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What is Estate Planning?

Estate planning is the process of arranging your affairs now to ensure that you are protected should you lose capacity and there is an efficient and tax effective distribution of your estate after your death.

A Will can help ensure your wishes are carried out

Preparing a Will is the most fundamental of estate planning strategies. A professionally drafted Will should help ensure your estate is distributed to your beneficiaries in accordance with your wishes. In your Will you are able to:

- Make gifts of assets or money that form part of your estate (but be careful, as some of your assets, such as superannuation, may not form part of your estate)
- Establish trusts for the ongoing management of your assets for your beneficiaries
- Appoint an executor and trustee
- Appoint guardians (for example, to look after your minor children).

How can you minimise tax for your beneficiaries?

(NB: Whether these solutions are appropriate for you will depend on your individual circumstances, needs and wishes.)

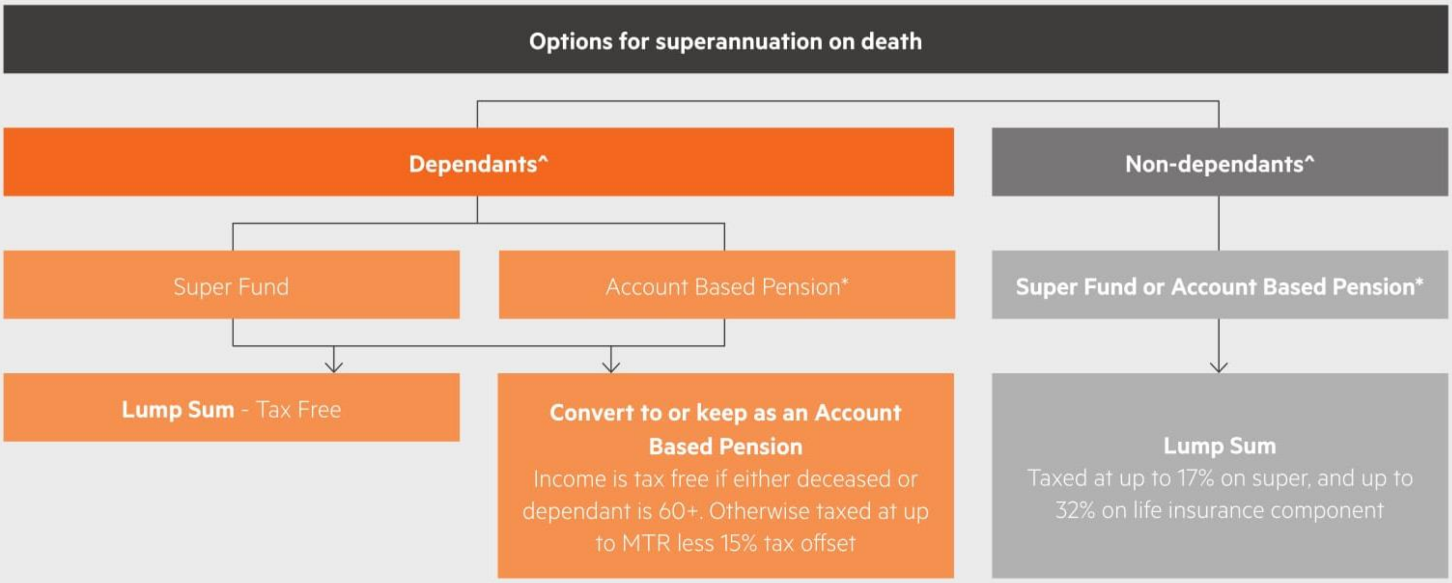
- Nominate your spouse and dependant children to be the recipients of your superannuation. Superannuation paid as a lump sum to your tax dependants on your passing is tax free (see section on superannuation).
- Incorporate a testamentary trust into your Will. This could create capital gains tax savings as well as ongoing income tax savings for your beneficiaries.

  A testamentary trust is established upon the passing of the Will maker, and is a structure in which certain assets are held and from which distributions are made.
- Consider holding your key investments (other than your family home) in a family trust. This could create tax savings for you now, as well as ongoing tax savings for your beneficiaries into the future.
- Bequeath assets with low or no capital gains tax liabilities (such as investments purchased prior to 1985) to beneficiaries with high marginal tax rates and vice-versa.

How is superannuation treated on death?

Money in superannuation and account based pensions (or allocated pensions) should be gifted to dependants due to the associated tax benefits.

A dependant includes a spouse, ex-spouse, and children under the age of 18.



^For taxation purposes dependants include spouse, ex-spouse, children under age 18 (or under 25 if studying), and persons who were financially dependant on, or who had an interdependency relationship with, the deceased. Non-dependants include adult-aged children and grandchildren. *Or allocated pension

Non-dependants (such as adult children) must take all death benefits from superannuation and account based pensions as a lump sum and pay tax at marginal rates on the superannuation component. If there is a life insurance component, it could be taxed at up to 32%.

Choosing the Right Executor

The executor is responsible for making sure that the instructions in your Will are carried out, and can be:

- One or more persons, or
- A trustee company.

Your executor should be someone you trust and who is willing to take on the work, responsibility and risk. If the executor you have chosen pre-deceases you or is unwilling to act as executor, your estate may be administered by someone you did not choose.

What cannot be in a Will?

- An asset owned by a trust, or any benefits received from a trust
- Life insurance policies where the beneficiary is another person
- Superannuation and retirement income streams, which have current 'binding nominations' to be distributed directly to dependants, or income streams that are 'reversionary'
- Assets that are held in a 'joint tenancy'.

How can you manage your estate planning objectives?

Life insurance can be an important instrument in helping you meet your estate planning objectives. For example:

- You should be able to purchase sufficient life insurance to ensure your partner and children have adequate funds to finalise your debts, meet large expenses (such as school fees) and continue to live a comfortable life.
- If your estate will have large taxation liabilities, you may be able to protect your beneficiaries by purchasing an appropriate life insurance policy. Obtain sufficient insurance cover to enable beneficiaries to pay out your estate's taxation liability without requiring funds from their inheritances.
- If you are in business with partners, a life insurance policy on each partner can help protect the viability of the business and the financial position of the surviving partners if one of you were to pass away.
- If it is important that your dependants are given equal shares of your estate, a life insurance policy can be used to equalise your estate (see next section).

What is estate equalisation?

A common estate planning dilemma is where a Will maker intends to gift their main asset (e.g. the business or home) to one of their children when they pass away – because, for example, the child might have helped them to build the business.

Unfortunately, this may mean the Will maker's other children will be disadvantaged financially on the Will maker's passing, because their other assets do not hold the same value as their key asset.

The Will maker usually does not wish for this inequality – nor do they intend for the asset to be sold on their death to facilitate an equal distribution. What can they do? One solution is to use insurance to equalise the value of their estate. Here's a case study to show you how this strategy works.

John is a single divorcee, and has a son and a daughter. John owns a successful business – a business which has a bright future.

John's daughter has been helping him manage the business since she left university, and shares his passion for it. On the other hand, John's son has interests elsewhere and has chosen to not participate in the business.

In the event of his passing, John would like the business to 'stay in the family' by arranging for it to pass to his daughter. However he recognises this would be unfair to his son because his other assets are worth only a fraction of his business.

The solution for John is to increase his life insurance to the value of his business minus the value of his other assets. On his passing,

Estate equalisation

the insurance payout and other assets could be given to his son, and the business could be transferred to his daughter. In this way, John is assured of a fair and equal distribution of his assets. Both of his children will be pleased with the financial outcome – and his business will stay in the family.

How can you minimise the chance of your estate being challenged?

You could consider the following:

NB: You should consider your own individual circumstances before implementing and of these strategies

- Ensure your Will is current, comprehensive and fair
- Hold your key assets in a family trust (as these assets are owned by the trust and not you, their ownership is not affected by your death and are not subject to challenge)
- Have a binding nomination for your superannuation to be transferred to a dependant/s (this generally cannot be challenged)
- Give your executors adequate power to carry out your wishes.

How can you protect your assets for the next generation?

If you are concerned your dependants do not have the ability to manage or protect your assets after you pass away – or if you feel the assets you bequeath may be at risk due to the possibility of your dependants facing bankruptcy or legal action, it might pay for you to consider using a family trust or testamentary trust.

The trustee of these trusts legally owns the assets you place in them, and those assets are therefore generally protected from your dependants' creditors. They are also protected from a dependant who is not capable of managing money. You will need to appoint someone you trust to act as trustee, or use the services of a trustee company.

How can you protect your assets from your child's divorce?

With the high rate of divorce, many parents are concerned the inheritance they leave to their children could end up in the hands of their son-in-law or daughter-in-law if their child's marriage breaks down.

If a child receives an inheritance in their own name, that inheritance will generally form part of the child's assets, and therefore part of the matrimonial property. This could then be available to the Court for distribution upon the divorce proceedings.

Check List - Implementing an Effective Estate Planning Strategy

It is important your estate planning strategy ensures that those you care about are well provided for. Some examples of the issues you should consider are:

Families with minors

- Have you nominated a guardian for your children?
- Should your Will make provision for investment income to be paid through a trust to avoid the minors losing much of the income from the estate in tax?
- Do you have sufficient assets in the estate to provide an income stream to the minors?
- Does your Will make provision for your assets to be held in a trust to protect the minors' interests?

Families with children who may be facing bankruptcy, divorce, or own their own businesses

- Does your Will cater for a testamentary trust for each child to protect your assets from creditors or bankruptcy?
- Does your Will protect your assets if a child faces divorce – so your assets do not pass to your children's ex-spouses?

Families with a large amount of superannuation

- Should you make a binding nomination with your superannuation fund to provide certainty as to who will receive your superannuation benefits? Or do you want your super paid to your estate?
- Will your superannuation benefits be paid in the most tax effective manner? If the payment of your superannuation is made to non-dependants, it must be taken as a lump sum and tax of up to 17% could be payable. If your superannuation is paid as a lump sum to dependants there is no tax (see section on super, page 1).

Families with siblings who may be spendthrifts

- Does your Will provide a structure that will prevent spendthrift children from squandering your assets?
- Do you want your Will to have provisions that will maintain your assets for the benefit of your grandchildren?

Families that own a family business

- Will your family business pass to those that you want to control it?
- Will the control of the business pass in the most tax effective manner?

Families with members who are disabled or infirm

- Does your Will have a trust structure to provide for the long term care of family members who are disabled or infirm?

Multiple marriages and children from other marriages

- Does your Will ensure that children from all your marriages will be looked after?
- Do you need your Will to ensure that your assets pass to your children and not those of your current spouse?
- Does your Will protect your current spouse from the claims of previous spouses?
- Does your Will need to provide for an ex-spouse?

However, if the assets are distributed to a properly structured testamentary trust, the inheritance may be kept apart and protected from a divorce property settlement. However, it is imperative that the trust be drafted appropriately to ensure this strategy is successful in protecting the assets.

What is a Power of Attorney?

An enduring power of attorney is a formal instrument by which one person empowers another person to represent them or to act in their stead for certain purposes. For example, if you are unable to manage your own affairs due to serious illness or accident, you may need someone to look after your finances. An enduring power of attorney will give that person the authority to act on your behalf. If you do not have an enduring power of attorney, you do not have control of who may be given the responsibility of handling your finances.

What is a Life Interest?

A life estate comes into effect via your Will. It provides a person with the use of an asset of yours during that person's life-time, but on that person's death the asset is distributed according to your wishes not theirs. For example, you may have someone living with you to whom you do not wish to bequeath your home. If you wish, a life interest could allow that person to continue living in your home after you pass away. After they pass away, the home would be bequeathed to whoever you nominated in your Will.

What is a Buy-Sell Agreement?

A buy-sell agreement is used by partners in a business to ensure that the business interest of one owner will be able to be sold to the other owners when a trigger event occurs. Trigger events include the death of a partner.

Insurance is often used to finance a buy-sell agreement to ensure the surviving partners have sufficient money to buy the deceased's partner's share of the business. As a result, it means the deceased partner's estate is fairly compensated for giving up their rights to the business.

Case Study One - Ensure your estate plan has sufficient funding

Liz and Stuart have two small children and a large mortgage. Stuart's small business is starting to succeed, and life is looking good for the couple. Unfortunately Stuart passes away in an accident. While the mortgage is covered by his life insurance, there is little left over to help Liz support herself and their two children. Liz therefore has to find a job, but this means she has less time to spend with her children.

Stuart and Liz did not have an effective estate plan. They failed to provide adequate funding (via life insurance) in the event that one or both of them died.

Case Study Two - Protect your assets by ensuring they pass to those you intend

Jack and Penny own an investment portfolio they had built up over a lifetime of hard work. When they both pass away they leave their estate to their only daughter Mary.

Mary is married to James and they have three children. Mary and James' business is experiencing financial difficulty as James often squanders the profits. Finally the business goes into liquidation.

As Mary and James had personally guaranteed the debts of the business they lose their home and all of the inheritance from Jack and Penny. If Jack and Penny had made a provision in their Will for the establishment of trusts they could have protected their assets from creditors and ensured that their grandchildren had benefited from their estate.