NEWSLETTER

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Chartered Accountants
Level 5
75 – 85 Elizabeth Street
Sydney NSW 2000
Telephone +61 2 9232 1588
Facsimile +61 2 9235 1211
www.goodco.com.au
contact@goodco.com.au

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This newsletter is written to assist in recognising issues and developing strategies so as to maximise profits and minimise and / or defer taxes payable in the current and future years. Estate planning must be an integral part of that strategy, so Wills should be reviewed concurrently and as family dynamics change.

Taxes, superannuation, dividends, equities and properties all need to be considered, because they are all (including taxes) an integral part of your Family's wealth creation and can be designed to provide substantial tax savings if correctly structured and managed.

If a strategy is to work, all the elements must be considered and kept in balance.

The strategy does not have to be in writing, but the elements should be clear and understood.

You need to have wealth and tax strategy that deals with:

- ***increasing your return on investment;***
- *paying off your home with pre-tax dollars;*
- *lowering tax rates across the family's income spectrum; and*
- ***freeing up cash to invest and by such means increasing your wealth***.

The strategy should be understood by the owners, operators and their advisers.

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HOW OLD IS YOUR TRUST?

IF IT WAS SETTLED (ESTABLISHED) AROUND 1950 YOU NEED TO DO SOME PLANNING

Under Trust Law usually after 80 years from the date the Trust is settled the Trusts must vest. *(This depends on the Deed and when and where the Trust was established)*. To vest, the Trust must be wound up by selling or transferring all its assets and distributing those proceeds to the beneficiaries prior to the vesting date. Trust Deeds for Trusts settled in South Australia can be an exception.

The ramifications of not vesting a Trust on or before the vesting date are enormous:

- This effects the Trust, the Trustees and most particularly the Beneficiaries;
- There are both civil and tax ramifications involved; and
- Seeking remedies after the date is very expensive. The trust funds will be materially eroded by providing funding for lawyers, accountants, tax and applications to the Court in an effort to minimise the damage to the parties involved.

There are very many old Trusts in existence and there are a lot of examples where Trusts that should have vested have continued. The tax consequences and the effect on beneficiaries can be debilitating. This is because assets are deemed disposed (tax will be levied on any gains) and income has been derived by parties who may no longer be beneficiaries. The ability for the Trustee to use their discretion to distribute income and capital will cease at the vesting date.

Where the Trust Deed nominates Default Income and Capital beneficiaries, they will automatically be entitled to **ALL** distributions on or after the vesting date. The original groups of Primary and General Beneficiaries will cease to be beneficiaries after that date.

It is not uncommon, particularly in the tax arena, to see default beneficiaries issued with assessments even though other beneficiaries received the distribution and those recipient beneficiaries paid tax on those distributions.

It is unlikely the Trustees will get back amounts that have been distributed to other beneficiaries that should never have been entitled to it. The Trustee is then liable for any amounts that have been incorrectly appropriated to those beneficiaries.

Any Trust that is within 10 to 15 years of its vesting date should have a plan in place and start developing and implementing that strategy. The plan should deal with disposing of the Trust's assets, which ideally would be over a period of time so that there is minimal extra tax. If left until the last minute the tax bills arising from the forced sale of assets will be significant when it could have been reduced to a much more manageable amount if disposals were properly planned.

Another key element in your plan should be to consider what assets are in the Trust's asset pool and obtain advice as to how to avoid any hidden traps associated with those assets. One of the lesser known sections of the Income Tax Assessment Act is that a pre-CGT asset may convert to a post-CGT asset. This is where the Company or Trust has property acquired after 20 September 1985 (post CGT property) with a market value that represents at least 75% of the net value of the company or trust. Again, this can be avoided by pre planning by the Trustees.

There are other ways around the problem, and they are all valid but dealing with a vested trust is incredibly difficult and expensive; it happens regularly.

IN AN AGING POPULATION - THE REQUIREMENT TO HAVE REPLACEMENT APPOINTORS

Many years ago, we pioneered the concept that Trust Deeds should have Replacement Appointors nominated in the Deed of settlement. If this was not practical, they could be added by way of a Deed of Variation.

The Replacement Appointor takes control should the Appointor die without nominating their replacement in their Will or where the Appointor become incapable through illness.

The reason we did this was because it was not uncommon to find Wills that were drafted with little or no reference to the Family Trust controlled by the Appointor and there was no reference to whom the Appointor wanted to take over when they died.

After that date some Deeds carried a Replacement Appointor paragraph, but it only came into effect on the death of the Appointor where the Appointor had not made a nomination in their Will.

Over the last several years we have noticed that firms have started to drop the use of Replacement Appointor paragraphs, preferring to suggest that the issue should be covered by a Will. Wherever we have been involved in the formation of Trusts we have inserted into the deed the paragraph or paragraphs to ensure that it covers both death and incapacity .

Today people live longer, as we have more medical intervention, but the flip side that incapacity is becoming more prevalent and a real issue for families. Should an Appointor have a medical issue and be incapable of making a decision then the Replacement Appointor could act instead of the Appointor's.

Equally, there is a risk that younger adults may be involved in accidents or develop illnesses that require treatment and are incapable at that time of approving the decisions that require the Appointor's approval as a requirement of the Deed.

If you have a Discretionary Trust, irrespective of your age, it is becoming a critical issue where there is no replacement nominated. You should check and ensure that your Trust Deed provides the Appointor with the power to nominate their Replacement in their Will. The Deed should also nominate a Replacement Appointor who will act either on the Appointor's incapacity or on the Appointor's death if there is no nomination in the Appointor's will.

MEMORANDUMS OF WISHES – ARE THEY USEFUL OR A NUISANCE?

It could be generally and accurately said that we live in an era of entitlement. One example is that beneficiaries and carers seem to believe they have a right and a capacity to demand more both while you are alive and most particularly when you pass on.

A Will once you die is a public document around which probate is granted so that the wishes of the deceased can be carried out. **A Memorandum of Wishes however, is not a public document** and is not available to beneficiaries unless it is entered into evidence when a Will is contested or is, by consent of the Executor, provided to beneficiaries.

It is very important that you do not try and rule from the grave. There is a fine line between protecting the surviving family members to ensure they are provided for financially and trying to rule from the grave. E.g. you cannot leave a bequest which is subject to a condition, such as "My child can have the bequest only if they use it to buy a domestic residence."

Historically it is less common for children to challenge a Will when the first of the parents passes away. The first parent may in the main leave their estate to their spouse or partner. However, the death of the surviving parent frequently sees siblings challenge Wills and have other parties coming out of the wood work. One, if not more, of the children or past carers of the deceased look for their perceived entitlement in the estate.

The parties make claims that the deceased had made promises to them and that they had been told repeatedly such provisions were made in the Will to reward them, or that there were statements made like "don't worry I've organised for you to be looked after should anything happen to me".

Many adult children become involved in looking after their parent's assets as their parents age and become less able to manage their own affairs. It is sadly becoming more common that as the parent gets older, the child or children help themselves to, or "borrow", some of their parents' assets. When this becomes detected by the parent or reported to the parent it is all hushed up and no one outside the family hears about it. If you do not put these sorts of events into a document such as a Memorandum of Wishes, then each child will be treated as per the Will. Making provisions in the Will alone may leave it open to attack from beneficiaries that feel they have been hard done by. Someone that has been left less will claim that they have been unfairly treated and potentially have a claim against the Estate.

Typical reasons we see claims made is that the younger children complain that the elder children were provided primary, secondary and tertiary education, and all their medical expenses were paid for while the parent was living. The younger children then argue that they will have to pay for those same benefits out of the capital bequeathed to them, if they have not done so already.

Nobody knows the beneficiaries better than you do; you are the only one (in many cases) that can truthfully tell the readers the specifics of many issues not generally known to third parties. Most importantly you know the intimate issues and interrelationships within the surviving family members. Therefore, it is very important that you spend the time and effort explaining why your Will says what it does. Memorandum of Wishes contain this explanation.

The Memorandum of Wishes is not a legally binding document. However, it can guide executors and trustees as well as lawyers and judges and give an understanding of why you have structured the Will the way you have. It also details why you want certain beneficiaries to be treated equally or unequally and the reasons behind why that should occur.

A Memorandum of Wishes does not have to be financially related. Other matters you should consider including in your Memorandum of Wishes may be Funeral Arrangements, Burial or disposal of ashes, contacts of your advisors such as Accountants and Lawyers etc.

You can also include Wishes of how you would like the beneficiaries to use their bequest, but this will be no more than a suggestion as the Memorandum of Wishes is not a binding document.

As described briefly in the opening of this article your Memorandum of Wishes is not a public document unlike your Will, only your executors get to read this unless there is a challenge in the Courts. Should a challenge occur it is important that any reasons why the Will has been structured the way it was needs to be put into that document. What we are suggesting is not easy to write but if you want your wishes upheld by the Courts then you need to give readers the understanding of why you have done what you have done and why you wanted that outcome and how you assessed that outcome to be fair and reasonable. It is equally important within that document that a statement be made as to any suggestion that provisions should or should not be made to any possible third party or beneficiary.

TESTAMENTARY TRUSTS A FRESH APPROACH

Most Wills are drafted where:

- There is an absolute entitlement of cash or property because the deceased believe the beneficiaries have the maturity to handle the bequest;
- A small bequest is left to the beneficiaries and the balance is retained in a Testamentary Trust; or
- The entire bequest is held by a Testamentary Trust, as one or more of the beneficiaries are under 18 years of age or have a medical issue.

Many adult children for various reasons object to anything other than an absolute entitlement. They want access to the bequest; they want it now. They give no regard that the bequest may have the capital locked up for a period of time with income being streamed to them on an annual basis.

We are regularly involved in discussing with clients as to why they have had drafted their Will the way they have. There may not be a Memorandum of Wishes that accompanies the Will and we then explain the purpose of such Memorandum and how that will explain the things that are not apparent from the Will.

As we have expressed previously in our Newsletters, we always ask the question of the client; “Do you want the children treated in the same way as though you were alive?” The answer is frequently always yes, however the Will usually does not reflect this. Most Wills leave a testamentary benefit to any minor child or a child that may need extra financial support for various reasons.

There are other reasons for using a testamentary trust, such as the beneficiaries are very unsophisticated with finance or have medical issues. This however does not solve the problem where the younger children state that the elder children received more benefits during the life time of the deceased. On the flip side, the elder children then argue that each child should receive an equal proportion of the assets and what Mum and dad gave me was their business.

It is common to find within most families that given say ten years after inheritance is provided to the family that:

- one of the children has gone through all of the bequest;
- one or more have been divorced;
- one is in financial difficulty; and
- one of them has a major medical issue.

The problem with separate Testamentary Trusts or absolute bequests is that once it is gone, it is gone. Unfortunately, it is very rare that a sibling will stand up and support another sibling in an event that causes financial difficulties.

If you wish to make provisions on your death to protect your spouse, partner and/or children we have found that the single bequest and the traditional Testamentary Trusts do not allow for changes to be made when unforeseen events arise.

Giving a full bequest to a beneficiary before a particular time does not allow for flexibility for unforeseen events. Accidents or sudden onset of illness may leave your partner of children in a circumstance where they may be unable to manage their affairs.

There are many professional scammers out there as we read in the papers almost daily. Even knowledgeable and vulnerable people can fall for advice for which the adviser is the primary beneficiary.

You can't protect beneficiaries against fraud, but you can minimise the chance of the bequeathed assets being misappropriated or diminished through excessive charges or fraud if you take the right steps.

In consultation with a couple of barristers and lawyers we have developed in concept a proforma Will, that in many ways will allow you to provide for your children in a form that gives them some capital today, annual income going forward and the remaining balance at a prescribed future point.

The Will bequeaths a specific amount of money to each of the beneficiaries who are of legal age or the money is held by the Trust until they become adults, or some later age as may be appropriate. By way of example if the children are all minors, you may say, leave each of the children $100,000 but they have to be at least 25 years of age.

You then leave the balance of the estate in a Trust until the day the youngest of the children reaches something like 40 years of age at which point the Trust is vested (wound up) and the funds distributed to the surviving children or should they not be alive that child's children. In the interim and at the discretion of the Trustee and Executor of the Estate (subject to special needs for each of the Beneficiaries) each beneficiary will receive a proportion of income derived by the Trust annually.

Between the time of you passing and the youngest child reaching 40 years of age the Testamentary Trust's capital can used at the discretion of the Trustees to support a spouse or other beneficiary should they need financial support or to go to the cost of their education and provide say, an interest free secured loan to each child that can only be used to assist in paying for a domestic residence in which they live. The loan would be limited to a proportion of the gross wealth of the Trust, and income to that beneficiary would be proportionally reduced on its advancement.

BINDING AND NON-BINDING DEATH BENEFITS – SUPERANNUATION ON DEATH

Many people do not understand that Superannuation is not an asset that is covered by your Will unless you nominate to leave it to your Estate.

Like Trusts, Superannuation Funds are governed by a Trust Deed. Trust Deeds may include Death Benefit nominations, however, there are certain requirements that need to be fulfilled to ensure that your nomination is valid.

It is very important when drafting a Will that you ensure that the Death Benefit nomination is completed correctly because if it is not the Trustee of the Superannuation Fund can distribute that capital as it sees fit.

A Trustee is bound by a binding Death Benefit Nomination, whereas a non-binding Death Benefit only gives the Trustee an idea of where you would like the Death Benefit paid, but the Trustee still has the ultimate discretion as to who it goes to.

Do you know if you have a Death Benefit Nomination and whether it is binding or non-binding?

If you do have a binding Death Benefit Nomination, for this to be valid it must:

- be made to the Trustee of the Superannuation Fund in writing and clearly set out the proportion of the benefit to be paid to each person nominated. It may also include the type of benefit payment (such as a lump sum and/or an income stream);

- be signed by the member in the presence of two witnesses over 18 years of age and who are not nominated as beneficiaries;

- contain a signed witness declaration; and

- be sent to the trustee (a nomination will not be valid until it's received by the trustee).

