

Estate Planning

Part 1 – Invest the time *now* to plan for your financial future

The information in this article was extracted from a client seminar prepared and presented by Bernie O’Sullivan, Bernie O’Sullivan Lawyers at McLean Delmo on Wednesday 26 October 2011.

Why has Estate Planning become so complex?

- Wealth is increasingly being held in vehicles that do not form part of a person’s estate (and therefore are not dealt with by the person’s will)
- Tax system is not ‘fair’
- Concern about childrens’ relationships breaking down
- Concern about re-marriage of a spouse
- Longevity adding complexity and delaying transfer to next generation

There are currently 5 Topical Issues in relation to Estate Planning, these are:

1. Testamentary trust structures
2. What to do with my superannuation?
3. Who controls my SMSF on my incapacity or death?
4. What to do with my family trust?
5. Can I protect my children’s inheritance from relationship breakdown

Over the next few issues of our newsletter we propose to explain these topics by way of examples. Within this issue we will cover topical items no 1 & 2.

The assumptions that we will make for the purposes of our example are as follows:

Parents

Asset	Name	Value	Other
Home	Max + Mary	\$2m	
Investments	Max	\$1m	Share options in business
Investments	Mary	\$1m	ASX listed shares
SMSF	MM Pty Ltd	\$1.21m	Max + Mary (\$600k each) and Alice (\$10k) are members & directors
Family trust	MM Pty Ltd	\$1m	Max + Mary joint appointors

Children

Child	Age	Status
Alice	18	Completing VCE
Bob	15	Year 9
Charles	13	Year 7

Strategy 1A: Spouse Testamentary Trust

- Max dies
- Leaves \$1,000,000 to Mary and there is no testamentary trust
- If Mary invests the \$1,000,000 and earns \$100,000, Mary could potentially pay \$38,500 in tax leaving her with a net \$61,500

Mary invests	Income year 1	Tax	Net income
\$1,000,000 @ 10%	\$100,000	\$38,500 (38.5%)	\$61,500

HOWEVER

- Max dies
- Leaves \$1,000,000 to Mary via testamentary trust
- If the Trust invests the money and earns \$100,000, the Trust could distribute to the children resulting in a tax liability of \$11,100, leaving the Trust with a net \$88,800

Trust invests	Income year 1	Distribute to	Tax	Net income
\$1,000,000	\$100,000	Alice \$33,333	\$3,700	\$29,600
		Bob \$33,333	\$3,700	\$29,600
		Charles \$33,334	\$3,700	\$29,600
				\$88,800

The savings (in one year!) $\$88,800 - \$61,500 = \mathbf{\$27,300^*}$

*This example assumes there is no other income earned by Alice, Bob and Charles and also allows for other assumptions.

Strategy 1B: Childrens' Testamentary Trusts

- Max dies leaves everything to Mary
- Years pass and Mary (now worth \$6m) dies, leaves everything to 3 children directly
- Alice could pay \$70,000 in income tax
- Bob could lose \$1m due to a workplace accident
- Charles could lose 50% due to a relationship breakdown

Children	Inheritance	Result
Alice (has 3 minor children)	\$2m	Invests it at 7.5% and pays \$70k tax on \$150K income, in one year only (assumes other income)
Bob (landscape gardening business)	\$2m	Employee loses sight of an eye in workplace accident. Bob negligent for failing to supply safety goggles. Not properly insured. Bob loses \$1m of inheritance
Charles (married)	\$2m	Relationship breakdown and loses half of inheritance

If Mary had instead established separate testamentary trusts:

- Alice could pay \$28,000 in tax thereby saving \$42,000 in one year
- Bob's \$2m would be protected from the workplace insurance claim
- Charles \$2m may be protected but is open to a Family Court determination

Child	Inheritance	Testamentary trust	Result
Alice (now has 3 minor children)	\$2m	Invests it at 7.5% and distributes \$50k to each minor child Tax paid \$9,300 each	\$70k less \$28k = 'saving' of \$42k in one year only
Bob (landscape gardening business)	\$2m	Assets in trust not property of Bob, so protected from lawsuit	\$2m protected
Charles (married)	\$2m	Assets in trust not property of Charles, however open to Family Court to determine otherwise (this will be discussed in a later newsletter)	\$2m may be protected

Strategy 2A: Why binding superannuation nominations are not always ideal

- Max and Mary make binding nominations leaving all their superannuation benefits to each other
- On either's death the survivor takes the lump sum and invests – similar poor outcome to Strategy 1A
- Instead, consider leaving open to discretion of SMSF trustee: SMSF can decide whether better to direct to
 - death benefits dependants (Spouse and/or children)
 - superannuation proceeds trust (Spouse and/or children); or
 - Estate (to testamentary trusts or superannuation trusts)
- However, be careful of Alice's role as director of SMSF

Strategy 2B: Why binding superannuation nominations are not always ideal

- On death of survivor of Max and Mary, Alice is independent but Bob and Charles remain financially dependant
- What is the better option:
 - force the trustee to pay all 3 children equally? or
 - retain discretion?

Option	Tax	Total tax paid
Trustee bound to pay all 3 children equally (\$200k each)	Bob* and Charles*: nil Alice: \$200k x 16.5% = \$33k	\$33k (Alice)
Trustee exercises discretion to pay super to Bob and Charles only#	Bob* and Charles*: nil	Nil
'Saving'		\$33k

* Assumes still death benefit dependants.

Trustee would only do this if enough other assets to equalise

Strategy 2C: Reversionary Superannuation Pensions

- The ATO recently issued a draft taxation ruling TR 2011/D3 in relation to members receiving superannuation pensions - is it surprising news?
- If Max is receiving a superannuation pension, should he consider nominating Mary as reversionary?
- And if Mary had pre-deceased, consider nominating children under 25 as reversionary pensioners, but only if equalisation can be achieved via estate or family trust

Look out for our discussion on topical items 3, 4 and 5 in the February 2012 issue of McLean Delmo's Quarterly Client Newsletter. For more information please contact David Taylor on 9018 4666, david.taylor@mcleandelmo.com.au or call your Client Partner.