A BEGINNERS GUIDE TO ESTATE PLANNING

What is Estate Planning?

This can be described as a planning strategy aimed at giving:

a) financial security for a person during their lifetime, including an ability to meet lifestyle expectations; and

b) an uncomplicated, cost effective transfer of that person's assets to their beneficiaries on their death.

The broad scope of this type of planning has to take into account a lot of issues including

- emotional and lifestyle issues, including having a Power of Attorney and appointing a guardian in the event that the person may not always have the capacity to make decisions about financial and lifestyle matters;
- the passing of assets to heirs with minimum financial disincentives on their death;
- ensuring the person has a will;
- the financial and emotional wellbeing of minor dependants and the present and future financial needs of the person's family, dependants, business and assets;
- the person's actual contingent and potential liabilities;
- the needs of physically or intellectually challenged dependants and the protection of assets for the benefit of dependants, including whether assets would be available to creditors, the possibility of claims under the Family Provision Act, the effect of holding assets under joint tenancy, collection of overseas assets, life insurance, superannuation, relevant revenue and insolvency legislation.
- the use of family and testamentary trusts as vehicles for holding assets.
- evolving appropriate investment strategies for the person, and also for any trusts.

Estate planning is most effective when there is collaboration between the person, their financial adviser, their accountant and their solicitor.

An estate planning strategy is not static and should be reviewed at intervals to meet changing circumstances. For instance, a new Will may need to be made in the event of marriage, divorce, entering or dissolving a de facto relationship, the death of an executor appointed under the person's will; the sale of assets which are specifically mentioned in the person's will, the birth of further children or the death or loss of capacity of a beneficiary under the person's will. A new Will may also be considered necessary if family or financial circumstances change substantially.

Keeping control during your lifetime:

Powers of Attorney and appointments of a guardian are important tools in the event of mental or legal incapacity during a person's lifetime. This incapacity may be caused by injury or illness. If a person loses the capacity to make decisions regarding their financial and lifestyle matters, and they have previously made a Power of Attorney and appointed a guardian, they will almost certainly have greater assurance that those matters will be dealt with as they would have wished. However, without those appointments in place, decisions regarding property, medical treatment, accommodation and lifestyle may pass to a person whom they would not otherwise have chosen to make such decisions, or such control may even need to be determined by a State Tribunal.

It goes without saying that, in appointing an attorney under Power of Attorney, or a guardian under an Appointment of Enduring Guardian, it is essential to appoint someone who can be trusted and who respects the person's wishes. More than one person may be appointed, although it is important to ensure that the decision makers are able to reach a consensus in making decisions, and also that they are able to perform the role into the future. The attorney might not need to act under the Power of Attorney for many years and it is important that his or her health is adequate to carry out the tasks when the time comes.

Gifts given during lifetime:

Some people prefer to give gifts to dependants or other persons during their lifetime, rather than leaving those gifts in their Will. They may do this for the satisfaction of helping out their children or other family members, or they may wish to dispose of some assets for family law, social security tax or bankruptcy reasons. In making any such disposal of property, one needs to consider the implications for stamp duty, capital gains tax, and possibly the foregoing of superannuation and other income tax concessions which are available on death. In addition, anti-avoidance provisions of the Family Law Act, Social Security, Tax and Bankruptcy Acts may make gifting strategies during a person's lifetime vulnerable.

Family provision legislation:

This legislation is significant as it imposes real restrictions on the freedom of a person to dispose of their assets in their Will, where provision for family members is considered inadequate. An otherwise valid Will may be granted probate, but may then be subject to alternative orders of the Supreme Court if a claim under family provision legislation is successful. Essentially, the legislation gives the Court powers to make an order for further provision out of the estate of a deceased person if the provisions of the deceased's Will, or the intestacy laws of the relevant State, fail to make adequate provision for the proper maintenance and support of an eligible person. In New South Wales, those people who can make a family provision claim are a spouse (including de facto spouse), a person living in a domestic relationship with the deceased (including a member of a same-sex couple), a child of the deceased, a former spouse of the deceased, and other dependent persons (eg a financial dependant) who is a grandchild or a step child who was a member of the same household.

The question of whether a person is entitled to further provision than is provided by the Will of the deceased has traditionally been summarized as a question whether the deceased breached his or her moral duty to make proper and adequate provision for the applicant. The Court will take into account the following factors:

- the applicant's financial position;
- the size and nature of the deceased estate;
- the relationship between the applicant and the deceased;
- the relationship between the deceased and other persons who had legitimate claims upon him.

In certain circumstances, in New South Wales, the Court can also order that certain assets over which the deceased had control during his lifetime and which have passed to another person on his death, can be clawed back (even if it has already been distributed), if the deceased either transferred those assets, or failed to secure those assets for his estate when he could have done so, (eg by failure to sever a joint tenancy, failure to change beneficiary under life policy). In New South Wales strategies to manage claims are likely to be ineffective unless they involve outright disposition of property, and take place more than three years before death.

Family Provision legislation claims in New South Wales must be commenced within 18 months of the date of death of a deceased person, although this may be extended if sufficient cause is shown.

Some alternative ways of holding assets to ensure that the assets pass to the desired beneficiary are:

- joint tenancies with the beneficiary;
- trusts created for the beneficiary during the lifetime of a person;
- use of superannuation and binding death benefit nominations directly in favour of beneficiaries;
- life insurance owned or on statutory trust for the beneficiary; and
- outright gifts to the beneficiary.

Family provision legislation is a challenge to the testamentary intentions of the Testator and an analysis of the types of persons eligible to make a claim, and the strength of the testator's responsibility to provide for them, should be considered when a Will is made.

Intestacy:

A person will die intestate where he or she has left no effective Will to dispose of his or her estate, or has left a Will that does not dispose of a part of the property of an estate. An estate can be wholly or partly intestate. An intestate estate will be total if the deceased dies without having executed a valid Will, or has made a Will which was signed under duress, coercion, or undue influence, or if the Testator lacked testamentary capacity (ie was not fully aware of what he or she was signing).

A partial intestacy only affects the property not disposed of by the Will. This may occur if the Will does not dispose of all of the property of the Testator, or the Will is not properly executed, or a particular bequest or gift made by the Will is invalid, or a beneficiary has predeceased the Testator. Another reason for a partial intestacy is by the operation of the doctrine of forfeiture, which prevents a person named as a beneficiary in a Will from receiving an interest in the estate of a deceased person if they are criminally responsible for his or her death.

Where a person dies intestate, or leaves a Will which does not nominate an Executor, or where the Executor appointed under a Will is unwilling or unable to act due to ill health, etc, then the distribution of the deceased's estate will depend on a person applying for Letters of Administration from the Supreme Court to administer the estate in accordance with the statutory rules. Those rules also set out who is to inherit an estate in the absence of an effective Will, and vary, depending on which relatives the deceased leaves:

Presently, in New South Wales:

- if the deceased is survived by a spouse but no children, the spouse receives the whole estate after the payment of any liabilities. This applies regardless of whether the deceased also left other relatives. "Spouse" for the purposes of the intestacy rules, includes a de facto spouse..

- if the deceased is survived by a spouse and children, the spouse receives the household chattels, the first $200,000.00 and one half of the residue. The remainder of the residue is held on statutory trust for the deceased's children.

- if the deceased left children but no spouse, the entire estate is held for the children.

- if the deceased left no spouse and no children, then the estate passes to the surviving parents.

- Where no parents survive, then to brothers and sisters; or if none, grandparents; or if none, uncles and aunts.

If a person dies intestate leaving absolutely no relatives outlined in the intestacy rules, the whole estate will pass to the Crown.

Therefore, it is very important to ensure that a person has a Will which has been properly prepared and validly executed.

Estate Planning Vehicles:

There are some vehicles under which assets can be held which give greater flexibility in the ability to pass assets to beneficiaries. Some of these are:

- Joint tenancies: Where, on the death of one of the joint tenants, that person's interest passes to the surviving joint tenant(s). The property does not form part of a person's estate to be dealt with in their Will.

- Trusts: These can be in the form of a family discretionary trust or a unit trust created by the Testator during his lifetime, and which is governed by the terms of a trust deed. Assets are transferred into the Trust and capital and income are distributed to named beneficiaries of the Trust at the discretion of the trustee of the trust. However, in situations where the vast majority of a testator's wealth is held by the trustee of a discretionary trust, the beneficiaries under the estate may be disappointed to find that they have been left virtually nothing under a Will, and that they are at the whim of directors of a trustee company to determine what they might receive.

- Direct gifts to beneficiaries: One factor against the decision to gift assets during a person's lifetime is the less generous tax treatment of such non-testamentary gifts. For example, real estate valued at $500,000 can be transferred to a beneficiary under a Will on payment of $10 stamp duty, but if the same property is transferred from one living person to another, then the stamp duty payable on that transfer would be $17,990.00. Furthermore, a gift that is made during one's lifetime is not revocable. The provisions of a Will, by contrast, may be amended at any time before death.

Also, the anti-avoidance provisions of social security law (relating to the assets test) mean that if eligibility for social security entitlements is the motivation for such gifts, they may not be effective to achieve the desired result.

- Testamentary trusts: Virtually all Wills create testamentary trusts. Once the Executor has performed the function of paying the deceased's creditors and paying legacies, the balance of residue of the estate is then held "on trust" by the Executor, who then becomes a trustee.

  One form of testamentary trust is a life interest, in which certain assets are left to a beneficiary for the duration of his or her lifetime only, and on their death passes to the ultimate beneficiary of those assets.

  Another form of testamentary trust is the formation of a discretionary trust within the terms of the Will, giving the trustee power to distribute the residue to one or more beneficiaries in such proportions as the trustee considers appropriate.

- Superannuation Funds: In many cases, a person planning for provision for dependants will need to consider what type of benefits are appropriate, given the legal incapacity of children, and perhaps the financial immaturity of other dependants.

  Knowledge of the types of pension terms and conditions that are consistent with the superannuation legislation is essential.

Estate planning is a very clinical and objective process. However, the emotional needs of family members should not be overlooked as a relevant factor for consideration in defining an estate plan. Some very tax effective estate plans or asset protection schemes may be inappropriate if the proposed beneficiary is uncomfortable with a perceived loss of control or ownership of an asset.

Furthermore, as cash may be needed in the event of the death of a breadwinner, if discretionary trusts are contemplated in a will to quarantine wealth, it may be appropriate for the testator to ensure that there is a joint account or cash legacy immediately payable to the partner on death to provide immediate funds to maintain the partner and/or children. Also immediate cash may be accessed if superannuation payments are released immediately on death.

There are a number of structures that might be used to make careful provision for spendthrift or otherwise vulnerable dependants; eg discretionary trusts, protective trusts embedded in either a traditional trust or superannuation pension, or possibly annuities, or life interests. The discretionary trust is the most flexible of these options as it can be used to distribute both income and capital. The tax advantages of superannuation funds have to be weighed against the flexibility that discretionary trust offer. Obviously, where vulnerable beneficiaries are involved, the choice of trustee and provisions for control the appointment of trustee are of paramount importance. In the case of discretionary trusts this is more significant because the risks of poor trustee selection are not limited to fraud or abuse of power, but extend to unchallengeable exercise of wide discretions in relation to distribution of trust property.

Death Benefits from Superannuation:

Through compulsory superannuation and education, more Australians now have superannuation savings. The purpose of superannuation benefits is to provide retirement savings for the member, or benefits to dependants in the event of the member's death. Superannuation is one asset which may not form part of the person's estate as it can be paid directly to beneficiaries rather than the deceased's estate. This is an opportunity for individuals to determine who will receive the amount of their superannuation benefit in the event of their death. Depending on the rules of the funds, the person may also be able to specify how the benefit will be paid (eg lump sum or income stream).

It is necessary to understand who can be nominated to receive a person's superannuation and what options are available within the superannuation fund. The tax implications of receiving the superannuation death benefit also need consideration.

Part of the strategy for estate planning is protection of the wealth which has been created and one method of providing this protection is through insurance. Life insurance can form part or a person's estate; or can be directed specifically to a beneficiary; or can be paid to the policy owner. Term insurance is the simplest example of estate planning and its purpose is to provide a lump sum benefit on the death of the life insurer. It is possible to nominate a beneficiary of the policy. Term insurance can be held within superannuation so that on the death of the member the proceeds of the policy are paid to the superannuation fund, which has the effect of increasing the death benefit payable.

The superannuation legislation outlines who can receive a death benefit from superannuation and the trustee of a superannuation fund must consider dependants of the members before other beneficiaries.

There are different types of nominations of beneficiary within superannuation and each fund can choose the options they wish to provide. If no nomination is made, the trustee will exercise discretion as to whom to pay, or the trust deed may specify the payment must be made directly to the deceased's estate. The types of nominations are:

1. Nominated beneficiary: Merely an indication to the trustee of your wishes. This type of nomination is not binding on the trustee and the trustee will choose to whom to pay the benefit.

2. Binding death benefit nomination and reversionary nomination: These can be binding on the trustee provided the person nominated falls within the definition of dependant under the superannuation legislation.. Individual product providers may have a narrower definition of a dependant than that provided in the legislation and this may be relevant where the benefit will be paid as an income stream (eg only a spouse can be a reversionary beneficiary).

   In many public offer superannuation funds a binding death benefit nomination is only valid for up to three years unless reconfirmed. In some funds binding nominations are non-lapsing. For lapsing nominations, if the nomination is not reconfirmed within three years, the nomination lapses and the payment of the death benefit after this date will be made according to the trust deed. For non-lapsing nominations, if a person's circumstances change and they are incapable of changing the nomination, the nomination remains unchanged.

3. Beneficiary specified in trust deed.

The Superannuation Industry (Supervision Act 1993) has a broad definition of a dependant, which includes any spouse (either legal or de facto), child of the member, a person who is financially dependent upon the member, or another person with whom the member has an interdependency relationship, which means that the parties have a close personal relationship, live together, and provide each other with financial support and domestic support and personal care. There is no requirement for the people to be a family.

A member can also nominate their benefit to be paid to their estate under a binding death benefit nomination. The ability to nominate the estate depends on the trust deed of the superannuation fund.

In some cases, the nomination will be specified in the trust deed. For example, some superannuation funds may specify that death benefits are only paid as a lump sum to the estate.