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## ON THE SUPERANNUATION FRONT

### Changes to small superannuation fund pension regulations

On 20 December 2005, the Government announced the release of the final regulations to implement its response to the review of pensions in small superannuation funds. The regulations, which take effect from 1 January 2006, update the allocated pension and annuity draw down factors in line with current life expectancy.

### Choice and Flexibility

In response to concerns raised by some people that they may outlive the payments from their income stream, under the new regulations they will now be able to select a term for their life expectancy or market-linked income stream based on the possibility that they (or their partner) will live to age 100.

The pension valuation factors (PVFs) for allocated income streams have been updated to align the allowable minimum and maximum limits on payments with the improvements in life expectancy that have occurred since their income streams were introduced in 1992.

### Selection of PVF Factors for Allocated Pensions

The new regulations effectively mean that there will be four groups of allocated pensioners from 1 July 2006:

1. Those which commenced their pensions prior to 1 January 2006, which are subject to the current PVF factors
2. those which commenced on or after 1 January 2006 and prior to 30 June 2006, which have elected to use the current PVF factors
3. those which commenced on or after 1 January 2006 and prior to 30 June 2006, which have elected to use the new PVF factors, and
4. those which commenced on or after 1 July 2006, which are subject to the new PVF factors.

### Splitting of Superannuation

Legislation has finally been enacted allowing the splitting of superannuation between spouses. The new rulings come into force from 1 July 2006.

A split of superannuation will take the form of a transfer of part of the member's contributions to a spouse's account, either in the same or separate superannuation fund. A split can be requested after the end of the financial year.

*Source: Summarised from an article by Reece Agland in National Accountant, February/March 2006.*

## DISCRETIONARY TRUSTS AND THE POWER TO DISTRIBUTE CAPITAL

The discretionary trust has traditionally been a source of asset protection for families, in part through restrictive provisions regarding capital distributions.

In recent times, this aspect of asset protection has been diluted, due mainly to the call for greater flexibility in the operation of trusts.

In many of the most modern deeds for discretionary trusts the role of guardian or supervisor has been omitted, leaving the only potential limit or control on the power of the trustee being through the powers of the appointor.

Many modern trust deeds do not require the trustee to obtain the appointor's consent when exercising certain powers, including the distribution of capital.

The divergence of views between bankruptcy and family law only serve to cloud the issue of control, leaving beneficiaries unclear whether the assets of the trust are exposed. Quite clearly when establishing or reviewing a discretionary trust careful consideration must be given as to whether the priority in its establishment is asset protection for both this and succeeding generations or flexibility.

If the desired outcome is effective succession planning, a more restrictive trust deed would provide greater asset protection for the next generation.

Ultimately the choice between asset protection and flexibility will rest with those establishing the trust. However, careful planning and advice should be sought to maximise the protection available to the assets of the trust from the risks of those directing the use of those assets.

*Source: Summarised from an article by Anita Aarons of Harwood Andrews Lawyers in Taxation in Australia, issue 40 no. 6, December 2005.*

**Baby boomers' Wills: don't forget testamentary trusts**

by Chantal Olz, Tax Consultant, Horwath Tax Sydney

Baby boomers, the wealthiest generation in human history, are writing their Wills. And the planning involved in preparing those Wills provides opportunities for tax agents to help these clients with estate planning issues. The use of testamentary trusts for these clients is a major planning avenue because, from an estate planning perspective, testamentary trusts offer almost endless flexibility.

The most fundamental advantage of testamentary trusts is the opportunity for tax savings they provide as a result of the concessional tax rates afforded to them. The use of such a trust allows beneficiaries who are under 18 to have the benefit of adult income tax marginal rate scales (compared to the usual 48.5% tax rate applicable to income over \$772).

A properly structured testamentary trust can thus ensure that income is tax-effectively distributed to the deceased's children or children's children. Tax is saved by splitting income across one or more minor beneficiaries rather than adults who are taxed at the top marginal tax rate.

**Acting smart**

In the absence of a testamentary trust, if people simply leave their personal wealth to their children, it is the deceased's children who bear the tax burden associated with the inheritance. The deceased's children will have no other option than to support their own children from birth to adulthood out of money that has been subject to tax at 48.5% (assuming the deceased's children are in the highest marginal tax bracket).

The use of a testamentary trust, on the other hand, significantly alters the tax outcome for the beneficiaries of the deceased estate. By setting up a testamentary trust, the deceased's assets can be distributed to beneficiaries in a manner that ensures the deceased's grandchildren can be brought up with money that has been taxed at marginal tax rates.

**Example**

Jane and Jill are both 80 years old. They each have 4 young grandchildren (below the age of 18) and want to leave their respective grandchildren with a \$2m inheritance. Jane's tax adviser recommends that she set up a testamentary trust. Jill's adviser does not.

On Jane's death, the \$2m is vested in a testamentary trust. The trustee of the trust invests the \$2m and distributes the income of the trust evenly to Jane's 4 grandchildren. Assuming her grandchildren receive distributions of trust income amounting to \$400,000, taxed at the marginal tax rates applicable to adults, the total tax on the distributions will be \$128,500 (ie distributions to each of the 4 grandchildren of \$100,000 taxed at marginal tax rates).

On Jill's death, her 4 grandchildren receive \$2m (ie \$500,000 each). The grandchildren invest these funds, generating \$100,000 of income per grandchild. The total tax liability arising on this income is \$194,000 (ie 4 grandchildren with \$100,000 income each). As all her grandchildren are under 18 years of age, income generated by their investments is taxed at 48.5%.

Jane's grandchildren are better off by \$65,500.

**A good testament**

The flexibility afforded by testamentary trusts has a number of additional benefits. As testamentary trusts can be tailored to meet the specific needs of each person, they can also be created to extend over a number of generations, allowing the deceased to have influence over the assets for a period beyond that usually available. Similarly, the use of a testamentary trust shifts control over assets from beneficiaries, who may be at risk of misusing the funds, to an independent trustee with investment expertise.

*[This article is an edited version of the article published in the February 2006 issue of Thomson's "inTAX" magazine. The topic of testamentary trusts is covered in detail in Thomson ATP's Australian Financial Planning Handbook which discusses and explains - with checklists, examples, and case studies - both the benefits and disadvantages of these trusts from an estate planning, social security and general taxation perspective.]*

**Speak to your Abacus consultant for more information on anything contained in this newsletter. Either for clarification, further information or to find out how a particular item could be applicable to your situation.**

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**Quote of the Month**

"Your chances of success in any undertaking can always be measured by your belief in yourself."

**Robert Collier**