WEALTHMATTERS

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Why use a testamentary trust?

A testamentary trust is a trust created by a will which arises upon the death of the testator.

While testamentary trusts can help protect assets when they pass to beneficiaries, it is important to weigh up the advantages and disadvantages of trusts before establishing one.

Testamentary trusts are designed to be a tax-effective estate planning tool, as they provide more control over the distribution of assets to beneficiaries. However, they can also be complex, expensive to manage and create issues for some family members.

Here are some of the advantages and disadvantages to consider before creating a testamentary trust:

Advantages

A testamentary trust is designed to provide maximum flexibility and allows for optimum allocation of income and capital. This may permit beneficiaries to qualify for aged, disability and sole parent pensions, Austudy etc, for which they would otherwise not have qualified under a normal inheritance.

Testamentary trusts are extremely tax effective especially where people have children under 18 receiving income from the trust as minors are taxed as though they are adults, gaining the benefit of the tax free threshold. This is in contrast to the lower threshold for unearned income distributed to children.

Assets are protected from varying degrees of potential claims, which is particularly beneficial for beneficiaries in high risk professions or businesses, those that become bankrupt or go through a marriage breakdown.

Disadvantages

The costs of running a trust are high, both from an establishment and ongoing point of view. The size of the estate is a determining factor in relation to whether or not it is commercially viable to establish a testamentary trust.

Testamentary trusts make wills more difficult to prepare, as they involve consideration beyond death unlike a will where an estate is distributed.

Disputes can often arise between trustees and beneficiaries that may alienate family members. Therefore, an appropriate amount of consideration should be taken when selecting the people for the role of the trustee, as they are responsible for ensuring that the estate is divided accordingly.

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Buying property with a buyer's agent

Buyer's agents are property professionals who specialise in searching, evaluating and negotiating the purchase price of property on behalf of a buyer.

While many buyers find their services invaluable, this kind of industry knowledge can come at quite a cost. For example, buyers can end up paying 3 per cent of the value of the property their agent finds for them.

Therefore, before employing the services of a buyer's agent, buyers need to carefully assess whether the cost will pay off in the long term. As there have also been numerous cases where buyer's agents have gone behind a buyer's back to receive incentives such as commissions from sellers, buyers should also check the qualifications, experience and independence of their agent.

Essentially, buyer's agents must be able to offer advice to the buyer without fear or favour. Buyers should look for those who hold professional indemnity insurance and have at least two years of experience as a buyer's agent and/or five years experience in the property industry.

All commissions, fees and expenses they charge should be based upon their level of service and set out in writing. Fees generally range from 1.5 to 3 per cent of a property's purchase price for sourcing and securing a property. When a buyer has already found the property, the fees range from 0.5 to 1 per cent of the purchase price for securing it.

An agent's quote for bidding at an auction or negotiating a contract of sale varies widely.

The basic fees for a complete service, which involves finding, buying and settling a property, and finding a tenant are $12,000-$15,000. These can vary depending on the property's value and time taken.

Buyer's agents fees form part of the cost base for capital gains purposes, providing the property is for investment purposes. Therefore, minimising the capital gains tax payable.

However, if you engaged with a buyer's agent to assist you to purchase a property to live in (owner occupier) then you will not be able to claim the fee as a tax deduction.

While finding the right property, buyer's agents should also coordinate and complete inspections, surveys, contracts and insurances.

Reviewing your personal insurance policy

Reviewing your personal insurance policy may seem like a monotonous task, however, a periodic review can ensure your policies are high quality, competitive and are still right for you.

A periodic review is good practice if you have had your policies in place for some time as your cover may need to be reassessed and adjusted to meet your current needs.

Individual circumstances change over time and consequently there may be coverage that needs to be removed, added or increased. Changes in relationship status, address, renovations etc. all warrant a reviewal of your policy, as you do not want to risk being underinsured.

To safeguard against underinsurance, consider all of your liabilities and review your sums insured frequently, not just at renewal.

When comparing policies, consider product inclusions, deductibles, exclusions and coverage limits that are most appropriate for your needs. Check the cost of your policy to ensure you are not overpaying for what you are receiving and that your coverage remains comprehensive. It is also worth noting some policies, such as income protection insurance, are tax deductible

Avoiding SMSF disputes

Self-managed super funds (SMSFs) can be vulnerable to disputes, especially when family members are involved.

If left unresolved, disputes surrounding SMSFs can result in a hefty bill. SMSF disputes may be caused by various relationship breakdowns, for example, those funds with parents and siblings as members and trustees, or in cases where there is simply a clear difference of opinion.

More often, the key triggers of disputes within a SMSF include:

- Disagreements regarding investments and investment strategy.
- Differences in opinions regarding the payment of benefits, especially in funds with both parents and children.
- Disputes regarding the payment of death benefits.
- Disagreements between surviving members over the payment of SMSF death benefits received compared with amounts received under the deceased's will.

When sorting out disputes, the SMSF trust deed will provide provisions which determines the trustees' rights, obligations and options. Therefore, ensuring the SMSF trust deed has up-to-date dispute minimisation provisions can avoid the impact of a dispute.

The provisions may include allowing trustee decisions to be made by a simple majority rather than unanimously or providing a casting vote to a particular trustee in case a deadlock occurs.

Provisions could also include voting rights that are based on the value of a member's account balance within the fund, which eliminates a member with minority interest outvoting a member with a large fund account balance.

In addition, there should be provisions that deal with situations where disputes cannot be avoided, for example, the deed would require the parties to go to mediation, conciliation and arbitration before going to court. For a SMSF with corporate trustees ensure that similar provisions are contained in the constitution regarding decision making by the directors.

Taxation of employment termination payments (ETPs)

Redundancies, whether forced or elective, can become complex as there are many taxation issues to consider when receiving a payout.

The most common form of payment an employee will receive is an employment termination payment. Employment termination payments (ETPs) include payments for unused rostered days off or for unused sick leave; payments in lieu of notice; payments due to redundancy or early retirement that exceeds the tax-free amount, or payments due to invalidity.

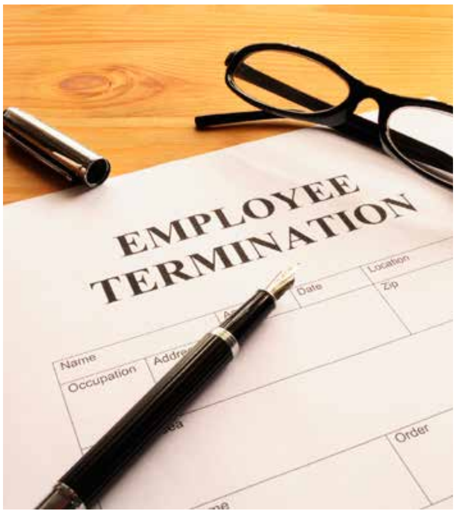
Mistakes in employment termination payments (ETPs) are common as it is up to the employer to work out how much is owed to the employee and how much tax needs to be withheld from the various components that make up an ETP. Errors are generally made around how much leave is owed, whether the payment includes the correct tax-free amount and if the correct tax rate is used.

ETPs are made up of two components, the tax-free component and the taxable component. The tax treatment of the components will vary depending on the type of redundancy, whether it is an early retirement scheme; genuine redundancy; invalidity or compensation for personal injury, unfair dismissal, harassment and discrimination.

The ATO classifies a redundancy as "genuine" if the employer has made a decision that the job no longer exists and employment is to be terminated. A genuine redundancy has special tax treatment where an amount paid up to a limit is tax-free. To qualify for tax concessions the employee must be dismissed before the day they turn 65 and there must be no arrangement at the time of termination to re-employ the dismissed person.

Employees being offered a redundancy payment should check the right tax is applied to the right component. A genuine redundancy payment is tax-free up to a limit based on a formula which includes the base amount determined by the ATO. This is added to a service amount multiplied by the years of service. The base rate for 2016-17 is $9936 and the rate for each completed year of service is $4969. The formula depends on completed years.

Tax will be withheld by the employer where there is unused long service leave, rostered days off, pay in notice of lieu or golden handshakes. The tax withheld on long service leave would be either 17 per cent or 32 per cent depending on the age of when redundancy occurred. For those over the preservation age (usually 55 and over)



you will pay 15 per cent tax when you take redundancy and for those younger, 30 per cent tax will be payable, excluding Medicare.

Amounts that exceed the tax-free limit will be taxed based on your preservation age at the date of the redundancy and individual marginal tax rate. There is an ETP cap, which for the 2016-17 year is $195,000. When the cap is reached, the individual's marginal tax rate is applied, plus the Medicare levy.

Employees receiving a redundancy payout need to ensure they understand how the calculations have been worked out and seek professional advice to confirm they are accurate.

Transitional provisions for SMSFs

The Government will apply transitional arrangements to SMSFs affected by the retrospective aspects of the Federal Budget's proposal to limit non-concessional contributions.

In the 2016-17 Federal Budget, the introduction of a lifetime cap of $500,000 on non-concessional superannuation contributions, including contributions since 2007, was announced.

The proposal casted concerns for SMSF members who had entered into a contract for the purchase of an asset using a limited recourse borrowing arrangement (LRBA) prior to budget night, with settlement after budget night.

In these situations, SMSF members would provide part of the sale proceeds using non-concessional contributions to the fund to enable the fund to complete the contract.

The Treasurer has since announced that transitional provisions will apply to SMSF members with these existing financial arrangements to allow for further non-concessional contributions to enable the pre-existing contract to be completed. These additional non-concessional contributions will count towards the lifetime non-concessional cap, but will not result in an individual breaching the lifetime non-concessional cap.

Transitional arrangements will also apply to SMSFs with existing borrowings, including LRBAs, until 31 January 2017. SMSF members with existing borrowings will be permitted to make further non-concessional contributions to the extent necessary to ensure the legal obligations of the SMSF that existed on or before Budget night are met or comply with the ATO's Practice Compliance Guideline 2016/5 (PCG 2016/5).

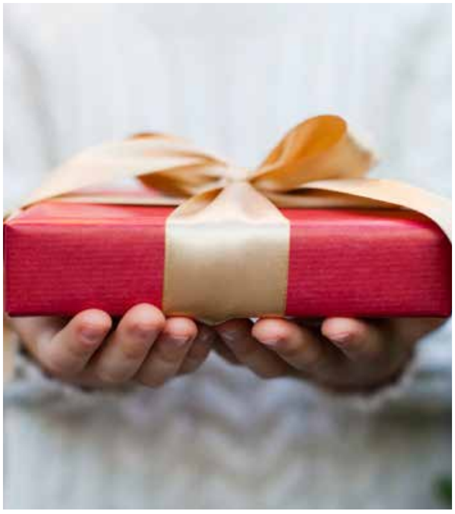
Once legislated, this deadline will be extended only in exceptional circumstances and at the discretion of the Commissioner of Taxation. The Government plans to consult with industry stakeholders when the regulations are being drafted and will be open to any other reasonable amendments for other reforms announced in the Budget.

Giving gifts to children

Gifting money to your children can require some planning, particularly for those approaching their retirement age.

When you reach the stage of being able to live comfortably, many start to feel that giving gifts to their family is a worthwhile cause. Gifting involves parents giving away assets or transferring them for less than their market value. When considering gifts in retirement, the most common types usually fall into one of the following categories:

- Gifting money to help children or grandchildren with their finances, for example, their education, purchasing a first home or reducing debt
- Transferring assets, such as a family holiday house, to children
- Making bequests or donations
- Reducing assets to qualify for a government pension



Other examples of gifting include transferring shares or units in a trust or company and not receiving the full market value for them, or relinquishing control of a private trust or private company.

Parents can give away money or other assets to any value they choose at any time. However, before making a gift, parents should carefully consider the effect it may have on their financial security. While gifting is usually conducted with the best intentions, the consequences can be detrimental to parent's wealth.

Parents can gift up to $10,000 a year up to a maximum of $30,000 over a five-year period to their children (for Centrelink purposes).

Amounts that exceed these thresholds are considered as deprived assets and included in the assets test. This is called the $10,000 rule. $30,000 is the maximum amount that can be gifted over a rolling period of five financial years. It must not exceed $10,000 in any one year to avoid deprivation. Only $30,000 of gifting in a five-year period can be exempted. This is called the $30,000 rule.

Gifting does not include selling or reducing a person's assets to meet normal expenses e.g. to buy a washing machine or pay for holidays. It also does not include payments for services parents receive from their children, such as lawn mowing.

Quite a number of parents may also want to give their children a financial advantage by selling them a property for less than its market value, or underwriting a home loan by signing their name on the deed. However, doing so may cause more harm than good. For example, if a parent helps a child purchase a home that the child will one day want to own for themselves, the parent will have to pay capital gains tax when they transfer their share of the property to the child - even if the property is treated as a gift.

Importantly for those close to retirement; the five year period also includes the lead-up to retirement. Therefore, if a person's retirement age is 66 and they are expecting to receive an age pension or allowance, they will need to consider any funds gifted since they were 61.

The gifting rules are the same for singles and couples i.e. couples cannot double the allowable limits.

Recipients of gifts are also not liable for tax on the gift. However, if they invest the gift received, then they will become liable for tax on any income they make on the gift's investment.

ATO targeting SMSF tax avoidance

The Australian Tax Office has its sight set on an emerging tax avoidance tactic being taken up by a number of self-managed superannuation funds.

The ATO has warned individuals (at or approaching retirement age) not to use a strategy known as personal services income (PSI) through their SMSF to minimise or avoid their income tax obligations.

Even though only a handful of cases are currently being investigated, the Tax Office believes the strategy could become more widespread and is undertaking reviews over the coming months.

Consultants and contractors often receive a personal services income (PSI) which is paid via a trust, partnership or company for legitimate tax advantages. PSI is common in professions such as finance, IT, engineering, construction and medicine, as it is distinct from salary income paid by an employer.

The ATO had become aware of instances where PSI was placed into an SMSF so that the income was either exempt from tax or taxed at a concessional rate rather than the individual's full marginal tax rate.

The Tax Office has released a statement that seeks to make it clear that individuals who are minimising or avoiding paying income tax by directing their earnings into their SMSF are breaching the law.

The ATO is urging individuals and trustees to come forward before 31 January 2017 to have administrative penalties remitted in full. However, shortfall interest charges will still apply. Individuals will be addressed on a case-by-case basis, but the individual's co-operation will be taken into account when determining the final outcome.