-120.

2 [2009] QSC 26. See ¶15-120.

Issue	Options	Comments
Are there reserves in the fund?	If the fund has reserves, consider permitting new members to join the fund	Consider risk of introducing new members and trustees
Are there losses in the fund?	If the fund has tax losses, consider permitting new members to join the fund	Especially if an anti-detriment payment is made and a deduction claimed (but often difficult to make such a payment in a single member fund without reserves)