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2010 Estate Planning & Succession Update

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The purpose of this update is to provide a general summary of how recent and proposed changes in laws or their interpretation might have an impact on a person's estate planning and succession objectives in 2010 and to alert readers to possible review issues which they (or their clients) may need to consider.

In recent times, the change with probably the most extensive estate planning and succession implications for many people was on the family law front. In March 2009 the jurisdiction of the Family Court expanded from covering just marriages (and child residence and support issues) to cover the breakdown of cohabitation between de facto partners whose cohabitation endures for a total of 2 years duration or has produced a child. This extended jurisdiction applies to residents of 6 of the 8 Australian states and territories, ie excluding South Australia and Western Australia.

The family law changes are an issue not only for de facto relationships, whether heterosexual or same sex, but also for people in harmonious and enduring marriages and other balance of lifetime relationships who aren't confident that their children or other intended beneficiaries will enjoy the same kind of enduring domestic relationship.

It is always difficult to predict what the developments will be in a forthcoming year, but 2 likely developments of significance in the 2010 calendar year are:

1. Taxation of trust and deceased estate income and capital

A decision *re FCT v Bamford* is likely to be handed down by the High Court during 2010. This decision may (or may not) end years of uncertainty about the income tax treatment of income and net taxable capital gains in the hands of a trustee or an executor and in the hands of the beneficiary or unitholder of a trust or a deceased estate.

2. Division 7A and family homes

The introduction, in *Tax Laws Amendment (2010 Measures No 2) Bill 2010* of amendments to the deemed dividend provisions in Division 7A of *ITAA 1936*. These amendments, if enacted as proposed, will tax as a deemed dividend the value of benefits provided on non-commercial terms to associates of a company or, in some cases, of a trust. The type of benefits to be deemed as deemed dividends include the value of the non-commercial use by associates of a house, a beach house, ski lodge or yacht. Trusts will only be affected by this amendment if the trustee has what is defined as a distributable surplus, essentially holding unpaid allocations of income to a company beneficiary.

30 June 2010 is shaping as "D Day" in terms of this proposed change to the income tax laws.

Apart from the developments and the anticipated developments that have already been mentioned, the following areas are seen as among the ones that are likely to warrant review for many people during the 2010 calendar year:

1. Parent to child loans

What starts as a loan or a gift from a parent to a child (eg to help a child purchase a home in days when housing prices are a much greater multiple of average salaries than was the case a generation previously) can at a later date become any of:

- a bonus for the child's estranged domestic partner (whether married or de facto, heterosexual or same sex)
- a bonus for creditors of the parent or child's business
- a barrier to a means tested pension for the parent or child
- the subject matter of a family provision dispute when the parent dies.

Without forward planning (often needing to occur at the time a loan or gift is made):

- the Family Court can view a loan as a disguised gift (providing that a loan with non-commercial terms only has to be repaid on the breakdown of a relationship can also be seen by the Family Court as indicative that the loan is a disguised gift)
- a trustee in bankruptcy can relegate repayment of the loan to the low or zero priority of an unsecured creditor
- Centrelink can deem the loan to be an asset of the aspiring pensioner
- the loan can form part of the deceased estate or notional estate of the lender
- where interest is charged on the loan, the interest received can be assessable for the parent, but the interest paid may not be deductible for the child.

When a loan is made, but not documented, a child can also get selective memory and recall that it was a gift that was made, rather than a loan, notwithstanding the parent's protestations.

For all of these reasons, care needs to be paid to identifying the terms of the loan. The treatment of the loan can be very different if interest has been paid, there is a realistic repayment, the domestic partner of the child has acknowledged the loan or the loan is secured.

2. Binding financial agreements

Couples (including de facto couples or same sex couples, and those married or planning to marry) can enter into binding financial agreements (BFAs) before they commence a relationship, during a relationship or after their relationship finishes. The agreement stipulates what property they each receive upon separation and what "spousal maintenance" one should pay the other upon separation (if applicable).

The Court case of *Black v Black (2008)* cast doubt on the BFA provisions of the *Family Law Act* suggesting that BFAs could easily be challenged and set aside through the Courts. This sent shock waves through the legal profession.

Parliament has now amended the *Family Law Act 1975* to correct these problems with BFAs, with the amendments commencing on 4 January 2010. The amendments are also retrospective so that old BFAs which were imperfectly prepared may now be able to be salvaged – although legal advice should be obtained to double check that the old agreements are valid.

The most common problem with BFAs, especially prenuptial agreements, is when a party comes to their lawyer to get an agreement prepared shortly before the marriage. Agreements can be challenged if entered into under "duress" and therefore it is highly undesirable to sign a BFA within say one month of a wedding. Needless to say the preparation process for the BFA should start at least a few months before that as well.

Another common concern with BFAs is that both parties must have independent legal advice before signing them. Both lawyers obviously have to be paid for their work and it is their duty to "fearlessly" tell their respective clients if the proposed agreement in their view is fair or not. The legal costs are not low since a BFA is not a pro forma document and it must reflect the particular circumstances of the couple in question.

A common limitation of a BFA relates to obtaining complete protection from spousal maintenance claims. If a BFA attempts to prevent a party claiming spousal maintenance from the other, that provision will be invalid if on the day the agreement "comes into effect" the potential claimant for maintenance is unable to support themselves without a Centrelink benefit. The agreement usually comes into effect at about the date of separation. Hence the BFA should say that the wealthier party will give the poorer party a lump sum (possibly quite a modest one) immediately when the agreement

comes into effect so that they can at least for a period support themselves without a means tested pension. Then the spouse maintenance protection is effective.

3. Capital reserved trusts

An alternative to a binding financial agreement (BFA) is the establishment of a capital reserved trust, either by a trust deed or a declaration of trust, to hold investment, lifestyle or business assets or to be the provider of all or part of the funds used to acquire those assets.

The income beneficiaries of a capital reserved trust resemble a family trust, with the trustee having the discretion to choose between members of a class of income beneficiaries each year when deciding who is to receive the income of the trust. The capital beneficiaries, by contrast, are not discretionary and are set out in the terms of the trust. They usually do not receive the capital (with the exception of funds to meet capital gains tax assessments that they might receive as a result of a CGT event involving the trust) until after the death of the principal lifetime beneficiary.

As a vehicle for providing family law protection, there are 3 important caveats regarding the effectiveness of such trusts, ie the timing of the establishment of the trust, the timing of transfer of funds to the trust and the observance of the terms of the trust. A Court is far more likely to look relatively favourably on such a trust if it was already in place when the relationship started, has not been augmented by transfers made during the course of the relationship and the capital is clearly being reserved for the capital beneficiaries. In such cases, the trust is likely to be viewed as a resource, but unlikely to be subject to orders as to the transfer of trust assets. If the trust does not meet those attributes, a result akin to the 2009 High Court decision in *Kennon v Spry* might occur. In that case the husband's conversion of an existing fully discretionary family trust into a capital reserved trust with a 3rd party lawyer acting as trustee as his long term marriage started to flounder proved ineffective in stopping the Family Court from making orders in respect of the transfer of assets to the wife.

A disincentive in the short term to the establishment of a capital reserved trust can be the CGT and state or territory duty that is payable when assets are transferred to the trust. CGT and duty are not an issue if cash is transferred to the trust – the opportunity for this often occurs when one asset has been sold and a replacement asset is being purchased with the sale proceeds. CGT and duty are also not an issue for a capital reserved trust established by Will (often referred to as a flexible life interest) and funded by the willmaker's assets.

4. SMSFs and financial attorneys

The holder of a financial enduring power of attorney can act as trustee of an SMSF or as a director of the trustee company in lieu of a living member of the SMSF. There is no requirement for the member to have lost financial decision making capacity, eg the attorney may act in the role while the member is overseas.

Where the fund member has appointed 2 or more people to act as the fund member's financial attorney, only one of the attorneys can act on behalf of the member in respect of the SMSF, eg as a trustee or director in place of the fund member. Just who that person is may be set out in the terms of the financial enduring power of attorney or (as is often the case) may be left to the attorneys to decide between them.

An administrator acting for a living person can also act as trustee of an SMSF or as a director of the trustee company in lieu of a living member of the SMSF for as long as the member is under a legal disability, but not otherwise. Similar rules apply to a parent or guardians of a child who is yet to attain 18 years of age.

The attorney or administrator cannot charge a fee for being a trustee or a director.

A major estate planning issue with attorneys and SMSFs is the personal decision making advantage that an attorney who is a dependant of the fund member for superannuation purposes may receive in relation to the preparation, revocation or overriding of a fund member's binding death benefit nominations.

5. Special disability trusts – 2 taxation changes

It can hardly be said that since their introduction in 2006, special disability trusts have become hugely popular. These trusts, with significant means tested pension concessions for their principal beneficiary, have not been taken up in great quantities, principally for 4 reasons:

- eligibility to be a principal beneficiary of a special disability trust is restricted to people that Centrelink or the Department of Veterans' Affairs consider have a severe disability – the narrow interpretation of that term has proved a major barrier to eligibility
- the expenditure of the trust is limited to care and accommodation, with narrow definitions as to what constitutes care and limited availability of accommodation for people with severe disabilities
- transaction taxes such as capital gains tax and state and territory duty have often made transferring assets into a special disability trust a costly exercise (not an issue when assets are transferred by Will)
- the trust income is taxed at significantly higher rates than the marginal tax rates paid by most of the likely funders of the trust, ie parents who are at least 60 years of age and who no longer have to pay tax on most superannuation income streams.

As a result, most special disability trusts are being established by Will and will only come into being on the death of the willmaker or the death of the willmaker's domestic partner.

In 2009 the Federal Government made 2 favourable, if relatively minor, changes to the treatment of special disability trusts, ie:

- clarification that the main residence of the principal beneficiary can be exempt from capital gains tax if held in a special disability trust
- removal of a strange requirement that all trust income not spent on a principal beneficiary in a financial year had to be accumulated (and thus taxed at 45%, plus Medicare Levy), rather than allocated to be spent on the principal beneficiary in a future year.

Hopefully the changes are the start of the implementation of a series of changes that have been recommended to the Federal Government by a working party it commissioned.

6. Private ancillary funds

Many individuals and families have used private prescribed funds as their preferred structure for tax deductible philanthropic giving. New requirements apply to these trust funds, now known as private ancillary funds.

Under the new arrangements, the trustee must be a corporation, a minimum amount must be distributed each year, regular valuations must be conducted and the trustees must manage the fund in accordance with an investment strategy. The changes stem from a desire on the part of the Federal Government to improve the integrity of prescribed private funds and to clarify trustees' obligations.

Strict requirements apply to trustees, and penalties can be imposed on trustees and their directors for failing to comply with the new rules. Further technical details are available on the [ATO website](#). There are transitional arrangements for existing private prescribed funds.

This update (or a later version) will form part of the Reviewing Estate Planning Chapter of the 1st edition of the forthcoming CCH Australian Master Estate Planning and Succession Guide. The author of the update, Allan Swan is both an **EPSS** principal of the Victorian law firm **MOORESLEGAL** and the principal of his own presenting business. The contribution of Stephen Winspear and Libby Klein to parts of the update is gratefully acknowledged.

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