ISSUE 52

WEALTH MATTERS

Your personal guide to wealth creation

INSIDE:

- Avoiding SMSF disputes
- SMSFs and succession planning
- How CGT applies to deceased estates
- And more

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What are the tax consequences of resettling a trust?

The resettlement occurs when a trust is varied or amended to the extent that it is deemed to be a new trust, triggering a range of tax obligations.

The ATO deems a trust to be resettled when "it might be concluded that there is not sufficient continuity between the trust as originally constituted and the trust in its current form."

Changes to the essential features of a trust such as the terms of the trust deed, the trust property or the members of the trust can trigger a resettlement. There can be significant tax consequences associated with a resettlement of a trust including income tax, stamp duty and triggering capital gains tax (CGT).

A resettlement is a notional creation of a 'new' trust. When a CGT event is triggered, the trust is deemed to have sold all of the assets to the resettled trust at market value. This poses problems as either pre-CGT assets will become post-CGT assets or a capital gain will occur equal to the difference between market value and the cost base of post-CGT assets held in the trust.

Accumulated tax losses from operating the trust before resettlement cannot be carried forward into the resettled trust for the purposes of calculating the taxable income for the fund.

One thing that trustees may want to determine is the potential CGT consequences for the trust if resettlement is deemed to have occurred. Once this is established, it may be appropriate to apply for a binding ruling from the ATO to gain certainty on whether resettlement has occurred prior to making any changes.

A trust deed cannot be amended without an express power to do so and trustees must consider whether the amendments maintain the continuity in the trust estate. The ATO is clear that any amendments must be made in accordance with the terms of the original trust. The problem for trustees is that resettlement needs to be assessed on a case-by-case basis.

Before making an amendment to a trust deed, trustees are cautioned to read the trust deed and check that the power specifically authorises the proposed amendment and that amendments made pursuant to a power are done so in accordance with any process outlined in the deed.

Resettlement of a trust can be complicated, particularly where a private ruling is included. It can be useful to seek professional legal help for binding advice on how the law applies to your circumstances.

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Retirement

How your allocated pension can hinder your Age Pension

It is not uncommon to set up an allocated pension as a regular income stream to lead a comfortable retirement life.

However, specific conditions may prevent you from accessing your Age Pension.

The Government offers Age Pensions to support retired Australian residents who have reached Age Pension age. The qualifying age increases by six months every 2 years, and will be 67 years by 1 July 2023. The size of your payment is based on whether you're single, and the results of your asset and income test.

Under the asset test, Centrelink may treat the balance of your allocated pension as an income producing asset. The income test, however, assesses amounts based on two conditions:

- Allocated pensions started after 1 January 2015 will be treated as a financial investment and the income test will be based on deemed income.
- For allocated pensions started before 1 January 2015, treatment is based on whether the pension is 'grandfathered' (you started receiving an account-based pension before 1 January 2015 and the age pension since 31 December 2014).

With a grandfathered pension, your assessed income is treated as the gross payment you earn from your allocated pension, minus your capital returns. In this case, only a portion of your annual income payments will be counted. If it is not grandfathered, then deeming rules are used to assess how much deemed income will be included in the test.

SMSFs and succession planning

Being an SMSF trustee means you are responsible for organising what will happen if a member dies or becomes incapacitated. This is called succession planning, which ensures that the right people will receive your intended proportion of SMSF assets when you are unable to.

There are a number of succession planning strategies available to ensure that your fund continues to do the right thing when you can no longer be involved.

Appoint another trustee

In the case that your SMSF is a sole member fund, consider appointing another trustee (employers cannot be a trustee unless they are a relative). Appointing another reliable trustee in your SMSF will mean that they have access and can continue to manage the SMSF after you pass. However, before appointing a family member or close friend a trustee, consider whether they are suitable for the role.

Running an SMSF requires expertise and knowledge, and appointing someone with limited experience may not be in the best interest of the fund's future.

Appoint an enduring power of attorney

An enduring power of attorney makes decisions on the trustee's behalf in the event that they become incapacitated or pass away. Common power of attorney candidates include accountants, financial advisors and lawyers, as they have the knowledge required for SMSF management.

Include a binding death benefit nomination (BDBN)

A BDBN is a notice given by a member or trustee to another (in the super fund) which directs the nominee to pay death benefits in accordance with the appointer's wishes upon their death. Since a person's superannuation does not make up part of their estate and is therefore not automatically covered by their will, a BDBN can be a good solution to help with the distribution of a member's super benefits.

Avoiding SMSF disputes

One of the benefits of SMSFs is the amount of control you have from managing it yourself. However, self-management can leave room for disputes among related parties, especially when family members are involved.

SMSF disputes can be caused by a number of factors, such as relationship breakdowns, (common in funds where parents and siblings are in a member and trustee relationship) and fundamental differences in opinions. Other common triggers for SMSF disputes include:

- investment strategy disagreements,
- differences in opinions over the payment of benefits, especially in SMSFs involving both parents and their children,
- payment of death benefit disputes, and
- disagreements on the distribution of SMSF death benefit payments between surviving members.

Consider the following methods to avoid SMSF disputes.

Clear decision-making procedures

Disagreements are bound to occur when it comes to money, so it is important to include concise decision-making provisions to keep things fair for all parties involved. For example, trustee decisions can be made by a simple majority rather than unanimously, and a particular trustee may be provided a casting vote in the case that a deadlock occurs. Provisions could also include voting rights that are based on the value of a member's account balance within the SMSF to avoid situations where a member with minority interest out-votes a member with a large fund account balance.

Updating your SMSF regularly

A SMSF trust deed will provide provisions which determine the trustees' rights, obligations and options. It is important to keep your SMSF and trustee information up to date to prevent any unwanted beneficiaries and claims. For example, in the case of an unfinalized divorce or legally unchanged relationship status, a former spouse can claim the others' superannuation death benefits. To prevent such situations and avoid disputes, be sure to update your super fund regularly.

Protecting your finances after separation

Dealing with the mental stress and emotional lows at the end of a relationship is never easy, let alone taking on complicated and tedious administrative tasks such as managing your finances.

To prevent long-term complications such as unwanted financial access, it is important to take the necessary steps to protect your finances. Here are the steps to consider when protecting your finances after separation.

Close joint accounts and cancel credit cards

Closing any joint accounts with your former partner will eliminate the possibility of them exploiting your finances in the future. In order to close a joint account, all funds must be cleared out and both account holders need to agree that the account should be closed. In the case that your joint account is overdrawn, make sure you pay it off. After closing your joint account, ask for a written confirmation of the closure from your bank for record-keeping purposes.

Cancelling credit cards that you both share will prevent any unwanted debt sharing with your former partner. Keep in mind that your balance must be nil before you can cancel your credit card, so the first step is to pay off your credit card in full, including any interest or fees. Discuss with your former partner to make payment arrangements.

Update your Will

It is essential to review your Will after a relationship breakdown, especially if your former partner is listed as a beneficiary or executor. In the case that you appointed your former partner as your power of attorney, you might also consider revoking them upon separation if you deem them untrustworthy or financially irresponsible.

Manage your income and expenses

Separating from your partner may mean that your income and expenses will change considerably. In order to make sure your lifestyle is not majorly compromised as a result, be sure to:

- Budget: Calculate your individual income and expenses.
- Consider government payments: Determine any government payments that you currently receive that must be cancelled or can be continued once you separate from your partner, as well as other pensions that you may be entitled to.
- Manage your debt: It may be more difficult to manage debt by yourself rather than with a partner. Seek financial advice to help you manage your loans.

How CGT applies to deceased estates

As the saying goes, there are only two things certain in life: death and taxes. Dealing with a deceased estate means facing both.

Beneficiaries or legal representatives of a deceased estate will acquire the assets they are entitled to on the day the person passes away. Capital gains tax (CGT) does not apply upon acquisition of the asset, however, it may apply if you decide to dispose of the asset later on.

Regular CGT rules apply when selling an inherited asset other than a dwelling. For example, legal representatives may need to dispose of some or all of the assets of an estate when winding up a deceased estate. These assets are subject to normal CGT rules and any capital gain made by the legal representative on the disposal is subject to CGT.

Inherited dwellings that were the deceased's main residence may be fully or partly exempt from CGT when selling or disposing of the asset. Dwellings inherited before 20 September 1985 are exempt from CGT upon their disposal. However, significant capital improvements made to the dwelling on or after 20 September 1985 may be taxable.

CGT may also not apply if the deceased acquired the dwelling before 20 September 1985 and died on or after 20 September 1985, even if the dwelling was not their main residence. CGT will not apply if either of the following conditions is met:

- The beneficiary or legal representative disposes of the asset within two years of the person's death. During these two years, the dwelling can be used as a main residence or to produce income.
- From the deceased's death until the disposal of the dwelling, the dwelling is not used to produce income and is the main residence of the deceased's spouse, a beneficiary, or someone who had a right to live in the dwelling according to the deceased's will.

For dwellings that were acquired by the deceased on or after 20 September 1985, beneficiaries or legal representatives can disregard any capital gain or loss made when selling it if either one of the following conditions applies:

- The dwelling was passed to the beneficiary or legal representative on or before 20 August 1996, and both the beneficiary and deceased used the dwelling as their main residence.
- The dwelling was passed to the beneficiary or legal representative after 20 August 1996 and is their main residence while they own it or dispose of it within two years. The dwelling also had to be the main residence of the deceased just before they died.

New rules on injected assets in testamentary trusts

Estate planning strategies often involve the use of testamentary trusts. However, individuals may need to update their estate plans and Wills following the Government's recent changes to the tax treatment of income related to testamentary trusts.

The new subsection to Division 6AA of the Income Tax Assessment Act 1936 was introduced on 23 June 2020. From this date, assets unrelated to a deceased estate cannot be injected into a testamentary trust in order to benefit from a lower tax rate. Prior to the law changes, all income of a testamentary trust was considered "excepted trust income." This provided potential tax benefits because even children under the age of 18 who were receiving a benefit from the testamentary trust could be taxed at ordinary rates rather than penalty rates, meaning that they could receive up to $18,200 per year from a testamentary trust without being subject to tax.

The updated rules ensure that the tax concession will no longer apply to assets unrelated to the deceased estate. Minors will now be taxed at adult marginal tax rates only in respect of income a testamentary trust generates from assets of the deceased estate, such as property transferred to the testamentary trustee as a result of a will.

Individuals may need to review their estate plans in consideration with the new law. Financial and legal advice may be required to address issues regarding the estate planning phase, the estate administration phase, and the administration of the testamentary trust.

When siblings dispute a parent's will

Dealing with the death of a parent comes with legal and financial obligations that need to be addressed, such as dividing up the assets of an estate.

This can often cause sibling disputes over a Will, which may result in lengthy and expensive legal proceedings.

When an estate is split between children, disputes can arise when the distribution is perceived to be uneven. This can result in a sibling contesting the Will if they believe they were treated unfairly; for example, they may not have been included in the Will or they believe they should be provided with more assets under the Will.

A sibling dispute of their parent's Will may also result in a challenge. Unlike a contest, a challenge disputes the validity of the entire Will. Challenges often arise when the Will is identified as a forgery, was improperly signed or witnessed, or if the person writing the Will is deemed mentally unstable or made the Will under the influence of others.

A Will can be contested or challenged on the following legal grounds:

Testator's family maintenance claim

This is the most commonly used way of challenging a Will. A testator's family maintenance claim can be made where a Will is considered valid, but a person believes they have not been adequately provided for under the Will. The court can assess this claim by considering:

- whether the deceased had a moral duty to provide for the claimant,
- whether the claimant has already been given adequate provisions,
- whether the claimant has the capacity to provide for themselves,
- the potential effect the claim will have on other beneficiaries.

Lack of testamentary capacity claim

This claim can be made on the basis that the deceased was not capable of understanding the moral obligations of creating a Will. Successful claimants must be able to demonstrate the deceased's lack of knowledge regarding the impact of their estate decisions.

Undue influence claim

A Will can be challenged if it is believed that the deceased was 'unduly influenced' by third-parties when making the Will. However, the decision-making process of the deceased is often difficult to prove and claimants should have substantial evidence before making a claim.

Breach of trust claim

Beneficiaries of a Will can request to have an executor or trustee who is believed to be incorrectly administering the Will. The Court can remove the executor or trustee when they demonstrate a breach of trust, such as if they failed to distribute the estate properly or kept assets for themselves.

We are here to help

Make use of us! This guide is merely a starting point, designed to help you identify areas that might have a significant impact on your personal and business planning.

We are always pleased to discuss matters with you and advise in any way we can.

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