

Wealth and Estate Planning

21st Century Wills



In the last 20 years, commercial, tax and investment law and regulation in Australia has become increasingly complex. Investment strategies and structures are being commonly utilised to create wealth and protect assets and minimise risk.

Almost invariably, the great majority of clients and associates use different legal structures including self managed superannuation funds to hold valuable assets.

Many clients spend their early years obtaining an education and skill set that allows them to subsequently create wealth and lifestyle opportunities for themselves and their families. Sophisticated clients prefer to minimise their risk profile and use life insurance and other insurance arrangements to ensure that there is adequate provision for their family in the event of their untimely demise.

The benefits enjoyed by clients, their families and dependants as a consequence of the implementation and maintenance of tax effective and asset growth strategies and structures during their life may be lost on death to the financial detriment of their surviving families because of poor estate and succession planning.

Estate and succession planning have become increasingly complex in the last 10 years. A will crafted in Dickensian tautology by professionals who have limited taxation, superannuation and trust law knowledge is no longer appropriate – indeed it can be very dangerous.

Given the sophisticated nature of clients' commercial, tax and investment activities, a 21st century Will needs to be a tailored plan that enhances a client's existing commercial, investment, superannuation and tax profile so that on their death, their assets are protected for the benefit of their family and dependants in a way that maximises tax effective investment income streams in the future.

A 21st century Will, if properly structured, will improve a client's ability to preserve their assets tax effectively on death and to allow them to increase and provide significant legitimate tax effective benefits to their children, grand-children and, potentially great grand-children.



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This memorandum provides a brief review of a number of strategies available to achieve a tax effective and beneficial result for your family following your death.

Once you have considered these strategies we recommend that you contact us to review your personal circumstances and to formulate a succession plan to meet your individual requirements. Any estate planning however must also take into account your business, investment and superannuation structures and strategies

If you have any questions or enquiries then please telephone us to discuss.

Yours sincerely

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DISCLAIMER:

Please note that the information provided here is based on the law and administrative practice as at the date of this article.

The information provided is general in nature and you should seek advice from us in relation to your particular circumstances before adopting any of the strategies outlined here.

In providing this information MBP Legal is not encouraging any person to invest or undertake the transactions outlined here, nor is MBP Legal purporting to provide any financial or investment advice. You should seek financial or investment advice from a licensed adviser.

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Explanatory Memorandum 21st Century Wills

Structuring your Will

Not all assets that you own will form part of your estate on your death. However strategies may be implemented during your life to ensure that:

- (a) your estate receives sufficient assets to pay your debts and estate expenses; and
- (b) your assets are dealt with in accordance with your wishes to provide the greatest benefit to your family.

These strategies also provide your family with tax effective structures in which your assets can be held and managed and, potentially, protected¹ for a substantial period of time².

Discretionary testamentary trusts are one such structure. The tax advantages and other benefits of using a discretionary testamentary trust in your will are discussed in detail below. These structures are flexible and can be adapted to your specific needs – providing you with a tailor-made succession plan and reassurance that your family will be provided for after your death.

Assets that can be dealt with by your Will

Some assets that you own on your death do not automatically form part of your deceased estate- most importantly assets held in superannuation funds and certain types of trusts – this is discussed below in the section “Assets which cannot be dealt with by your will”.

Your remaining assets will form your deceased estate and should be dealt with in your will. If you die without making a will then you will die intestate.

Generally, your executor will use these assets to pay debts and estate expenses³ with the balance being gifted in accordance with your will. Your executor will have the ability to sell estate assets if he needs to in order to pay debts and expenses and any remaining assets can be gifted in specie or as cash.

¹ see paragraph (d)

² a discretionary testamentary trust can ‘live’ for 80 years

³ Note that not all estate assets will be available for the payment of your debts and estate expenses. We will review your current asset position to determine whether you will have sufficient estate assets available to pay your debts and expenses on your death. If there is likely to be insufficient funds available, we may recommend implementing a strategy to enable additional funds or assets to be available to your executor



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- (a) **Specific Gifts**
If you have any particular assets – such as your wedding rings or other sentimental items – you may wish to leave these assets to a particular person. Your executor will not use these specific assets to pay debts and estate expenses unless the other estate assets are insufficient for this purpose.
- (b) **Remaining assets gifted to trusts**
All assets⁴ remaining after the payment of estate expenses will usually be gifted, in equal portions, to the trustee of discretionary testamentary trusts for each of your children.

Discretionary testamentary trusts

Many standard wills incorporate a fixed testamentary trust providing for assets to be held on trust for the benefit of a child until that child reaches a specified age. Once that child reaches the relevant age, the asset is transferred to the child and the trust is wound up.

This type of fixed testamentary trust provides the same tax benefits as a discretionary testamentary trust. However,

- (a) for a fixed testamentary trust, the tax benefits cease once the fixed trust is wound up, whereas
- (b) a discretionary testamentary trust can continue for up to 80 years – allowing the tax benefits⁵ to continue to be available for your children, grand-children and, possibly, great grand-children.

There is also less flexibility in a fixed testamentary trust as only the named child can benefit. If a discretionary testamentary trust is instead used, the trustee has a wide range of beneficiaries⁶ to whom he can distribute the income or capital of the trust, depending on the differing needs of each beneficiary.

Tax benefits arising from the use of testamentary trusts

The tax benefits available to child beneficiaries of testamentary trusts are substantial.

Children who receive “unearned” income⁷ from a standard⁸ trust are taxed at the highest marginal tax rate⁹, receiving only a very small tax free threshold. By way of comparison, income received by a child from a testamentary trust is taxed at the usual adult marginal tax rates.

⁴ except assets that have been specifically gifted.

⁵ and asset protection benefits– see further discussion below.

⁶ Beneficiaries in a discretionary testamentary trust are usually very broad and can include the named child, the surviving parent, the child's future spouse and children, their grandchildren, aunts/uncles/nieces/nephews, companies or trusts they control, etc

⁷ i.e. income received other than from paid employment

⁸ i.e. a trust that is not created by a will and is not one of the other excepted types of trust such as a trust for the benefit of a disabled child or for the maintenance of children after the breakdown of a marriage

⁹ currently 46.5% including the medicare levy



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Annexure A provides an example of the tax savings available by the use of a testamentary trust for the distribution of income to children. In the example, a **tax saving of \$86,000** may be made **every year** and this benefit may continue **for the life of the testamentary trust**.

Structure of testamentary trusts

As noted above, your discretionary testamentary trusts can be tailored to your individual wishes. Some of the features often incorporated into a discretionary testamentary trust include:

- (a) **Separate testamentary trust for each child**
You would usually establish a separate testamentary trust for each child – this allows each child to manage their trust for the benefit of their own family in the future without being “joined at the hip” with their siblings.
- (b) **Surviving spouse is a beneficiary of each testamentary trust**
Your surviving spouse would usually be included as a beneficiary of each testamentary trust to ensure your surviving spouse is provided for during the remainder of their life.
- (c) **Minimum age for your children to control their testamentary trusts**
As there are significant investment opportunities and tax benefits available in the testamentary trust, you would usually specify a minimum age at which your child will take control of their trust¹⁰. This ensures that your children will only control their trust when they have reached an age at which you believe they will be experienced and mature enough to recognise and manage the various benefits available by using the testamentary trust.
- (d) **Trustee of testamentary trust to have investment experience**
The initial trustee of the testamentary trusts would usually be the executors of your estate. This is usually your surviving spouse and we often recommend appointing a co-executor, being someone familiar with your family who has investment or commercial experience. This will ensure that the benefits of the testamentary trusts are fully utilised.

Summary of advantages from the use testamentary trusts

In a nutshell, the advantages of utilising a discretionary testamentary trust include:

- (a) Beneficiaries who are children under 18 years are taxed at adult rates rather than at normal penalty tax rates.
- (b) Assets can be held in the trust and the various benefits of the trust may continue to be enjoyed for up to 80 years.

¹⁰ While the trustee of a trust is responsible for the day to day management of a trust, the real control lies with the appointor who has the ability to replace the trustee. As such, your surviving spouse would usually be the initial appointor and your children would become appointor at the specified age. Some people also like to have a co-appointor with the child until a certain age. The tailoring opportunities are very broad and we will discuss your requirements with you when drafting these provisions.



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- (c) The trustee of the trust can make investments and distribute income and capital of the trust to beneficiaries depending on their circumstances and needs. The discretionary nature of the testamentary trust also allows the trustee to income split to take advantage of different beneficiaries' differing marginal tax rates.
- (d) The trust assets (which originate from your deceased estate) are not available to any current or future creditors of a trust beneficiary because the assets have always been held in the trust¹¹. These assets may also be protected from property orders resulting from the breakdown of a marriage or relationship.¹².
- (e) The appointor and trustee roles can be structured so that the passing of control of the testamentary trust to a child beneficiary can be managed appropriately.

Assets which cannot be dealt with by your Will

Certain assets that you own or that come into existence on your death cannot be dealt with by your will.

In some circumstances strategies can be implemented during your life to ensure that these assets will form part of your deceased estate on your death, however, such strategies will depend upon many factors personal to you and your present arrangements.

However, if any of your assets are unable to form part of your deceased estate, other planning opportunities may exist to ensure that those assets receive the best tax treatment available in respect of that particular type of asset.

The categories of asset listed below may not form part of your deceased estate – if you have substantial value in any of these assets, we recommend that you discuss with us the planning opportunities available to you.

Jointly held assets

- (a) Any assets that you and another person (usually your spouse) own jointly as joint tenants cannot be dealt with by your Will.

¹¹ Because the testamentary trust is discretionary no one beneficiary is entitled to the assets. As such, your child, for example, does not own the asset. This means that if your child is made bankrupt or their relationship fails, the testamentary trust assets will not usually be available to creditors or a disgruntled spouse and will be protected in the trust. However, the Federal Court case of *ASIC v Carey (No 6)* [2006] ("*Richstar's Case*") indicates that to preserve the asset protection qualities of the testamentary trust, 'control' of the trust should lie with an independent person. As such, at an appropriate time prior to bankruptcy, consideration should be given to the structuring of control of the trust. An independent person may need to be appointed to strengthen the trust's asset protection qualities. We can provide advice on this issue at the relevant time.

¹² Trust assets may not be protected from certain family law disputes that a trust beneficiary may be involved in. The powers of the Family Court are wide and there is no trust structure which can be made totally immune from its reach.



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- (b) For example, your family home will often be owned by you and your spouse as joint tenants¹³. This means that when one of you dies, the family home **automatically** becomes the property of the surviving person by virtue of the fact that together you held the assets 'jointly'.
- (c) You cannot gift your 'portion' of an asset held as joint tenants. By contrast, if you own an asset together with another person as tenants in common, then your share of the asset can be gifted under your will or, indeed, sold during your lifetime.

Assets held by a trust

- (a) Assets owned by a trust do not form part of your deceased estate because you do not personally own them – the trust does. Trust assets remain owned by the trust for the benefit of the beneficiaries after your death.
- (b) If you have substantial assets held in a trust structure you should discuss with us how you wish those assets to be dealt with on your death.
- (c) Depending on the terms of the trust, there are a number of options that may be available to “transfer” your interest in the trust on your death. These may include:
 - (1) amending your trust deed to ensure that your intended beneficiaries:
 - (A) become beneficiaries of that trust; or
 - (B) become trustee or appointor of that trust;on your death; or
 - (2) preparing a non-binding letter of wishes from you to the trustee of the trust advising how you would like the trust to be administered after your death. The trustee would be under no obligation to comply with your wishes, however, often you will control the trustee of your trust and can therefore be confident that your wishes will be followed.
 - (3) Note that if you have a fixed interest in the trust, such as units, then you may gift those units in your will;

Assets held by a company

- (a) Similarly, assets owned by a company will not form part of your deceased estate because you do not personally own those assets – the company does.
- (b) However, the shares you own in that company can often be gifted in your will¹⁴. The beneficiaries of those shares would then have the benefit of the asset by virtue of their ownership interest in the company.
- (c) We can also advise you on various business succession plans to ensure that your business is properly dealt with on your death.

¹³ A title search of your property will reveal whether you own your property as joint tenants. If you do not own the property, or any other asset, as joint tenants then you will own the property as 'tenants in common' – see paragraph (c)

¹⁴ The company constitution or other agreements may control the disposal of shares on your death. To properly advise you as to whether your shares can be gifted we will need to review those documents.



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Partnership property

- (a) A partnership interest may be gifted under your will provided this is permitted by the partnership agreement. We would need to review the partnership agreement to provide you with advice in this respect.

Superannuation proceeds

- (a) How your superannuation death benefit¹⁵ is paid on your death will be governed by the trust deed for your superannuation fund and any binding death benefit nomination that you have made. As such, these funds do not automatically form part of your deceased estate.
- (b) People often make a binding nomination leaving their superannuation death benefit to their surviving spouse. While this payment will be tax free, there may be more tax effective and flexible ways in which to deal with the death benefit.
- (c) In certain circumstances your superannuation death benefit can be paid to your estate and distributed in accordance with your will. However, these funds will not usually be available to your executor to pay estate expenses because the funds must be paid to a 'tax dependant'¹⁶ of yours to be tax free¹⁷.
- (d) If your super proceeds are received by your estate, you can provide for such funds to be held in a tax effective structure to allow those funds to be protected and invested for the benefit of your children¹⁸ or spouse.
- (e) We can provide you with further tax and estate planning advice in this respect. You should particularly request our further advice if you expect your superannuation death benefit to be substantial.

Life insurance proceeds

- (a) If you have lodged a binding nomination with your life insurer, any life insurance proceeds paid on your death will not form part of your estate¹⁹ but will instead be paid directly to the nominated party.
- (b) Depending on the terms of the life insurance policy it may be possible for the proceeds to flow to your deceased estate and then onwards to the beneficiaries under your will (which may include a testamentary trust).
- (c) Life insurance proceeds are generally protected from your creditors²⁰. As such, these funds will not be available to your executor to pay estate expenses unless your will expressly allows such use of the funds.

15 comprising your contributions and any life insurance proceeds from a policy owned by your superannuation fund

16 a 'tax dependant' in this context may include your minor children and your spouse. Your adult children and other people may also qualify as your tax dependant if it can be shown that they were financially dependant on you

17 Note: even if your executor is, say, your spouse, the payment of superannuation to your executor will not automatically be made to a tax dependant. Your executor is not the ultimate recipient of the funds but merely hold the funds on trust. As such, if funds are used to pay estate expenses, the recipient of the funds will not be your tax dependant.

18 only if the children are under 18 years or are financial dependant on you

19 s48A Insurance Contracts Act 1984



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- (d) If your superannuation fund owns an insurance policy on your life then your life insurance proceeds will be paid to your super fund and will form part of your superannuation death benefit. The treatment of your superannuation death benefit is discussed above.

Capital guarantee deposits

- (e) Some capital guarantee deposits where a beneficiary is nominated (these products may be provided by a friendly society or a bank) cannot be gifted under a will.

Changing your Will

We recommend that you review your will on a continuing basis, particularly when circumstances in your life change.

You should seek advice before making changes to your will to ensure that the changes are valid in law and do not upset already settled estate planning – for example, adverse tax consequences may be triggered by the change. We can provide assistance in ensuring such changes are valid and are tax effective.

You should also note that you can change your will at any time during your life without advising any other party. As such, if you and your spouse execute wills in the same terms, either of you can change that will at a later date without advising the other of that change.

Importantly, after one spouse has died, the surviving spouse can change their will. If your spouse's circumstances change after your death, if they get re-married or have further children for example, they may change their will to include their new spouse and children as beneficiaries. This will reduce the benefits you expected your children to receive under the terms of the previous will. Your children may even be excluded from your spouse's will all together.

To prevent this from occurring, we can prepare a **mutual will contract** which is, essentially, an agreement between spouses not to vary their wills without the consent of the other. After the death of one spouse the surviving spouse will be prevented from changing their will because they can no longer obtain the consent of the deceased spouse.

²⁰ Life insurance proceeds lose this protection if you have charged the policy or agreed that the policy be available to pay debts. If there is a concern regarding your personal solvency, care must be taken to ensure that this protection is not removed by the terms of your will, otherwise these funds may not be available to your beneficiaries.



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Example - Annexure A

Example of tax benefits arising from the distribution of income to children from a testamentary trust. This example is based on the marginal tax rates applicable in the 2008/2009 income year.

Alphonso executes a Will which has been drafted by MBP Legal to include the establishment of a discretionary testamentary trust for the benefit of his only son Mario (the Mario discretionary testamentary trust).

Alphonso subsequently dies and the value of his deceased estate which is bequeathed to the trustee of the Mario discretionary testamentary trust is \$8M net. At the date of Alphonso's death, Mario is 41 years of age, he is married to Stephanie (who receives no income) and has 3 children, Peter (12), John (10) and Jane (8). Mario is the only income earner as Stephanie is busy looking after the family. Mario has a house worth \$1.5 M unencumbered and \$300,000 in other investments.

The \$8M assets in earns \$400,000 income for the 2008/2009 income year. Each of Peter, John and Jane attend private schools and their school fees, together with normal living expenses amount to \$25,000 per year for each of Peter, John and Jane.

Set out below are the consequences arising where there is a traditional testamentary trust in place as compared to a tax effective testamentary trust.

Consequences under a traditional testamentary trust

Under a traditional testamentary trust, on Alphonso's death, Mario would have inherited the \$8 million. Since Mario was a mature adult as at the date of Alphonso's death, the traditional testamentary trust clause in the Will did not operate and Mario inherited directly. This is because traditional testamentary trusts are only in the name of one or more specific children and they cease when the child attains the age of 21 years or 25 years (or such date as the deceased may specify in the will).

*Under a traditional arrangement, Mario would derive the \$400,000 income because he would own the \$8M in assets. Mario will already earn \$360,000 income as a financial planner for that year and as such, Mario will pay top marginal tax on the \$400,000 investment income. **Tax payable on the \$400,000 would be \$186,000.**²¹*

Consequences under a tax effective discretionary testamentary trust

Compare this to the position where Alphonso's Will contains a discretionary testamentary trust – the Mario discretionary testamentary trust. In the relevant year after Alphonso's death, Mario distributes the \$400,000 income as follows:

Peter receives \$30,000, John receives \$30,000 and Jane receives \$30,000. Stephanie receives \$75,000. The class of discretionary beneficiaries described in the Mario

²¹ The top marginal tax rate including the Medicare levy being 46.5%.



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discretionary testamentary trust includes any companies in which Mario has a shareholding. Mario has a successful trading company called "EcoDeli" which needs working capital to consolidate the expansion of its retail operations. The trustee of the Mario discretionary testamentary trust determines that this company is also to receive \$235,000 as income. The total tax payable would be as follows:

<i>Beneficiary</i>	<i>Amount received</i>	<i>Tax payable</i>	<i>Net amount</i>
<i>Peter</i>	<i>\$30,000</i>	<i>\$3,960</i>	<i>\$26,040</i>
<i>John</i>	<i>\$30,000</i>	<i>\$3,960</i>	<i>\$26,040</i>
<i>Jane</i>	<i>\$30,000</i>	<i>\$3,960</i>	<i>\$26,040</i>
<i>Stephanie</i>	<i>\$75,000</i>	<i>\$17,115</i>	<i>\$57,885</i>
<i>EcoDeli Company</i>	<i>\$235,000</i>	<i>\$70,500</i>	<i>\$164,500</i>
<i>Totals</i>	<i>\$400,000</i>	<i>\$99,495</i>	<i>\$300,505</i>

Total tax payable on the \$400,000 would be \$99,495. *The net amount of \$26,040 for each of Peter John and Jane is applied in paying their private school fees and normal living expenses.*

Under this scenario, there is \$86,000 tax saving each year for Mario and his family. *This is a substantial tax saving. It should be noted that Mario can distribute income to his grandchildren and his great grandchildren in the years ahead as the Mario discretionary testamentary trust can continue for at least 80 years and it can become a substantial tax effective wealth creation and asset protection structure, not only for Mario but for his whole family.*