

Life Interests & Rights of Occupation

Can achieve a Willmaker's
estate planning goals

3 main options

- Fixed life interest
- Flexible life interest (capital protected testamentary trust)
- Right of occupation

Key Terms

CGT

“ownership interest”

“right of occupation”

Land tax

“Equitable interest”

Fixed Life Interest (separately illustrated)

This is a form of testamentary trust where a person (usually a surviving domestic partner) is granted a fixed lifetime benefit from the income, use and enjoyment of all or part of the assets of a Willmaker's estate. As with all testamentary trusts, the executor or trustee is usually given the express power to pay any taxable capital gain that might be assessed against the lifetime beneficiary under s 97 of the *Income Tax Assessment Act 1936* (“ITAA 1936”) or (if the beneficiary is under a legal disability or is a non-resident) under s 98 of *ITAA 1936*. Any CGT liability is met by the executor out of the life interest funds.

Flexible Life Interest or Capital Protected Trust (separately illustrated)

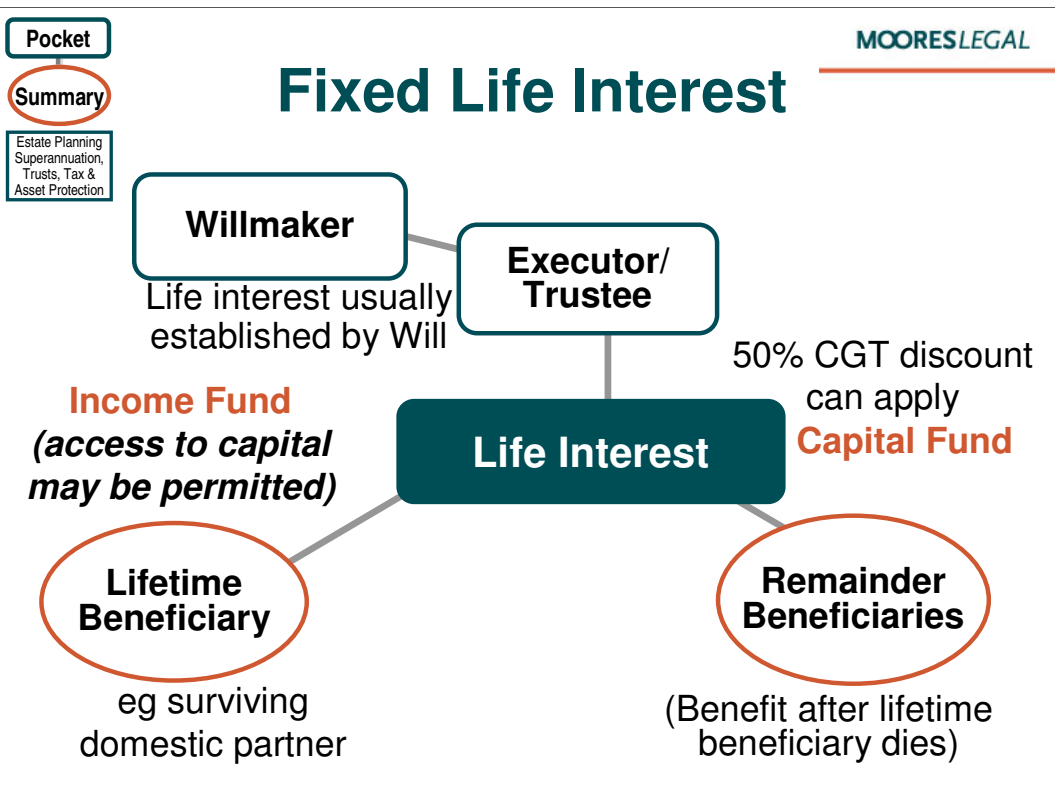
This is a flexible or discretionary form of life interest or capital protected trust where a person (usually a surviving domestic partner and usually known as the “primary life tenant”) is granted the default entitlement to a lifetime benefit from the income, use and enjoyment of all or part of the assets of a Willmaker's estate. The primary life tenant can consent to that income being split amongst defined relatives and other defined income beneficiaries, eg children and grandchildren.

Ownership Interest

To qualify for the main residence exemption from capital gains tax extension provisions (as set out in s 118-95 of the *Income Tax Assessment Act 1997* [“ITAA 1997”]), a surviving domestic partner must have been given or already hold an ownership interest in the main residence of the deceased. What constitutes an ownership interest is set out in s 118-30 of *ITAA 1997*, eg it includes a legal or equitable interest or a licence or right to occupy.

Right of Occupation (separately illustrated)

This is both a form of ownership interest provided for in s 118-30 and an express requirement in s 118-95 for anyone who is not the domestic partner of the deceased owner of the main residence.



Major Reasons for a Fixed Life Interest

To provide income and benefits to a lifetime beneficiary such as a surviving domestic partner in a fixed form. # Preservation of capital base – the Willmaker can ensure that the capital is preserved for beneficiaries such as the Willmaker’s children after the lifetime beneficiary dies. # Asset protection – a fixed (or flexible) life interest can protect the capital against a bankruptcy or family law claim made on the lifetime beneficiary after the Willmaker has died.

Income, Losses, Loans and Pension Benefits

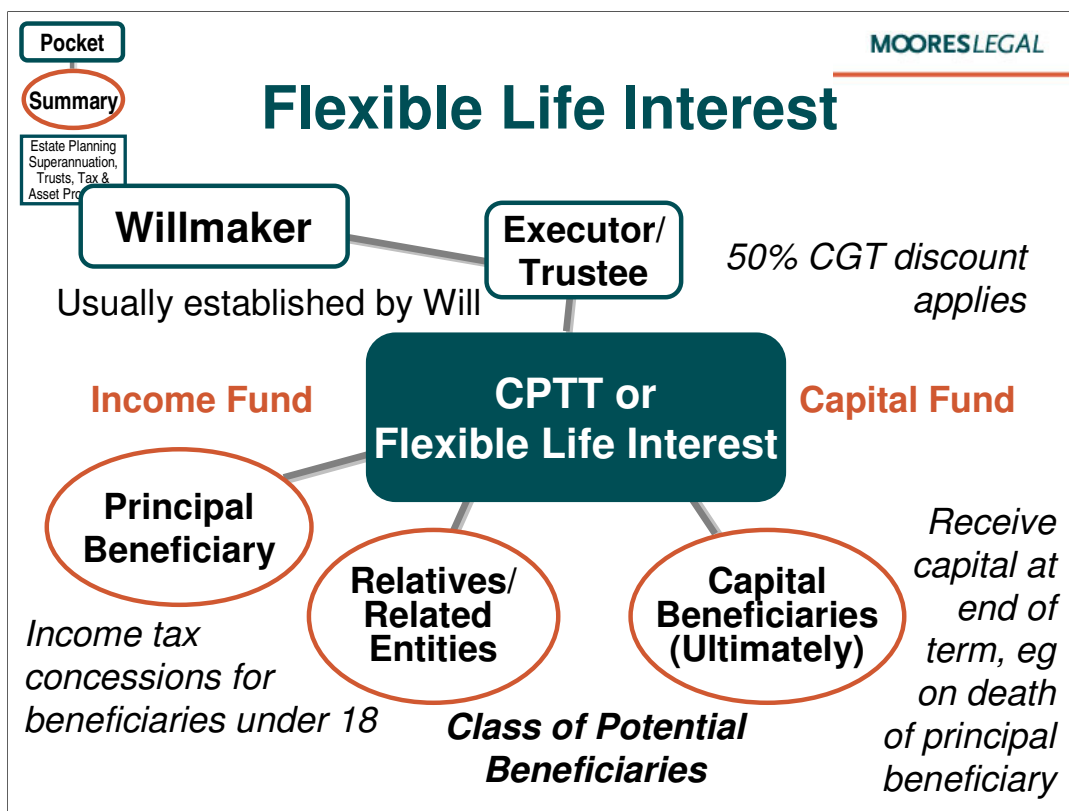
The lifetime beneficiary is taxed on all trust income spent on or allocated or paid and the lifetime beneficiary receives any franking or income tax credits. Income is usually defined as accounting income. A family trust election may be needed in respect of income losses, but not in respect of franking credits accompanying dividend income. Loans to the trust may need to be on arm’s length rate terms. Income (and assets, if the executor can use capital to benefit the lifetime beneficiary) can be counted for Centrelink means testing purposes for the lifetime beneficiary.

Capital Profits

If a Willmaker’s assets pass via the fixed life interest to the residual beneficiary, no taxable CGT event occurs until the residual beneficiary disposes of them. Other assets taxed as a capital gain on sale, distribution or disclaimer; the trustee is usually empowered to pay any CGT liability that might fall on the lifetime beneficiary.

Life Interests and Family Homes

Where, for asset protection reasons, one domestic partner is the sole owner of a family home a fixed life interest and a right of occupation are usually created in conjunction with a beneficiary controlled testamentary trust to give the surviving domestic partner both a CGT and a land tax main/principal residence exemption.



Major Reasons for a Flexible Life Interest

Preservation of capital base – the Willmaker may wish to ensure that the capital component of the inheritance is not run down or dissipated, eg because of a relationship breakdown of the principal beneficiary. (Note that this complete preservation of the capital may have family law advantages.) # Alternatively, the trustee can be authorised to make all or part of the capital available for the principal beneficiary (and any dependants of the principal beneficiary) on a “needs” basis.

Other Reasons include

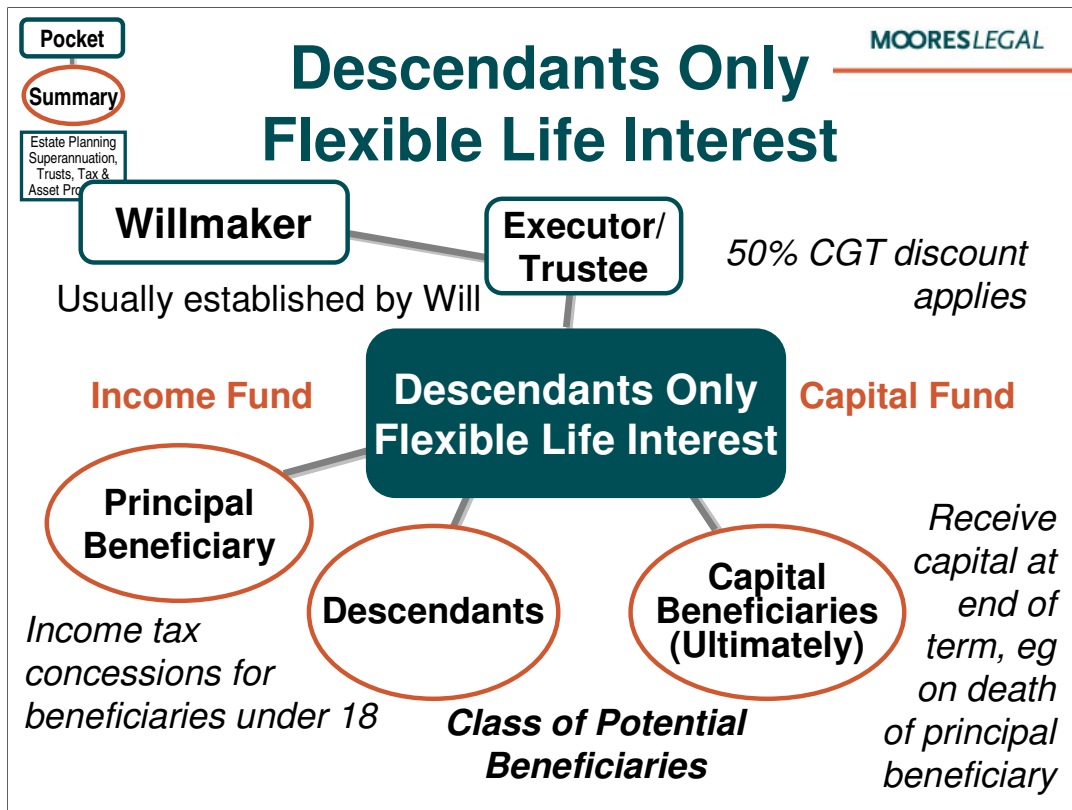
“Excepted” income for all beneficiaries under 18 years of age. # Flexibility – each year the trustee, if the principal beneficiary consents, can split income and benefits with family members. # 30% “parking” rate for income allocated to a company beneficiary. # Asset protection for the principal beneficiary from possible creditors.

Income, Losses, Loans and Benefits

Beneficiaries are taxed on all trust income spent on or allocated or paid to them and receive any tax credits. Income is usually defined as accounting income. Family trust elections may be needed. Loans to the trust may need to be on arm’s length rate terms. Income and assets can be counted for Centrelink means testing purposes for non-excluded beneficiaries of the trust.

Capital Profits (usually subject to a 50% discount)

If a Willmaker’s assets pass via the trust to the residual beneficiary, no taxable CGT event occurs until the residual beneficiary disposes of them. Other assets taxed as a capital gain on sale or distribution; the trustee is usually given an express power to pay any CGT liability that might fall on a beneficiary.



Limitations of an Australian Descendants Only Flexible Life Interest

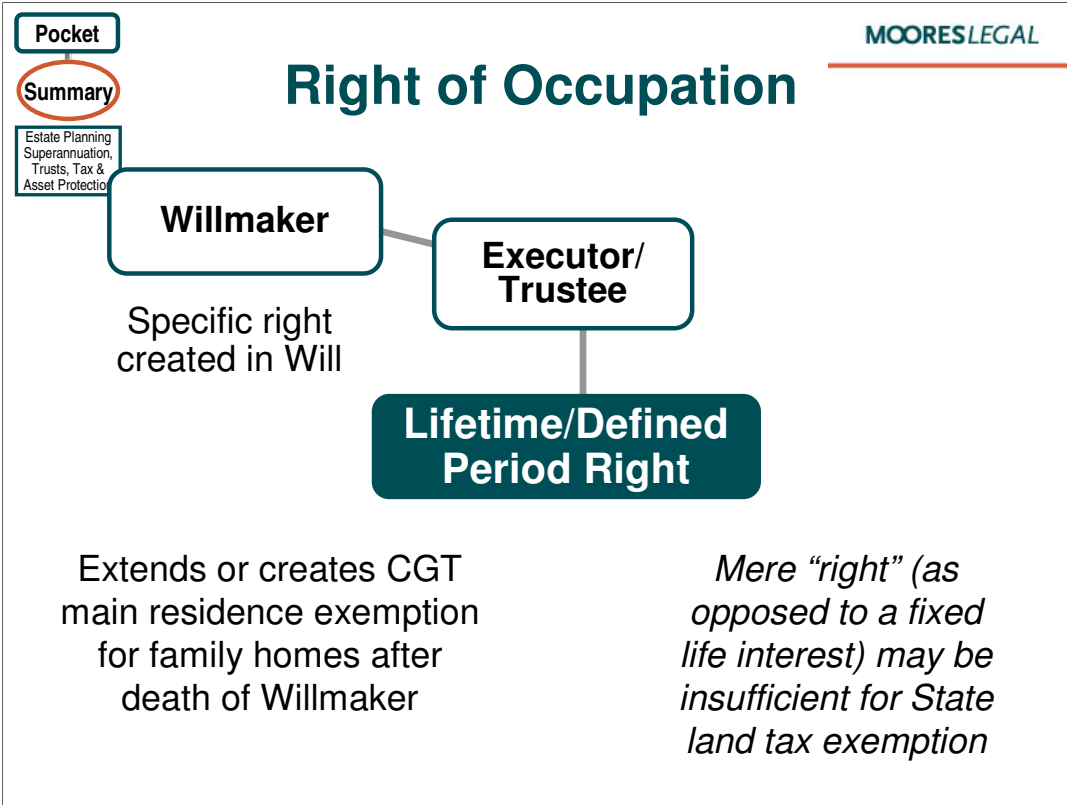
A descendants only life interest prevents the trustee allocating income or capital to the domestic partners or stepchildren of the descendants of either the Willmaker or the lifetime principal life tenant (or both). At first instance this often appears to be an attractive option for both the Willmaker and the beneficiaries.

In practice, however, there are 2 major drawbacks to having a narrower class of beneficiaries than is usual for a flexible life interest, ie:

- higher rates of income tax are often paid by the beneficiaries as the opportunity to split income with domestic partners is blocked; and
- the Family Court has the power to order that a payment be made by the trustee of the descendants only flexible life interest to a beneficiary and then from the beneficiary to the beneficiary's domestic partner.

Subject to the narrower class of income beneficiaries, a descendants only flexible life interest is administered in the same way as a standard flexible life interest.

Related companies and trusts are usually included in the class of income beneficiaries, provided that the beneficial ownership of those companies is confined to income beneficiaries of the descendants only flexible life interest.



Major Reasons for a Right of Occupation in a Will

To create an extension of a Willmaker's main residence exemption– the exemption created in the Will continues for as long as the person granted the right of occupation continues to exercise that right. (The creation of a right of occupation is often a prerequisite for CGT purposes for a surviving domestic partner and is always a prerequisite for any other beneficiary not receiving outright ownership.) # To create a personal right that is difficult, if not impossible, to attach a commercial value for bankruptcy purposes.

Family Trust Elections

The creation of a right of occupation may have family trust election consequences as it may be seen as an application of trust income or benefit under s 272-45 of Schedule 2F to *ITAA 1936*. If the person receiving the right of occupation also receives a fixed interest in the income from any listed securities owned by the deceased, then a family trust election is usually not needed for a non-trading deceased estate. Alternatively, if the only asset of the trust created by the Will is the main residence of the deceased and other estate assets such as listed securities are to pass via a separate trust or bequest, then there may not be any need to make a family trust election.

Alternatives to a Right of Occupation

Land tax considerations in particular Australian States and Territories may mean that it is preferable to also create an equitable interest such as a fixed life interest to qualify for the extension of the principal residence exemption in the relevant State or Territory.

Wills Creating Life Interests

Part A Revocation, Control & Terms of Life Interest	Part B Adjustment & Executor Discretion (if any)	Part C BCTT Terms & Executor Powers	Part D Definitions
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Wills creating fixed or flexible life interests are often accompanied by beneficiary controlled testamentary trusts (“BCTTs”) for the residual beneficiaries

Will Creating Life Interests

While the format of a Will creating one or more BCTTs can vary in format, a typical format is set out as follows:

Part A

Among the clauses included in this Part of the Will are the:

- Introduction to the Will identifying the Willmaker and dating the Will;
- Revocation of previous Wills and codicils and the setting out of limitations, eg limiting the Will to Australian assets or excluding assets in a particular country;
- Appointment of immediate and reserve executors, as well as the nomination of any preferred advisors.
- Provisions (if applicable) dealing with the control of self managed superannuation funds, family trusts and other non-fixed trusts (these clauses are always subject to the trust Deed governing the particular fund or trust);
- Terms of the fixed life interest, flexible life interest and/or right of occupation; and
- Division of estate provisions.

Part B

Part B instructs the executor to adjust estate distributions to reflect benefits that the principal and primary beneficiaries might receive from non-estate sources.

Parts C and D

Part C of the Will includes the terms of the BCTTs (for the primary beneficiaries not subject to life interest or capital protection provisions and for the residual primary beneficiaries) and the administrative powers of executors and trustees. Part D sets out the definitions applying to particular words that are used in the Will, eg “child”.

Life Interests & Rights of Occupation – Further Reading

Australian Master Estate Planning Guide – Chapter 23

The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/estateplanning/pocketsummaries

Further Reading

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by CCH in 2012.
- *Estate Planning Documents* – Allan Swan, Moores Legal (includes many of the Pocket Summary series).
- *You Can't Take It With You* – Andrew Simpson, Wrightbooks.
- *Tax Issues in Family Law Property Settlements* – Peter Szabo, Moores Legal.

Australia-wide Seminar, Workshop & other Presentations – Allan Swan

EPSTTAP Introductory: • Estate Planning – The A-Z (includes page 1 of this Pocket Summary) • Superannuation – The A-Z • Trusts – The A-Z.

EPSTTAP Advanced: • Estate Planning – Case Studies • Estate Planning Masterclass (1-3+5-6) • Superannuation – Death Benefits & Binding Nominations • Testamentary Trusts – Drafting the 6 Major Types (1-3+5-6) • Trusts & Deceased Estates – Income & Capital Distributions (1) • AMEPG Chapter Workshops.

Allan's local Moores Legal client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations • Tax & Business Structures Overview • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.