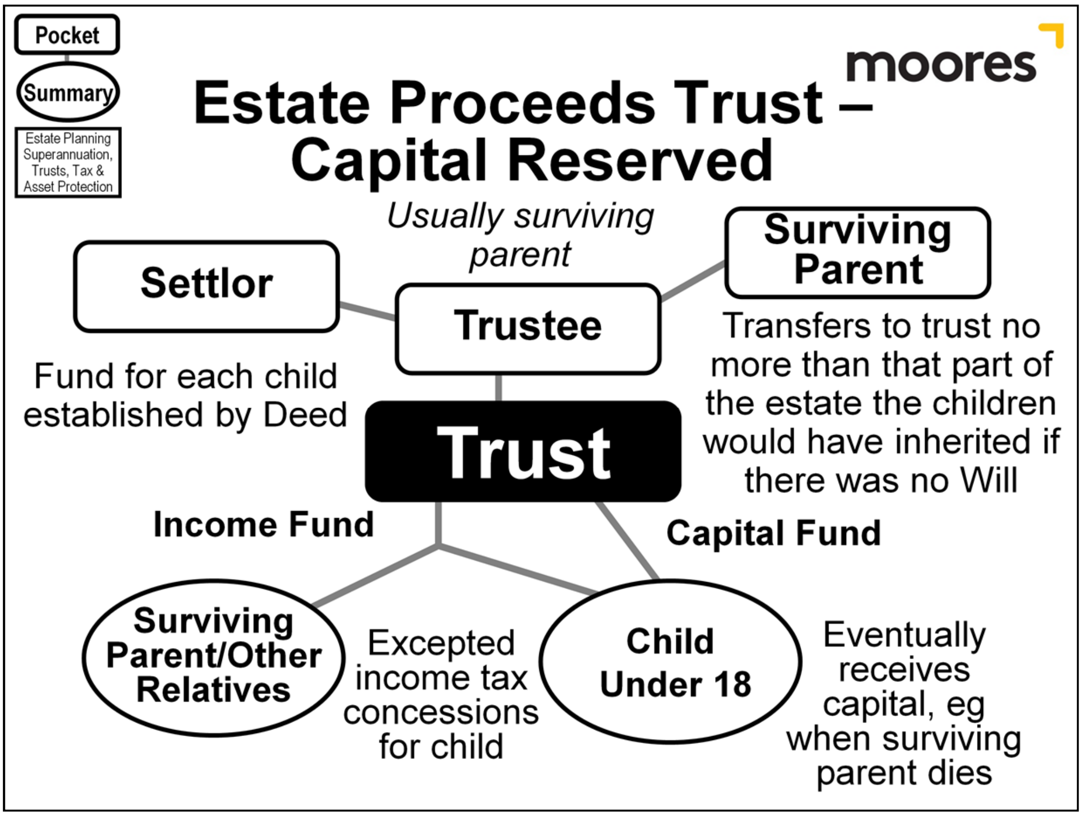


Major Reasons for a Capital Reserved Estate Proceeds Trust

To have income (generated from part of the assets of the deceased estate, including superannuation death benefits paid into the deceased estate, that the child would have received had there been no Will) taxed as excepted income of the child, rather than included in the surviving parent's income and taxed at the parent's higher marginal tax rate, eg 46.5%. # To thwart a challenge by a future partner of the surviving parent. # To still have flexibility as to the distribution of income (as opposed to a fixed trust option).

Trustee/Control

Usually the trustee is the surviving parent or a company controlled by the surviving parent. Control is held by the appointor (usually the surviving parent) until the trust ends and the capital beneficiary takes over absolute ownership. The capital beneficiary cannot be changed and no additions can be made to the class of potential income beneficiaries.

Trust Income and Capital

While trust income needs to be defined as accounting income, income beneficiaries are taxed by reference to the proportion and type of taxable income (including net capital gains) spent on or allocated or paid to them, with credit for any tax already paid, eg dividend franking credits. The trustee is usually expressly empowered to reimburse beneficiaries for any CGT liabilities. Capital profits (usually subject to a 50% discount) are taxed both when trust assets are disposed to 3rd parties and on winding up of the trust. Loans to the trust usually need to be on arm's length terms.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and non-excluded beneficiaries of the trust.

Pocket

Summary

Estate Planning Superannuation, Trusts, Tax & Asset Protection

moores

EPT Funding Limitations

Need a deceased estate with assets – many deceased estates pass automatically to a surviving parent as the surviving joint tenant or directly to a dependant

Trust(s) can hold all or any part of the share of the deceased estate the child/children would have received had the deceased parent died without a Will

Share of estate varies depending on jurisdiction, eg in

- NSW – children receive ½ of the estate less $200,000
- Qld & Vic – children receive 2/3 of the estate less $150,000 (Qld) $100,000 (Vic)

Barriers to Establishing Estate Proceeds Trusts

Estate proceeds trusts are often partial substitutes for the testamentary trusts the deceased parent of a child or children under 18 years failed to include in the Will. Like testamentary trusts they have the barrier of needing to be funded by deceased estate assets, but unlike testamentary trusts they can only have as their capital beneficiary a child who would have inherited had there not been a Will.

Need for a Deceased Estate of Value

This can be an obstacle even for relatively high net worth people as many people die with greater wealth outside their deceased estate than inside their deceased estate, eg because assets were held:

- As joint tenants;
- In the surviving spouse's name (eg for asset protection purposes or to "simplify" life insurance policy ownership);
- In superannuation and paid directly to dependants;
- In a family discretionary trust.

"Notional Intestacy" Entitlement

An estate proceeds trust, because of subsection 102AG(7) of *Income Tax Assessment Act 1936*, can only be funded by that part of the deceased estate that would have passed to the child had the deceased not made a Will. This means that the deceased needs to have been the child parent (or the child's grandparent in the uncommon situation that the child's parent has died before the child's grandparent of the same family line). The notional intestacy entitlement can vary between the different Australian States and Territories (as well as between different overseas jurisdictions).

Pocket Summary

Estate Planning Superannuation, Trusts, Tax & Asset Protection

moores

Capital Reserved Trusts – Stages of Administration

(For most estate proceeds, super & other death benefit trusts)

While child is under 18 (or still financially dependent) –
Income is distributed to child's legal personal representative for maintenance & education expenses

When financial dependency ceases –
Trust usually operates as a discretionary income trust (or for a fixed trust, interest is no longer charged)

When surviving parent dies/decides to end trust –
Child receives trust capital

Stages for All "Capital Reserved" Trusts

These 3 stages are typical of the stages of administration of all of the "capital reserved" trusts that need to meet the requirements of subsection 102AG(2A) of *Income Tax Assessment Act 1936*, including estate proceeds, child support (maintenance), superannuation death benefits and employer funded death benefits trusts. A separate trust is established for each child, often using a single trust Deed. The definitions of income and capital in the Deed are the accounting definitions (because the requirement for "accounting" capital to eventually be paid to the child).

Stage 1

The surviving parent is able to split "accounting" income with the child and use that income to financially support the child (and yet still retain control of the funds).

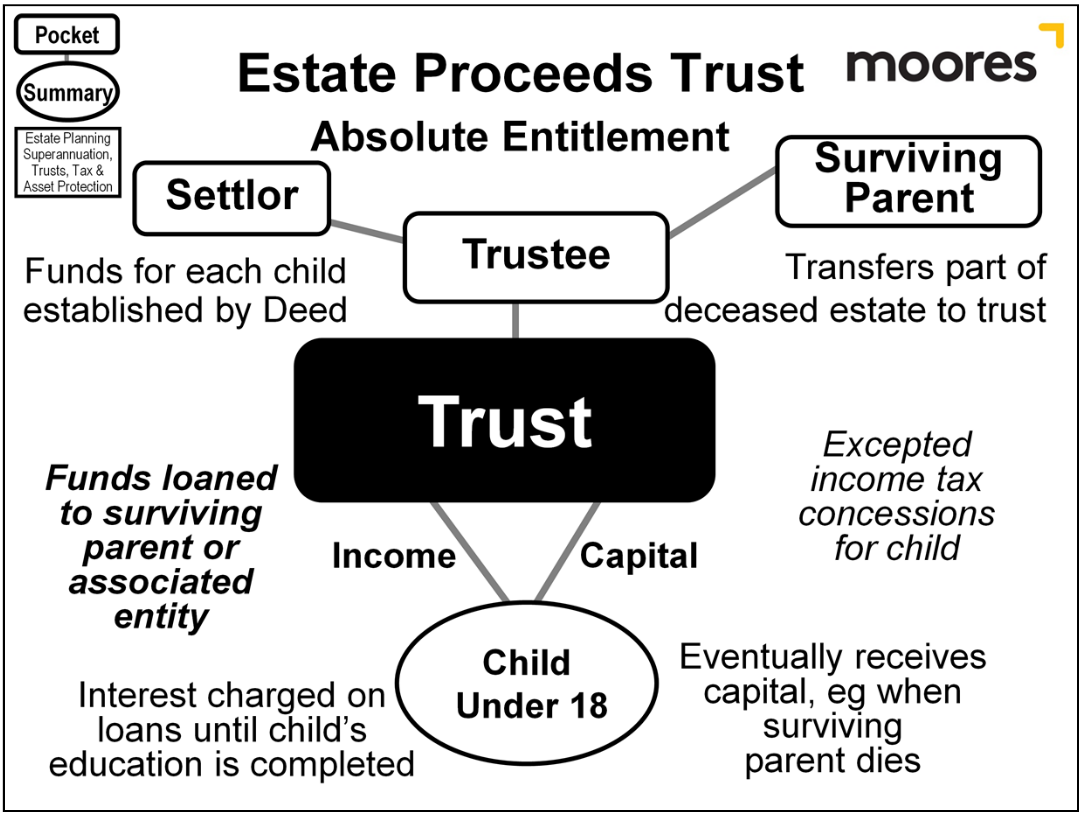
Stage 2

Unless the trust is a fixed trust (as opposed to a non-fixed, capital reserved or split fixed trust – see separate pocket summaries), the surviving parent does not have to pay the trust funds over to the child and can continue to enjoy the benefit from the capital for the balance of the surviving parent's lifetime either by:

- receiving the income personally (capital reserved or non-fixed trusts only); or
- receiving the benefit of an interest free loan.

Stage 3

On the death of the surviving parent (or such other time as the surviving parent nominates during their lifetime or in their Will), the trust assets pass to the child.



Major Reasons for an Absolute Entitlement Estate Proceeds Trust

To achieve most of the advantages of a capital reserved estate proceeds trust (other than flexible income distributions). # To ensure that trust assets will pass to the child without a CGT event occurring when the trust ends.

Trustee

Usually the surviving parent or a company controlled by the surviving parent.

Ultimate Control

Control is held by the appointor (usually the surviving parent) until the trust ends and the beneficiary takes over absolute ownership. The beneficiary cannot be changed and, unless the assets of the trust are ones that prevent a handover, eg a (documented) lifetime loan, (unlike the non-fixed version) the beneficiary can demand payment of the capital on attaining 18 years.

Trust Income and Capital and Pension Means Testing

The beneficiary is taxed on the taxable income (including net capital gains) of the trust, with credit for any tax already paid, eg dividend franking credits. The trustee is usually expressly empowered to reimburse the beneficiary for any CGT liability. Capital profits (usually subject to a 50% discount) are taxed when trust assets are disposed to 3rd parties, but (unlike a capital reserved trust) not on winding up of the trust. Loans to the trust usually need to be on arm's length terms.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and the beneficiary of the trust.