**"MADA NEWS" DECEMBER 2008 EDITION**

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## INTRODUCTION

Welcome to our Xmas 2008 edition of MADA News, our last newsletter for 2008.

Having recently being caught up in the chaos in Bangkok and survived, I thought it opportune to reflect on estate planning and making sure your financial affairs are in order should the unexpected strike. I went over to Thailand for a Yoga Festival and ended up being caught in the middle of the crisis finally escaping via a 27 hour ride on a private psychedelic double decker bus to Kuala Lumpur to fly out of Malaysia. What an adventure!

I am glad to be back on Australian soil to wish all of our clients a happy, healthy and prosperous 2009.

## Estate Planning and Testamentary Trusts – Protect Your Assets

Everyone needs to consider estate planning. Effective estate planning ensures that assets are directed to the right beneficiary at the most appropriate time. Other benefits of an effective estate plan are managing the tax implications on passing assets to beneficiaries. In estate planning it is not the will but the strategy that produces the right result.

A will is a legal document which allows you to choose who receives your belongings and assets after you die. It is the only legal way you can tell others how you want your assets to be distributed upon your death. Wills provide for clarity and may prevent future family feuds.

By having a valid will, your assets will <u>not</u> be managed by the State Government who in certain circumstances will deal with estates where there is no valid will.

<u>Testamentary trust</u>

Use of a testamentary trust may be a useful tool in managing tax implications and also achieving asset protection objectives.

A testamentary trust is a trust created by a will upon death. It may last as long as 80 years or may be terminated at any time at the direction of the trustees. It is generally a discretionary trust where the Trustee has full discretion about who benefits, and to what extent, under the trust. A discretionary trust is generally the most flexible type of trust. A testamentary trust can be established under a will to appoint a trustee to use property for the benefit of the beneficiary in the way that the will specifies. The trustees have broad powers to invest funds while under their control.

A testamentary trust has two significant advantages for the maker of the will and the nominated beneficiaries.

*Income Splitting*

The Tax Act provides that income and capital gains derived by children under 18 years of age received as a result of a will are not subject to penalty tax rates. As most of you would be aware, children under 18 may receive passive (unearned) income of up to $1,325 tax free before penalty rates of 45% plus Medicare levy of 1.5% kicks in. Children who benefit under a will are taxed at the normal marginal rates. In addition:

- Each child has a tax free threshold of $6,000. Based on rates for the 2008/09 year, taxable income between $6,001 and $34,000 will be taxed at the low rate of 15%. The Medicare levy of 1.5% is also payable if the taxable income is in excess of $17,309.

- The main advantage of using a discretionary, testamentary trust to bequeath assets to beneficiaries is that any income gains, capital gains and franked dividends can be distributed among the beneficiaries each year in the most tax efficient way.

Note that tax concessions also apply to income and capital gains derived from assets acquired from the re-investment of moneys received from the original inherited assets.

*Asset Protection*

A person making a will wants to make sure that the assets of the estate are protected and that they remain within the family and are used to benefit family members.

A significant advantage of a testamentary trust is that there is a separation of control and benefit. The assets are owned by one party (i.e. the trustee) and the benefit of the income and capital passes to another person (i.e. the beneficiaries). A testamentary trust is therefore able to address the following concerns:

- Beneficiaries becoming bankrupt;
- Beneficiaries becoming divorced and their assets being split in the divorce;
- Spendthrift children;
- Ensuring that the surviving spouse will pass on their assets to their children upon that person's death;
- Looking after handicapped children.

The terms of the testamentary trust are set out in the will. These terms can restrict the ability of any of the beneficiaries to control the activities and investments of the trust or give them total control. The person making the will therefore needs to decide whether he/she wishes to sacrifice the independence of the beneficiary to ensure that the inherited assets are protected and used sensibly for the benefit of the family.

We recommend that the majority of our clients create a testamentary trust under their will.

*<u>Consider the following example:</u>*

*Laurence is a general practitioner. He is married to Jasmin and they have three young children. Concerned with protecting his assets from potential risk associated with his occupation, Laurence has carefully structured his investment and asset ownership so that his wife Jasmin owns most of the marital assets including the family home.*

*Laurence and Jasmin have both made simple Wills leaving everything to each other and then equally between their children.*

*Laurence did not realize that the assets may still be at risk if Jasmin dies before him. Because Jasmin's Will leaves everything to Laurence personally, upon her death he will inherit all the assets previously held by Jasmin. The assets will once again be exposed to the liability risks arising from his occupation.*

*The solution to Laurence's asset protection dilemma is for Jasmin to prepare a Will that provides for all assets owned by her at death to pass into a testamentary trust for Laurence's benefit. In this way the assets of Jasmin's estate are quarantined from Laurence's personal name and are therefore protected from any claims made against him in his professional capacity.*

*Laurence's parents should also consider testamentary trust wills for any provision they intend making for him at their deaths.*

*Do not let your assets be exposed through inadequate asset protection and estate planning*

Regular reviews

It is imperative that your will be reviewed on a regular basis i.e. 3 years to ensure executors and guardians are still appropriate and your assets are being distributed according to your wishes.

Events such as marriage or divorce necessitate a review of your will (and in the case of marriage any existing will is revoked unless it is expressed to be made in contemplation of that marriage).

We work closely with your nominated solicitor (or if you do not have one we recommend one experienced in estate planning that we can refer you to) to determine all relevant assets held in your name and that that assets outside your will (as below) are treated appropriately. We prepare a detailed structure diagram for our clients so there can be no uncertainty as to relevant assets held. We also assist in such matters as choosing appropriate executors and guardians or expression of wishes e.g. which school they wish their children to attend, a desire for monies to be spent on certain things for beneficiaries while still held in trust, etc.

Your solicitor should be experienced in estate planning; we can assure you a cheap will costs heaps. Further the traditional one page will is (in all but the most simple of cases) ill equipped to deal with 21$^{st}$ Century issues.

Excluded property

There are certain kinds of property that you cannot will away as follows:

- Jointly held property (upon death the real estate automatically passes to the other person)
- Property held in trust
- Partnership property (depending on the terms of the partnership agreement)
- Superannuation (in certain circumstances)

- Life Insurance Policy proceeds (in certain circumstances)

<u>Powers of Attorney</u>

We further recommend our clients have appropriate Powers of Attorney. These are vital if you want someone to take care of your financial and legal affairs, or want someone to take care of you if you have an accident or sudden illness which leaves you incapable of doing it for yourself. It can also facilitate medical decisions on your behalf if you become unconscious or otherwise incapable of making those decisions for yourself.

There are two essential types:

1. Enduring Power of Attorney (Financial)

   This is used in case you suffer an accident, sudden illness or disability, offering security that someone will look after your financial health and legal affairs. You must make such a Power while you are still capable of making legal and financial decisions for yourself.

2. Enduring Power of Attorney (Medical Treatment)

   In this instance the attorney is required to make decisions about your physical health as opposed to your financial and legal affairs. This power authorizes your appointed person to authorize medical treatment, such as an operation, when you are not in a position to make that decision or give that consent yourself. To activate this Power, you must be either unconscious or otherwise incompetent.

<u>Why sign an enduring power of attorney now?</u>

Such a Power must be signed while you are still legally capable of managing your affairs. Most situations requiring such a Power happen quickly and without warning (just look what happened to my husband in Singapore earlier this year with his fractured skull). Once you lose the capacity to make your own decisions, you cannot sign a Power of Attorney, and other avenues to appoint a manager of your affairs can be time-consuming and costly.

Your attorney must be at least 18 years old and themselves capable of managing their own affairs. You must have confidence in their ability to manage financial and legal affairs and must obtain their consent to the appointment. Your appointed Attorney is obliged to always act in your best interests.

*The contents of this article are general in nature and are not advice that applies to any particular client situation. Whilst every care has been taken in preparing the article, specific advice should be obtained before proceeding with any suggestion or recommendation made*

*By Caroline Poon, Director, Medical and Dental Accounting Pty Ltd. Note Caroline Poon is a Chartered Accountant with a Masters of Taxation degree from Melbourne University.*