Estate planning, superannuation and taxation

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Overview of Estate Planning

- **Purpose:**

  (1) Protect assets – in the event of bankruptcy, marital breakdown, or professional negligence;

  (2) Minimise tax; and

  (3) Cost effective transfer of wealth to family / dependents on death.

- **Why relevant?**

  Most people will typically have at least 3 major assets that require protection and planning:

  (i) A property;

  (ii) Superannuation; and

  (iii) Assets held in a family trust.

Plan early, review plan regularly

- Plan ahead – before a situation arises where you need asset protection
- Review asset protection plan regularly:
  - (i) assets change;
  - (ii) beneficiaries may change, their circumstances may change;
  - (iii) Both impact on the most tax effective way to distribute assets.
- Ensure assets can be passed to down to future generations in accordance with your wishes

Why do you need asset protection – The risks?

- Marital breakdown / planning for multiple marriages;
- Bankruptcy – failed business ventures, professional negligence liability;
- Breach of directors duties - penalties; and
- Death – ensuring assets are passed to desired beneficiaries tax effectively.

Bankruptcy – S 116 Bankruptcy Act (Cth)

- "Divisible property" at risk – essentially property held by bankrupt:
  - (i) at time of bankruptcy;
  - (ii) acquired before discharge of bankruptcy.
- "Excluded property":
  - (i) Certain superannuation payments;
  - (ii) Certain life insurance payments;
  - (iii) Compensation payments for personal injury
  - (iv) Household items and mode of transport to the value of around $10,000

Bankruptcy - clawbacks

- Undervalue transactions and gifts:

  (i) General rule – transactions up to 5 years before commencement of bankruptcy can be voided / clawed back;

  BUT, if transferee can demonstrate solvency of transferor, then transactions to;

  (i) Unrelated transferee – clawed back 2 years prior to commencement of bankruptcy;

  (ii) Related transferee – clawed back 4 years prior to commencement of bankruptcy;

Bankruptcy – clawbacks – general rule

- General rule – transactions entered in to where the "main purpose" was to defeat creditors:

  (i) Subjective test - inferred from circumstances of transaction;

- Superannuation contributions - where main purpose of making contributions was to defeat creditors.

Asset protection / planning vehicles

- Private company
- Discretionary "family trust"
- Self Management Superannuation Fund (trust)
- Testamentary Trust
- Superannuation Proceeds Trust

Private companies

Advantages

- Limited liability;
- Good control if major shareholder;
- 30% flat tax rate on profits;
- Refund of excess franking credits;
- Easier to utilise losses.

Disadvantages

- Directors exposed for insolvent trading insolvent or breach of director duties;
- No automatic access to 50% capital gains discount;
- 20% holding requirement for small business capital gains concessions;
- No ability to stream tax attributes – capital gains / franking credits

Discretionary family trusts

Advantages

- Good asset protection – particularly with a corporate trustee:
  - (i) Assets not held in personal name;
  - (ii) Mere possibility/expectancy in relation to distributions.
- Flexible distributions to beneficiaries to maximise tax efficiency
- Access to 50% 12-month CGT discount
- Ability to stream capital gains and franked dividends

Disadvantages

- Risk of resettlement – changes to beneficiaries and trust property
- Losses trapped in trust – cannot be distributed;
- Land tax – no primary residence exemption;
- In NSW, the Succession Act claws back transactions with a trust that the deceased controls.

Family trust election

- Generally it is wise to make a family trust election
- Relatively generous rules apply for utilising losses;
- Beneficiaries generally don’t have the ability to access franking credits unless a family trust election is made

Family Trust Election

Advantages

- General beneficial to make election if making distributions to a "family" group;
- More generous loss and bad debt utilisation rules (simplified COT, most trust loss rules do not apply)
- Generally the best way to maximise franked dividends for beneficiaries

Disadvantages

- Punitive tax at 47% (plus Medicare levy) on distributions made to beneficiaries outside "family" group
- Class of beneficiaries restricted - "Family group" determined by reference to a "specified individual" – election of a "specified individual" can only be changed once
- "Family group":

  (i) parent, grandparent, brother or sister of the test individual;

  (ii) nephew, niece, child and their lineal descendants;

  (iii) The spouses of any of the above.

Streaming of capital gains/ franking credits

- From 2011 year onwards capital gains and franked dividends can be streamed to specified beneficiaries
- However, trust deed must specifically empower trustee to do distinguish between franked and unfranked dividend distributions
- If not, may need to consider amending trust deed
- Cannot make a resolution where expenses exceed amount of dividend
- Trustee must specifically record distributions of franked dividends / gains in its account
- Anti-avoidance rules apply to tax-exempt beneficiaries

Amendment of trust deed – will it trigger a resettlement / capital gain?

- Amending a trust deed may trigger a resettlement
- May trigger capital gains and stamp duty liability
- Must be able to demonstrate continuum of:
  - (i) Constitution / regime of trust obligations affecting property
  - (ii) Trust property;
  - (iii) Members / objects of trust

  (Federal Commissioner of Taxation v Clarke (2011) 190 FCR 206 and Federal Commissioner of Taxation v Commercial Nominees (2001) 47 ATR 220)
- Strict or partial identify not required – (Federal Commissioner of Taxation v Clarke (2011) 190 FCR 206). However, uncertainty as to when a resettlement might be triggered
- TD 2012/21 indicates that amending a trust deed to add beneficiaries or allow streaming of capital gains and franked dividends would generally not of itself trigger a resettlement (however, amending a deed to hold certain assets for a certain beneficiary would generally constitute a resettlement)

Tax planning opportunities in the event of death

- Make the most of the CGT death exemption:
  - (i) Assets passing to executor / beneficiary generally exempt from CGT;
  - (ii) BUT, assets passing to non-residents, tax-exempt bodies and superannuation funds do not have access to this concession. Avoid gifts to these entities;
- Smart use of Primary Residence Exemption by beneficiaries
- Testamentary Trusts - split income between minor beneficiaries at preferential tax rates
- Superannuation – smart planning
- Life insurance – CGT exemption for payment to policy holder, spouse or 'family member' (child, parent, grandparent, aunt, uncle, niece, nephew, brother or sister). Exemption will not apply for joint policies between unrelated parties.

CGT – primary residence exemption on death

- Pre-CGT asset (earlier than 20 September 1985)
  (i) If sold (proceeding to settlement) within 2 years of deceased death or such long period as the Commissioner allows; or
  (ii) If sold later than 2 years from deceased death and either the:
    (1) Spouse of the deceased immediately before death; or
    (2) A person given a right of occupancy under the deceased's will; or
    (3) Beneficiary who acquired the property under the deceased's will;

    occupied the property as their main residence from deceased's death until when they (the taxpayer) disposed of the property.
- Post-CGT asset; deceased must have occupied main residence continuously and must not have been used for an income producing purpose at the time of their death – other requirements above apply.

CGT – main residence exemption

- Main residence exemption available on up to 2 hectares of land on which residence sits, provided land used for private / domestic purposes;
- Main residence exemption not available for subdivided land where main residence does not sit on subdivided parcel
- A granny flat is a separate CGT asset
- If land subdivided and or a granny flat is built, was the main purpose to make a profit (i.e. is gain income or capital in nature?)
- Taxpayer acquires a new dwelling that is to become main residence – both properties treated as main residence for up to 6 months;
- Taxpayer acquires property with intention of building to live in as main residence – exemption applies for up to 4 years from when you acquired the land (or such longer time as the Commissioner allows)

Deceased estate – main residence exemption example

- Worked example:
  - (i) 1980 – Mary brought a house in Eastwood for $100,000
  - (ii) 2002 - Mary built a granny flat on this house for $80,000 and rented the flat out
  - (iii) January 2010 – Mary passed away
  - (iv) June 2012 – Mary's will is finally administered. Her son John becomes the owner of the property
  - (v) September 2012 – John sells the property in Eastwood for $1,500,000. What are the tax consequences?
- Tax issues:
  - Main residence and granny flat are separate CGT assets;
  - Was the flat built with the purpose of making a profit? (gain on income or capital account); and
  - Valuation needs to be done at time flat built if taxable. Capital proceeds allocated according to land that granny flat occupies;
  - GST – applies to new residences (but not if rented out continuously for 5 years)

Superannuation – tax in a fund

- Income derived by super fund taxable at 15%;
- Capital gains received by a super fund are taxed at 10%;
- Concessional contributions made to fund are taxed in the fund at 15%;
- Non-concessional contributions (e.g. contributions made on behalf of a spouse, rollovers from foreign funds) are not taxed in the fund
- Excess non-concessional contributions: (2014/2015): Individual taxpayers are liable to pay tax at 49% for non-concessional contributions that exceed $180,000 (effective tax rate capped at 95% for top marginal rate taxpayers)
- 0% tax on earnings of fund when in pension phase

Taxation on payment of a super death benefit

- Generally payments (lump sum or pension) made to members over the age of 60 are tax free (see table below)
- Lump sum payments to a "death benefit dependent" or a person who is "terminally ill" are also tax free
- Non-dependents can only receive a lump-sum – taxable per table below
- Non-dependents - from 1 July 2007 they cannot receive a pension – pensions before this date are taxable at dependent tax rates

Taxation on payment of a super death benefit

Death benefit recipient	Lump sum	Pension – tax rates (slide below)
Spouse (include de facto and same sex, but not a former spouse)	Yes – Tax free	Yes
Child under 18	Yes – Tax free	Yes
Child 18+ and independent	Yes – Taxed	No
18-25 & financially dependent	Yes – Tax free	Yes
25+ & financially dependent	Yes – Tax free	Yes
Any age & "interdependent" relationship	Yes – Tax free	Yes
Any age & serious disability	Yes – Taxed	Yes

Taxation on payment of a super death benefit

Age of beneficiary / deceased	Part of	Effective tax rate
Beneficiary or deceased is greater than 60 years old	Taxed element	0%
	Untaxed element	Marginal tax rate less 10% tax offset
Beneficiary or deceased is less than 60 years old	Taxed element	Marginal tax rate less 15% tax offset
	Untaxed element	Marginal tax rate
Non-dependent – receipt of lump sum	Taxed element	Marginal tax rate or 15%, whichever is lower, plus Medicare levy
	Untaxed element	Marginal tax rate of 30%, whichever is lower, plus Medicare levy

Who is a ‘death benefit dependent’

- Death benefit dependent (sec 302-195 ITAA 1997):
  - (i) Spouse or former spouse
  - (ii) Child under 18
  - (iii) Person who deceased had an ‘interdependency relationship’
  - (iv) Person dependent at ‘common law’
- An ‘interdependent relationship’ exists where two persons (sec 302-200 ITAA 1997):
  - (i) Have a close personal relationship; and
  - (ii) Live together (unless either or both suffering from a disability); and
  - (iii) One or each provides the other with financial support or personal care.

General principles – payment of a death benefit

- Superannuation does not automatically form part of your estate on death. The assets of a super fund fall to be administered by the trustee:

  (i) According to the trust deed;

  (ii) As modified by the SIS Act / regulations

  (The trustee is not bound to follow a direction in a will; Ioppolo -v- Conti [2015] WASCA 45)

- A death benefit must be cashed (pension or lump sum) immediately upon members death (SIS reg 6.21)
- A death benefit must be paid to:

  (i) A dependent;

  (ii) The deceased legal personal representative / executor;

  (iii) If neither of the above can be found, such person as the trustee nominates (SIS reg 6.22)

Death benefit nominations

- Must make a death benefit nomination to direct the trustee you would like your superannuation distributed. There are 3 types of nomination:
  - (i) Non-binding nomination
  - (ii) Binding death benefit nomination – must renew every 3 years
  - (iii) Non-lapsing binding death benefit nomination (independent or built in to trust deed)
- Any nomination must be in accordance with trust deed
- Care should be taken to comply with trust deed and completing nomination form – otherwise nomination may not be binding (*Munro v Munro [2015] QSC 61)*
- Some authority that non-lapsing binding death benefit nominations are valid for SMSF's (*Munro v Munro [2015] QSC 61)*
- May have multiple nominations (e.g. Pay mutiple pensions or lump sums)
- May have cascading nominations (e.g. If a beneficiary predeceases taxpayer, then the taxpayer has a secondary nominee)

Advantages / disadvantages of different nominations

Type of nomination	Advantages	Disadvantages
Non-binding nominations	Flexibility for trustee decision making – can take account of tax and non-tax considerations	Deceased has no say in who super is distributed to
Binding nominations – renewable every 3 years	(i) Super distributed according to deceased wishes (ii) Difficult to challenge if done properly	(i) No flexibility for tax planning (ii) More administration – must be renewed every 3 years
Non-lapsing binding nomination	(i) Super distributed according to deceased wishes (ii) Some authority that it is binding for an SMSF (see above) (iii) Less administration – once off nomination	(i) No flexibility for tax planning

Reversionary pension

- If deceased was in pension mode – a nomination could be made to pay a reversionary pension to a death benefit dependent – spouse, minor child or other dependent (lump sums only payable to non-dependents SIS reg 6.17A)
- Any nomination for a reversionary pension must accord with trust deed and terms of pension

Advantages	Disadvantages
Preserve tax-free status of fund if in pension mode	Can't make nomination during accumulation phase
Less likely to be challenged that where no nomination – ATO considers a reversionary pension prevails over a BDBN where trust deed silent	Lacks flexibility for tax planning

Testamentary trusts – tax advantages

- Now typically a standard clause in most wills – a trust created by will upon death
- Tax advantage: can distribute income to resident minors (aged less than 18) at preferential marginal tax rates (excepted trust income within sec 102AG ITAA 1936)
  - (i) 0% tax on distributions up to 18,200
  - (ii) Highest marginal tax rate of 47% (plus Medicare levy) only reached when distribution exceeds $180,000 +
- In comparison, distributions to minor beneficiaries from *inter-vivos* trusts taxed at penalty rates of 47% (plus Medicare levy)
- Worked example: a widow on $100,000 income with 5 children; estate of $80,000 (2015/2016 year)

Scenario	Effective tax rate	Tax paid
Tax on $80K paid to widow	37% on widow	$29,600
Tax on $80K paid to children by existing family trust	49% on children	$39,200
Tax on $80 paid to children by testamentary trust	0% on children	$0

Testamentary trusts – advantages / disadvantages

Advantages	Disadvantages
Tax planning - Income can be distributed to minor beneficiaries are preferential tax rates	Lack of long term flexibility – beneficiaries determined by will. Cannot add a beneficiary
Some flexibility – the trustee can determine how distributions are made	No access to main residence exemption for CGT or land tax
Asset protection – creditors, vulnerable beneficiaries	On-going administrative costs
Streaming of capital gains and franking credits	

Superannuation proceeds trusts

- Trust set up, preferably under will, to hold superannuation money after death
- Ideally should be established under a will (otherwise ATO may not respect that income distributions to minor beneficiaries is "excepted trust income")
- Similar tax advantages to a testamentary trust
- Generally set up to segregate 'death benefit dependents' from other beneficiaries
- Not that all capital beneficiaries of the superannuation proceeds trust must be death benefit dependents.

Possible changes to negative gearing and superannuation

- Internal debate within the coalition government about scrapping negative gearing
- Not clear whether changes would affect existing property or just new property
- There will be no changes to superannuation for the over 60's
- Speculation of increased contributions tax, particularly those with incomes greater than $100,000 (marginal rate less 20%):
  - (i) Speculation that rates may increase to 17% for those earning over $100,000;
  - (ii) Speculation that rates may increase to 25% for those earning over $180,000;
  - (iii) But, contributions tax would be scrapped for those earning $17,000 or less
- Speculation that it would be politically easier for government to make changes to superannuation for high income earners, rather than scrapping negative gearing;
- There is a reasonable chance in the longer term that many of the current tax breaks for superannuation will be far less generous, particularly for high income earners / those with a large amount of superannuation

New proposed small business CGT rollover – 2015 exposure draft released

- To give small business owners more flexibility in changing their ownership structure from a company to a trust, partnership or being a sole trader
- Transferor entity: less than $2 million turnover ***or*** less than $6 million in assets
- Must transfer all CGT assets: trading stock, revenue assets and depreciating assets without realising a taxable gain
- Transferee and transferor must be Australian tax resident
- Transfer does not have the effect of changing the ultimate economic owner (with a trust, ownership within a family group permitted)
- Transferee inherits tax cost base of transferor
- Cannot transfer to an exempt tax vehicle or a superannuation fund
- Interesting issue: if there is a property that form part of the business, the better view is that this should also be transferred but it will be subject to a stamp duty charge in NSW

Land tax – New South Wales

- Land tax is imposed on the owner of land;
- It is imposed on the “unimproved value of the land”
- NSW land tax thresholds are set out in the table below:

Taxable value of land	Land tax payable
$412,000 or less	0
> $412,000 but < $2,519,000	100 + 1.6% of the value over $412,000
> $2,519,000	$33,812 + 2% of the excess over $2,519,000

- Land tax is assessed on a quarterly basis as at 1 July, 1 October, 1 January and 1 April

Land tax – New South Wales - Exemptions

- There are a number of specific exemptions that apply from Land Tax;
- Principal place of residence exemption – one property per family

  (i) but not in respect of any part of the land on which another person has exclusive use or occupation under an excluded residential occupancy (bed sits, B & B's and granny flats)
- Owner moving house may treat both residences as exempt provided the new residence is acquired within 6 months of the relevant taxing date and the old residence sold within 6 months of the relevant taxing date;
- Owner has acquired unoccupied land and intends to build or renovate – exclusion for 4 years after building commences;
- Owner moves away from property. Exemption for 6 years provided:
  (i) Owner does not have another principal place of residence; and
  (ii) The owner lived on the property as their primary place of residence for at least 6 months continuously before moving away.

  (The land may be leased on a short term basis to cover maintenance and expenses)

Land tax – New South Wales - Exemption

- Exemption on death of owner

  (i) for 2 years after the person dies; or

  (ii) where a person occupies the land/house under a right given in a will
- Primary production exemption:
  1. (i) if land zoned as rural (rural, rural residential or non-urban) the dominant purpose / use of the land must be for a primary production purpose to be exempt: keeping bees, running horses; and
  2. (ii) If the land is not zoned as rural the primary production activity must also have a significant and substantial commercial purpose for the land to be exempt.
- Land used primarily for low cost accommodation; is exempt;
- Land used and occupied as an aged care facility is exempt;
- Land owned by religious and no-for profit organisations is generally exempt.

Payroll tax - NSW

- Payroll tax is a state and territory tax imposed and controlled by 8 separate legislatures;
- Payroll tax is a tax on wages, allowances and benefits paid to employees;
- The payroll tax rate in NSW is 5.45%
- There is generally a threshold at which payroll tax is payable. In NSW:

Annual	Monthly (28 days)	Monthly (30 days)	Monthly (31 days)
$750,000	$57,534	$61,644	$63,699

- Payroll tax is paid on a monthly basis. Due by the time return is due
- Returns are due 7 days after the end of the month, except June when they are due within 21 days

Payroll tax - NSW

- General inclusions in the payroll tax base:
  - (i) Wages and salary;
  - (ii) Non-cash benefits – utilising the FBT taxable amounts
  - (iii) Gifts;
  - (iv) Holiday pay and long service leave;
  - (v) Payments to contractors (although there are 9 exemptions for genuine independent contractor relationships);
  - (vi) Superannuation contributions.
- Exclusions from the payroll tax base include:

  (i) Travelling allowances up to 75c/km and accommodation up to $250.85;

  (ii) Bona fide allowances to non-working directors for expenses

  (iii) Maternity leave from 1 July 2007, Paternity leave from 1 July 2010;

  (iv) GST; and

  (v) Payments to volunteer emergency workers

Payroll tax – NSW – general exclusions

- General exclusions from payroll tax include:
  (i) Religious organisations;
  (ii) Public benevolent institutions;
  (iii) Public or not-for profit hospitals;
  (iv) Schools / colleges providing education below secondary level;
  (v) Municipal councils;
  (vi) Charitable organisations.

Payroll tax – NSW – grouping provisions

- These are crucial as if companies are grouped, only 1 company will be able to utilise the exemption threshold. Others simply pay the flat rate tax on relevant wages and benefits;
- Determining whether a group exists is usually a determination made by a Commissioner of the OSR;
- Broadly, a determination that a payroll group exists may be made under 5 different provisions:
  (i) Two or more companies are related under the Corporations Act 2001 such that they have a parent-subsidiary relationship;

Payroll tax – NSW – grouping provisions

- Broadly, a determination that a payroll group exists may be made under 5 different provisions:
  - (i) Two or more companies are related under the Corporations Act 2001 such that they have a parent-subsidiary relationship;
  - (ii) Employees of one business perform duties solely or mainly for the benefit or another business;
  - (iii) There is an agreement between two businesses relating to the performance of duties by employees of one, solely for the benefit of the other;
  - (iv) The businesses are commonly controlled by the same person;
  - (v) Two or more groups have common members and as a result are subsumed in to a larger group of three or more members.

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