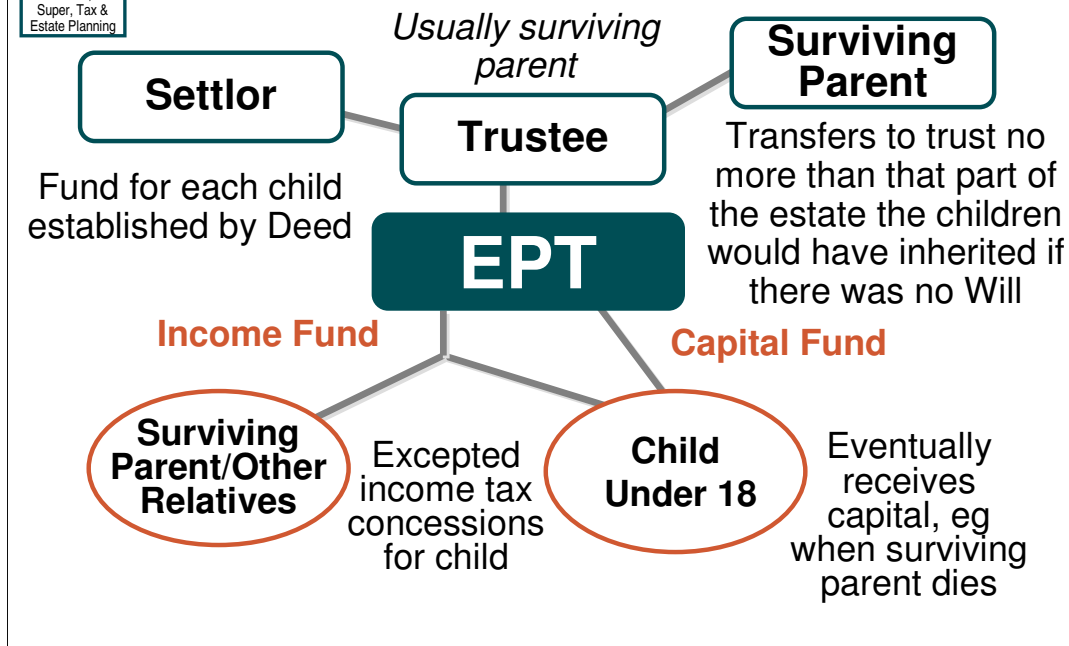


Estate Proceeds Trust



Major Reasons for a Capital Reserved Estate Proceeds Trust

To have income (generated from all or some of the part of the deceased estate, including superannuation death benefits paid to the estate, that the child would have received had there been no Will) taxed as excepted income of the child, rather than included in the surviving parent's income and taxed at the parent's marginal tax rate, eg 46.5%. # To thwart a challenge by a future partner of the surviving parent; trust capital must ultimately be paid to the child – payment of all or the balance of the capital usually occurs when the surviving parent dies. # To still have flexibility as to the distribution of income (as opposed to a fixed trust option).

Trustee and Ultimate Control

Usually the surviving parent or a company controlled by the surviving parent. Control is held by the appointor (usually the surviving parent) until the trust ends and the capital beneficiary takes over absolute ownership. The capital beneficiaries cannot be changed and no additions can be made to the income beneficiaries.

Income, Losses, Loans and Pension Benefits

The child and other beneficiaries are taxed on all income spent on or allocated or paid to them, with credit for any tax already paid, eg dividend franking credits. Separate trust needed (usually within the terms of a single trust deed) for each child. Loans to the trust need to be on arm's length rate terms. Income and assets can be counted for Centrelink means tests purposes both for the surviving parent and for non-excluded beneficiaries of the trust.

Capital Profits (usually subject to a 50% Discount)

Taxed as a capital gain for the child. A taxable CGT event may occur when the trust ends and the capital is distributed to the child; the trustee is usually given an express power to pay any CGT liability that might fall on a beneficiary.

EPT Funding Limitations

Need a deceased estate with assets – many estates pass automatically to a surviving parent as the surviving joint tenant or directly to a dependant

Trust(s) can hold all or any part of the share of the estate the child/children would have received had the deceased parent died without a Will

Share of estate varies depending on jurisdiction, eg in

- NSW – children receive ½ of the estate less \$200,000
- Qld & Vic – children receive 2/3 of the estate less \$150,000 (Qld) \$100,000 (Vic)

Barriers to Establishing Estate Proceeds Trusts

Estate proceeds trusts are often partial substitutes for the testamentary trusts the deceased parent of a child or children under 18 years failed to include in the Will. Like testamentary trusts they have the barrier of needing to be funded by estate assets, but unlike testamentary trusts they can only have as their capital beneficiary a child who would have inherited had there not been a Will.

Need for a Deceased Estate of Value

This can be an obstacle even for relatively high net worth people as many people die with greater wealth outside their deceased estate than inside their estate, eg because assets were held:

- As joint tenants;
- In the surviving spouse's name (eg for asset protection purposes or to "simplify" life insurance policy ownership);
- In superannuation and paid directly to dependants;
- In a family discretionary trust.

"Notional Intestacy" Entitlement

An estate proceeds trust, because of subsection 102AG(7) of *Income Tax Assessment Act 1936*, can only be funded by that part of the estate that would have passed to the child had the deceased not made a Will. This means that the deceased needs to have been the child parent (or the child's grandparent in the uncommon situation that the child's parent has died before the child's grandparent of the same family line). The notional intestacy entitlement can vary between the different Australian States and Territories (as well as between different overseas jurisdictions).

Capital Reserved Trusts – Stages of Administration

(For most estate proceeds, super & other death benefit trusts)

While child is under 18 (or still financially dependent) –
Income is distributed to child's legal personal representative for maintenance & education expenses

When financial dependency ceases –
Trust usually operates as a discretionary income trust (or for a fixed trust, interest is no longer charged)

When surviving parent dies/decides to end trust –
Child receives trust capital

Stages for All "Capital Reserved" Trusts

These 3 stages are typical of the stages of administration of all of the "capital reserved" trusts that need to meet the requirements of subsection 102AG(2A) of *Income Tax Assessment Act 1936*, including estate proceeds, child support (maintenance), superannuation death benefits and employer funded death benefits trusts. A separate trust is established for each child, often using a single trust Deed. The definitions of income and capital in the Deed are the accounting definitions (because the requirement for "accounting" capital to eventually be paid to the child).

Stage 1

The surviving parent is able to split "accounting" income with the child and use that income to financially support the child (and yet still retain control of the funds).

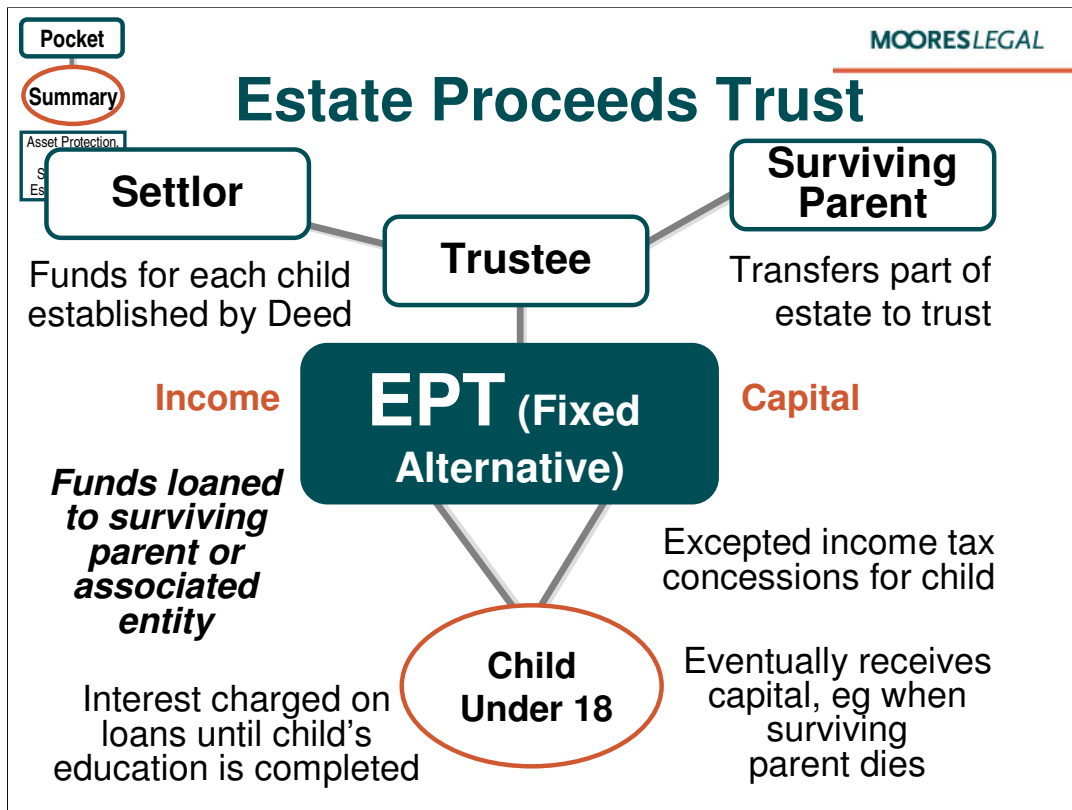
Stage 2

Unless the trust is a fixed trust (as opposed to a non-fixed, capital reserved or split fixed trust – see separate pocket summaries), the surviving parent does not have to pay the trust funds over to the child and can continue to enjoy the benefit from the capital for the balance of the surviving parent's lifetime either by:

- receiving the income personally (capital reserved or non-fixed trusts only); or
- receiving the benefit of an interest free loan.

Stage 3

On the death of the surviving parent (or such other time as the surviving parent nominates during their lifetime or in their Will), the trust assets pass to the child.



Major Reasons for a Fixed Estate Proceeds Trust

To achieve most of the advantages of a non-fixed child support trust (other than flexible income distributions). # To ensure that trust assets will pass to the child without a CGT event occurring when the trust ends.

Trustee

Usually the obligated parent or a company controlled by the obligated parent.

Ultimate Control

Control is held by the appointor (usually the surviving parent) until the trust ends and the beneficiary takes over absolute ownership. The beneficiary cannot be changed and, unless the assets of the trust are ones that prevent a handover, eg a documented lifetime loan, (unlike the non-fixed version) the beneficiary can demand payment of the capital on attaining 18 years.

Income, Losses, Loans and Pension Benefits (if fixed option is chosen)

The child is taxed on all income spent on or allocated or paid to the child, with credit for any tax already paid, eg dividend franking credits. Separate trust needed (usually within a single trust deed) for each child. Loans to the trust need to be on arm's length rate terms.

Capital Profits

Taxed as a capital gain for the child (usually subject to a 50% discount). Unlike the non-fixed alternative (included as part of the Pocket Summary), a CGT event does not occur when the trust ends and the capital is distributed to the child.

Estate Proceeds Trust – Further Reading

**Australian Master Estate
Planning & Succession
Guide – Chapter 40**

**You Can't Take It
With You –
Chapter 13**

**The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/epss/pocket-summaries**

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Further Reading

- The 1st edition of the ***Australian Master Estate Planning and Succession Guide*** by Allan Swan is scheduled to be published by **CCH** in 2011.
- The 1st edition of ***You Can't Take It With You*** by Andrew Simpson was published by **Wrightbooks** in 2009.
- The 5th edition of ***Tax Issues in Family Law Property Settlements*** – The Difference Between Hacking and Carving by Peter Szabo was published by **MOORESLEGAL** in 2008.

About the Author of the Pocket Summaries – Allan Swan

In addition to his main role as a principal of the **MOORESLEGAL** estate planning team (working in the areas of **Asset Protection, Trusts, Superannuation, Tax and Estate Planning**) Allan is also the principal of **APTSTEP**, a provider of training and materials. Allan's current presentation topics are:

- Asset Protection Planning
- Blended Families
- Business Structures Overview
- Estate Planning – Key Cases and Rulings
- Estate Planning – Practical Case Studies for 2010
- Estate Planning – Tax and Strategic Issues (includes all pages of this Pocket Summary)
- Funding Estate Planning
- Ruling from the Grave
- SMSFs – Planning Issues
- Superannuation Death Benefits (1-3)
- Superannuation Overview
- Testamentary Trusts
- Trusts – Income and Capital Distributions
- Trusts – The A-Z.

Contact Allan on 03 9843 2153 for further information regarding on the content of the topics, the fees charged and to schedule a presentation, workshop or seminar.