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Death and Taxes

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NEW SOUTH WALES	QUEENSLAND	VICTORIA
Sydney 1300 367 688 sydney@bantacs.com.au Burwood 1300 367 688 burwood@bantacs.com.au Central Coast 02 4390 8512 centralcoast@bantacs.com.au Hornsby 1300 241 248 hornsby@bantacs.com.au	Brisbane 1300 911 227 brisbane@bantacs.com.au Caboolture 07 5497 6777 admin@bantacsningi.com.au Gold Coast 0435 437 586 goldcoast@bantacs.com.au Mackay & Whitsundays 07 4951 1848 mackay@bantacs.com.au Ningi 07 5497 6777 admin@bantacsningi.com.au Toowoomba 07 4638 2022 toowoomba@bantacs.com.au	Melbourne 03 9111 5150 melbourne@bantacs.com.au North Melbourne 1300 123 842 northmelbourne@bantacs.com.au **SOUTH AUSTRALIA** Adelaide 08 8352 7588 adelaide@bantacs.com.au **FIND OUT MORE** http://bantacs.com.au/aboutus/

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Important

This booklet is simply a collection of Newsflash articles relevant to death and Taxes. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.

Basics for Executors of Deceased Estates

1) Trustee, Legal; and Personal Representative and Executor mean the same thing for the purpose of the following and it is assumed the beneficiary is an individual.
2) A deceased estate receives a tax free threshold and stepping of its tax bracket from there for up to 3 financial years after death but note the ATO can cancel this concession if the winding up of the estate is unduly delayed for the purpose of the tax benefit. The deceased also receives the tax free threshold and stepping up of his or her tax bracket for the tax return up to the date of death. This means that effectively two lots of tax free thresholds etc can be utilised in the financial year of death. While in most cases the tax concessions are the same for the deceased as the executor, consideration should be given to this point in deciding whether to pass an asset onto a beneficiary before it is sold.
3) To qualify for the 12 month CGT discount, 12 months must have elapsed from when the deceased entered into an agreement to purchase the asset regardless of whether it is held by the trustee or beneficiary when sold.
4) In most circumstances death will not trigger capital gains tax but it will start the clock ticking on pre 19th September, 1985 assets so it is important to have these valued at the date of death.
5) Most pre 19th September, 1985 assets will, in the hands of the executor or beneficiary, have a cost base of market value at the date of death. So when sold CGT will be payable on the difference between the selling price and the combination of the selling costs, holding and improvement costs since death and the market value at the time of death.
6) The main residence of the deceased will not attract CGT if sold within two years of death whether it was purchased pre or post 19th September, 1985 and there are further concessions if a beneficiary continues to live in the house. The main difference between pre and post 85 main residences is the two year concession applies to pre 85 dwellings even if they were rented out before and or after death whereas post 85 homes only receive the concession if it was the deceased's main residence just before death and was not also income producing at that time. If the dwelling fails this test it is treated like other assets discussed in point 5 above. There is a more detailed discussion of this issue later in the booklet.
7) Any capital loss accumulated by the deceased can only be offset against capital gains made up to his or her date of death. So neither the beneficiary nor the trustee can take advantage of the carried forward capital loss of the deceased.
8) Generally the passing of an asset from the deceased to either the Executor or Beneficiary will not trigger a CGT event nor will the transfer from Executor to the Beneficiary. Section 128-10.
9) The capital gains tax event arises on the date you agree to sell the asset to a particular purchaser, not the settlement date.

Testamentary Trusts

A testamentary trust holds the assets of the deceased for the benefit of his or her heirs in accordance with the terms of the will. The trustee can then distribute the income or assets as it suits each year. This can be used to protect the deceased's assets from being considered the property of the beneficiary and exposed to the family law court (not water tight) and the bankruptcy trustee. Another benefit of a testamentary trust is that it can distribute income to children and because it is received from a deceased estate the child is not taxed at the penalty rates applicable to passive income of children under 18.

Testamentary trusts are the most flexible if they are discretionary. You can create more than one testamentary Trust from your will. So if you want each of your children to have a clearly defined share but

then have the flexibility to distribute it amongst their own family as they see fit, you could create a testamentary trust for each of them.

If you choose a testamentary trust make sure the deed does not permit the trustee to admit new beneficiaries as this will compromise the trust's status as testamentary.

Part Owner of Parents' Home

A taxpayer who is part owner (as tenants in common) of her parents' home is concerned about the CGT consequences of her parents' death and whether there is any action she can take now to minimise the cost.
Answer:

As the property is held as tenants in common the deed will show just what percentage each of them own. Lets assume the child is a resident of Australia and owns half so the parents own a quarter each. Assuming the parents will their 1/4 of the house to each other on death then half the house will become part of the estate on the death of the remaining parent. The other half will just be an asset held by the child and subject to CGT via the normal provisions when sold. It is not affected by the death of the other owners of the property. When the last parent dies (assuming he or she lives in the house up until death) the beneficiaries of the estate will not be subject to CGT on their 50% unless they sell the property 2 years or later after the parents death TD 1999/70. If they do take longer than 2 years to sell the cost base will be the market value at the time of the last parent's death plus the normal extras such as commissions, improvements, insurance, repairs, interest rates etc since death, and costs of acquiring the asset such as probate. This is the case regardless of whether the house was purchased pre or post 19th September, 1985. The only difference joint tenancy as apposed to tenants in common would make is that it would be very difficult to convince the ATO the child owned anything different than exactly 1/3rd of the house.

As you can see because the child does not live in the house, the more the child owns of the house the higher the eventual CGT on its sale, even in 100 years time. Depending on the age of the parents it may be worth the stamp duty now to change the deed to only the name of the parents. This would be a deemed disposal and the child would have to pay CGT on the difference between his or her cost base and the market value of their share but at least then the CGT clock would stop until the parents die, assuming the parents live there until death. The child would need to see a solicitor to make sure her legal rights to the house were provided for within the parents will and be confident this was not going to change.

Death Benefits in Your Super – Tax Consequences

Careful consideration should be given to who you nominate as beneficiary of the life insurance component of your superannuation policy. A dependant will receive the death benefit tax free. The definition of dependant defined at section 27AAA(3) as:

> "Any person who is or was the spouse of the taxpayer, and any child of the taxpayer who has not attained the age of 18." Refer 27A(1).

Note the definition is not limited to this (refer IT2168) and it is recognised that a dependant does not have to be solely dependant on the deceased to qualify. For example a brother living with the deceased but receiving a social security payment would still be considered a dependant if it was proved that the social security payments were not enough to cover the dependant's share of living expenses. Further, a parent has been found to be a dependant of a deceased child, not on the basis of financial dependence but on the fact the parent was reliant on the deceased for nursing care.

If the payment is received by a non dependant it will be taxed at 15% (subject to some exceptions) in the beneficiary's hands if the payment is from a superannuation fund. If the payment is from the deceased's employer it will be taxed at 30% if paid to a non dependant.

If the death benefit is just paid to the estate of the deceased you are at the mercy of the Commissioner's discretion. Section 27AAA(3) states that the only tax free component is:

> "…such amount (if any) as the Commissioner considers appropriate having regard to the extent to which dependants of the deceased taxpayer may reasonably be expected to benefit from the estate."

Otherwise the amount is taxed in the deceased estate. Note a deceased estate can be taxed at the deceased tax rates (i.e. the first $6,000 tax free then only 17% until $20,000) for the first three financial years after death if the winding up of the estate is not unreasonably delayed. So if your beneficiary does not fit any of the exempt definitions it is better to pay the amount to the estate rather than directly to them.

If you have only been in the work force a short time superannuation entitlements may be minimal and you may disregard this article. But note your death benefits can be significant even if you are new to the fund.

In short, your will should specifically deal with your superannuation death benefit in the most tax effective way subject to your circumstances (i.e. paid to dependants only). Any generalisations will only result in the ATO being a beneficiary of your estate. And if you thought you hated paying the ATO while you were alive and able to provide for your family…

CGT Concessions for Deceased Home

The requirements to qualify for the CGT exemption vary depending on whether the Deceased purchased the property on or before the 19th September, 1985 or after that date.

Purchased Pre 20th September, 1985

If the Deceased purchased a house on or before 19th September, 1985 the CGT exemption continues for a period from the date of death until it is sold if during that period it has only been occupied by the spouse of the Deceased and/or the beneficiary and/or any other person given occupancy rights under the will. In this case the exemption will apply for the whole period. If it is not occupied by these people the exemption only lasts for 2 years. Refer section 118-195 for more specific details on when the 2 years can be exceeded.

Post 19th September, 1985

If the Deceased purchased his or her main residence on or after 20th September, 1985 the CGT exemption will only apply if the home is sold within two years of death and only if the deceased was living in it at date of death and not using any part of it for income producing purposes at the date of death. If part of the home was used for income producing purposes at the date of death the exemption is apportioned under section 118-200. If the whole of the property was rented out at date of death but had been the Deceased's home within the previous 6 years, section 118-190(4) states that the 6 year rule under section 118-145 can deem the home to be the Deceased place of residence at the date of death if no other residence is covered by the Deceased's main residence exemption.

The fact that the deceased may have used the property for income producing purposes at some earlier date is irrelevant providing the property was only used as a main residence for the Deceased at date of death or the 6 year rule applies and it was only used as the Deceased main residence before being rented.

In All Cases

If selling the home within two years of the date of death it does not matter what the beneficiary or trustee does with the Deceased's home between death and selling. For example it can be rented out - section 118-190(1) and TD 1999/70. This is the case regardless of whether the home was purchased before 20th September,1985 or afterwards.

Please note there are many little peculiarities regarding the concessions for Deceased Estates. The above is only a guideline for simplistic situations.

Superannuation and Death & Disability Insurance

Reference Part IX of the Income Tax Assessment Act 1936 (ITAA36)

Self Managed Funds:

Under Subsection 279(2) of ITAA36 a tax deduction is available to a superannuation fund for the full notional cost of a death and disability insurance policy to cover the life of a member even if the fund elects to only partially insure for its liability under a superannuation policy. That is, the fund can claim a deduction for insurance it has decided not to take out because the assets of the fund will cover the risk anyway. Note an actuarial certificate must be obtained (279(3)) but the cost of this is also tax deductible.

In the year a member dies or is disabled it may not be advantageous to claim this deduction or a deduction for any actual premium paid refer 279B. The advantage gain depends on the future of the fund after the member's death. If this is the case, an election can be made under 279(4). This election can be made on a member basis and does not have to be done until after the relevant financial year.

Members of Superannuation Funds:

Section 279D of ITAA36 allows a superannuation fund to, in the event of the death of a member, claim back the tax paid on contributions and pay it to the estate or dependants as part of a death benefit. Note this applies only to amounts that have been taxed in the hands of the fund - not undeducted contributions or proceeds of an insurance policy. It is unusual for a public superannuation fund to apply this so it is worth checking that their deed allows you to claim this entitlement and that they do apply it. Note a fund cannot use 279B and 279D in the same year so the benefits must be compared.

Will Preparation Checklist

The following is by no means an all inclusive list. It is simply a summary of the issues discussed in our Estate Planning Seminar. This list should only be used as an aid to discussions with your solicitor.

1) Consider giving the Executor of your estate the flexibility to decide whether to sell the estates assets or pass them to beneficiaries in specie. This will allow your Executor to make the most of CGT concessions and make the most of the differences between the estate's and the beneficiaries' marginal tax rates.
2) If you bequeath particular assets to certain beneficiaries make sure you consider the associated CGT liability when considering the value of the asset they receive. For example if you leave your home to one child and your rental property to the other and they both sell the properties within 2 years of receiving them. The child who inherited your home will have no CGT liability but the child who receives the rental property will probably have to pay CGT out of the proceeds of the sale.
3) Avoid granting a life tenancy.
4) If you intend leaving money to a charity that has tax deductibility status consider doing this before you die so that you can take advantage of the tax deductibility. If the charity receives the funds as a distribution from your estate it is not tax deductible. Not even to your estate. Another strategy is to leave the charity's money to one of your beneficiaries with instructions that it must be donated to the charity. The beneficiary would then be entitled to a tax deduction.
5) Don't rely on just one Executor. Make sure you appoint default Executors in case your Executor pre deceases you.
6) Do not leave an amount to your Executor, in your will as payment for them executing your will as this will be taxable income to him or her. It should be clear that any amount you leave your Executor is a gift unrelated to the services they perform as Executor.
7) Consider a Testamentary trust if your beneficiaries may lose their inheritance through legal action against their personal assets. If you do choose a testamentary trust make sure the deed does not permit the trustee to admit new beneficiaries as this will compromise the trust's status as testamentary.
8) If your spouse is receiving the age pension the asset test is much lower for a single person. To assist your spouse in meeting this lower threshold you should consider leaving some of your assets to your children rather than your spouse. Your children would then, hopefully, be in a position to help your spouse out when needed.
9) Before you go to your solicitor make sure you have the following information:
    - Personal details (Surname, Given names & Address)
    - Children (Names, Ages & Addresses)
    - Other beneficiaries (Names, Ages & Addresses)
    - Executor
    - "Reserve" executor
    - Summary of assets and details of the ownership of assets

- Details of any liabilities
- Details of insurance policies
- Details of superannuation funds and whether advisory/binding death benefit nomination has been made
- Wishes in relation to burial/cremation
- Wishes in relation to guardianship of any infant children
- Wishes in relation to organ donation

Thanks to Cec O'Dea from Schultz Toomey O'Brien Lawyers for his help in compiling this list. Cec's phone number is (07) 5413 8900

Estate Planning Through Superannuation

The only way to claim a tax deduction for your life insurance is to include it in your superannuation and if possible, then claim a deduction for the superannuation contribution (it may be necessary to salary sacrifice if you are an employee).

This article addresses the problem of then directing the benefits of the life insurance. Currently Superannuation law only allows the trustee of the super fund to decide or the person insured can make a binding nomination but after 3 years the binding nomination lapses and the power reverts to the trustee. This is ok if you can remember to renew your binding nomination every 3 years. Macquarie have a policy that allows you to have a non lapsing nomination by the trustee assigning its default power to you. Macquarie have sought legal council's opinion in this regard and are extremely confident that this arrangement will stand up to any challenge.

Inheriting a House

Avoiding CGT on Death

There is no Capital Gains Tax (CGT) payable on death unless the beneficiary is a non resident for tax purposes, a superfund or an entity exempt from tax. Section 128-15 ITAA 1997 covers the basic rules. It states that any capital gain tax event is disregarded on the transfer from the deceased to a beneficiary or to the executor and then to the beneficiary. The trouble is transfers to a testamentary trust are not included in the legislation so the transfer to the testamentary trust is exempt as it is considered the beneficiary but when the testamentary trust ultimately transfers to the beneficiary that transfer is not exempt. In PSLA 2003/12 the ATO recognises that this is the case at law but has agreed to treat a transfer from a testamentary trust to a beneficiary as exempt. A testamentary trust is one created by a will. This may be fine if you are currently a beneficiary of a testamentary trust but it does create an element of doubt if you are preparing your will as PSLAs are only ATO statements of practice and can be withdrawn at any time.

Note disregarding the capital gain event does not mean the asset is exempt from CGT while in the testamentary trust, the clock is ticking but a transfer from the trust to a beneficiary does not trigger a tax liability, the beneficiary takes over the asset at the cost base to the trust.

How the Cost Base Is Calculated

Hopefully, the above means the beneficiary has now received the house tax free. Section 128-15 also explains how the cost base is set. For houses acquired by the deceased prior to 19th September, 1985 the cost base is simply the market value at the date of death. This is regardless of where the deceased was living and whether the house was a rental.

If the house was acquired post 20th September, 1985 its cost base is the deceased's cost base unless it was the deceased's home at date of death, then it is inherited at the market value at the date of death. It does not matter if during the time the deceased lived there it was also used to run a business or partially rented out as long as this was not the case at the date of death i.e. it was only used as their home. Note section118-190 states you can use section 118-145 to have a house that was previously the deceased's home and not partially rented or used to run a business while the deceased was living there, considered the deceased's home at date of death even though he or she was not living there. This applies for up to 6 years before death if the home was rented out while the deceased was absent and indefinitely if it wasn't rented. Of course the concession associated with the deceased's home only applies to one property so if possible it should be applied to a post

20th September, 1985 property if the deceased had once lived there. If the deceased's home was purchased post 20th September, 1985 and he or she was partially using it to produce income at the date of death i.e. running a business from home or had boarders then the market value concession is not available. Accordingly, it is inherited at the deceased's cost base

Extending the Exemption Beyond Death

Section 118-195 allows an inherited house to continue to be exemption from CGT in certain circumstances. These concessions apply to a house that was the deceased's home at date of death or is deemed to be the deceased's home under section 118-145. They also apply to a house that was purchased by the deceased prior to 20th September, 1985 even if the deceased never lived there. So again, just as is the case with the cost base rules, if the deceased has lived in more than one property in the 6 years prior to death and you can choose between a pre 19th September, 1985 property and a post 20th September, 1985 property it is best to choose that the post 20th September, 1985 is the main residence. Note if the post 20th September, 1985 property was the deceased's home but was also used to produce income at the date of death (for example taking in boarders or running a business from home) then these concessions do not apply

If you sell a property that qualifies above then there is no CGT payable if it is sold within 2 years of the date of death. But be careful 1 day over the 2 years and you will have to pay CGT on the difference between the market value at date of death plus any non deductible costs associated with it and the selling price. This is where diligent record keeping can save you heaps. You can increase the cost base by any cost of acquiring title in the property, selling it, improvements and any holding costs you have not claimed against rental income. Holding costs include rates, interest, insurance, land tax, repairs and maintenance (Section 110-25). It is the repairs and maintenance that has huge potential, you need to get a big box and keep receipts for lawn mowing, plants, even changing a light globe, etc.

The 2 year limit is extended indefinitely while the house is the main residence of the spouse of the deceased or a person given the right to occupy the house under the will (i.e. life tenancy). There is a further concession if the occupier of the house from date of death until the eventual transfer of the house is a beneficiary entitled to receive all or part of the house (but not a life tenant). They would not be subject to CGT on what is technically their share of the sale proceeds. But if they had to buy out their fellow beneficiaries those beneficiaries will be subject to CGT on the proceeds unless they qualify for one of the other exemptions under section 118-195 as discussed above.

Note if you sell a pre 20th September, 1985 property or the deceased's home within 2 years of the deceased's death it does not matter who lives there or even if it is rental (118-190(1)), no CGT applies.

If the deceased made considerable post 19th September, 1985 improvements to a pre 20th September, 1985 property section 108-70 would have classed these improvements as a separate asset and thus subject to CGT. Fortunately, this problem dies with the deceased so such a property is simply inherited at the market value of the whole property even if the deceased never lived there. The same concessions apply if the deceased had used a post 20th September, 1985 property as a rental or for income producing purposes while living there. If the deceased had sold the property while alive he or she would have had to pay CGT on a portion of the gain. Apportionment is not necessary if the property is sold by a beneficiary or executor of the estate provided at the date of death the property was not partially used for income producing purposes i.e. it was totally the deceased's home or vacant or totally rented out but covered by the 6 year absence rule then it is simply inherited at the market value at date of death (Section 118-195).

Tips

The 50% discount is available on the sale of a house you have inherited even if you have not held it for 12 months, providing it is 12 months since the deceased entered into the agreement to purchase it. Section 114-10(6) and TD 94/79.

Leaving a beneficiary the right to occupy the house can cause major restrictions and CGT nightmares if things do not go specifically according to plan. Many of the problems surrounding this issue have not yet been addressed by the courts or ATO rulings so I cannot draw conclusions but the CGT laws as they currently stand could be interpreted to mean that should the person entitled to life tenancy ask the eventual beneficiaries of the house (remaindermen) to sell the home so they can move elsewhere such as a retirement village both the remaindermen and the life tenant could be subject to CGT on the transactions with a zero cost base.

There are more sections of CGT law relevant to this topic but they cover less common circumstances, and many little traps, in particular life tenancies are a minefield. So it is important to seek professional advice on your particular circumstances before you act on this information

Churning Investments Offset Losses Before Death

Any capital losses accumulated by the deceased are lost on death i.e. the estate cannot utilize them. When planning your estate it may be worth churning some post 20th September, 1985 assets to offset the loss and reset their cost base at a higher rate for the benefit of your beneficiaries. This may not be economical considering the transaction costs associated with houses but may be worth it for shares.

Life Tenancy - Wills

The form of life tenancy covered in this article is when the deceased leaves, through the operation of their will, a beneficiary (the life tenant) the right to occupy a property, owned by the deceased, until the life tenant dies. When the life tenant dies the property passes to another beneficiary or beneficiaries (remaindermen). This works reasonably well if the life tenant is happy to spend the rest of his or her life in that particular property but creates real problems and huge tax consequences if things don't go according to plan.

Warning, most of the following is based on TR 2005/D14 which is a draft ruling but we have been waiting over a year for the ATO to finalise it and 20 years just to get to the draft stage so there seems little point in waiting until we can be sure. But you should not act solely on this information in fact you should apply to the ATO for a ruling before you act on any of the issues discussed below.

Example 2 in TR 2005/D14 covers a **typical situation where the life tenant lives in the property until they die**. There are no CGT consequences for the executor of the estate, the life tenant or the remainderman. That is until the remainderman decides to sell the house after the life tenant has died.

TD 93/37 states that the remainderman is deemed to have acquired the property at the date of the original deceased's death, not the date of the death of the life tenant. This may mean people today are still inheriting assets that are classed as pre 1985 assets because the life tenant lived for another 21 years. TD 93/37 does not say if there is a difference in the treatment if the will created a trust to provide the life tenancy rather than a direct registering of the life tenancy on the title.

Even when all goes according to plan the remainderman's cost base varies depending on the legal circumstances of the life tenancy. If the will sets up a trust to hold the property the remainderman's cost base is the cost base at date of death (defined below). PLSA 2003/12 allows the transfer from a testamentary trust to the ultimate beneficiary to be protected by the exemption (rollover) in 128-10 that transfers on death do not create a capital gains tax event.

On the other hand giving the life tenant a direct legal interest means that the cost base at date of death is apportioned between the remainderman and the life interest. The life expectancy of the life tenant and the discounted cash flow of the rent during that period would contribute to the calculation of the life tenant's share of the cost base. The cost base of the life tenant dissolves on his or her death, even though the full rights to the property now transfer to the remainderman he or she is still left with his or her original apportioned cost base (TR 2005/D14 paragraph 137).

The cost base at date of death is, if the property was a post 19th September, 1985 asset in the hands of the deceased is the original deceased's costs base. If the property was the deceased home at date of death or a house the original deceased purchased before 19th September, 1985 then the cost base at date of death is the market value at date of death.

Now what if the life tenant decides they would prefer to live somewhere else, for example the property may become too hard to manage or he or she may need the extra care provided in retirement villages. **They may decide to sell the home and buy something more suitable or the life tenant may simply say you can have it now**. Either way the life tenant will have to give up his or her interest in that home, probably for no consideration. This is where the capital gains tax nightmare begins.

TD 93/37 does not address the situation where the life tenant moves out and I doubt that in the case of the life tenancy being held in a trust that the remainderman would be considered to have acquired the property at date of death if they received the property before the life tenant died. But if the will created a life tenancy direct onto the title of the property the date the remainderman acquired that property would be the date of

death of the original deceased but if they end up with the property before the life tenant dies they have acquired a second asset (at market value) at the date the life tenant gave them all rights to the property.

TR 2005/D14 states that in the case of a life tenancy that exists because the will created a trust over the property, then, if the property is actually transferred to the remainderman, before the life tenant dies, this is not a transfer under the will so no CGT rollover applies. This means that the trust has to pay CGT on the difference between the cost base at date of death plus holding costs etc and the market value at the time of transfer. Paragraph 56 of TR 2005/D14 confirms that the trust created by the will to hold the property is entitled to an exemption from CGT under section 118-195 for the period of time the property is the residence of the life tenant, if before the original deceased's death it was his or her home or if the original deceased purchased the home pre 19th September, 1985.

The remainderman will receive the property with a market value at time of transfer as his or her cost base. But the trap is that the life tenant and remainderman are also disposing of their interests in the trust. In the case of the life tenant he or she is deemed to have received market value for surrendering the right to live in the house (section 104-80) with zero cost base (section 112-20). The remainderman would also technically make a gain or loss under section 104-85 on the disposal of his or her future right to the house but fortunately this gain is ignored.

If the will did not create a trust but simply gave the life tenant and remainderman their legal interest on the title deed then a sale of the property before the death of the life tenant is a disposal of these legal interest. The estate is no longer involved, it is just a normal disposal of an interest in the property. The life tenant and remainderman get the deceased's cost base at date of death but have to apportion it between them. The primary factors being the value of the life tenancy base on the life expectancy of the life tenant and the rental income potential.

Now, what if the life tenant simply says look I don't want to live here anymore let the remainderman have the house? The life tenant is deemed to have disposed of his or her interest at the market value. The market value would be calculated considering the discounted cash flow of the rent value of the house and the life expectancy of the life tenant.

If the property subject to the life tenancy is held in a trust created by the will then the life tenant's only cost base would be any legal costs incurred in sorting out the mess. So for the life tenant under a trust, to give up their right they would somehow have to come up with the money to pay quite a large capital gains tax bill. Enough to make you hope no one ever makes you a life tenant, though if you act quickly after you become aware you have inherited a life tenancy you can disclaim it with no CGT consequences.

If, on the other hand the life tenancy is under a will but no trust is set up then the tenancy is registered on the title and it is a legal interest. This means that the estate actually transferred an asset to the life tenant so that life tenant is entitled to a cost base being the market value of the life tenancy. Given that one of the factors determining the market value is the life expectancy of the tenant the market value should decrease over time accordingly, this should only create a capital loss for the life tenant.

If you find yourself in the position of a life tenant or remainderman you can act quickly and dissolve the problems. If the life tenant and remainderman want to change the way the will, will be executed and do so right from the start no CGT events take place. Effectively they **disclaim their interest**. If the life tenant does this the remainderman receives the property as a normal beneficiary. If the remainderman disclaims his or her interest the residuary beneficiaries become the remaindermen. If the life tenancy goes along normally after that, the executor or beneficiaries' (if transferred in specie) cost base is the deceased's cost base at date of death, explained above.

Note all of the above only refers to life tenancies created by a will. A **life tenancy created outside a will** is treated completely differently. For a start the creation of the life tenancy triggers a CGT event at market value if the giver is still alive.

Conclusion:

Avoid life tenancies if at all possible. If the life tenant has a long life expectancy or clearly will not be able to continue to live in the home it may be better to simply bequeath them the home, first telling them that you would like them to leave it to the person you intended to be the remainderman. You have to weigh up legally protecting the remainderman's interest compared to restricting the life tenant's accommodation choices or lining the ATO coffers.

Please remember this is all based on a draft ruling, I have some concerns about the rulings thought process, the limit of the issues considered and the conclusions it draws. Even if the ruling proves to be a correct interpretation of the legislation, this may not have been what the government originally intended. So parliament may even change the law to sort out the inequities. This is a very difficult situation in which to prepare a will that will have effect many years in the future. It is ridiculous that, 21 years after capital gains tax was introduced, we still do not know with certainty how life tenancies will be treated. Not that it is the ATO's or governments problem because they have very cleverly introduced self assessment. This means that it is up to the individual taxpayer to interpret the law and prepare their returns correctly. Any help from the ATO in this regard is a privilege not a right and cannot be relied on to protect you should they change their minds later when it is too late to change your will.

Life Tenancies Table

For readers who are still trying to digest the article above on life tenancies the following table gives a summary but should not be viewed on its own. The detail in Newsflash 134 should also be reviewed. The moral of the story is to avoid life tenancies if at all possible.

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Death Bed Superannuation Withdrawals

From the 1st July 2007 people over 60 and retired will not pay tax on withdrawals from their superannuation fund. If you die and your superannuation is paid to your spouse or dependants they will not be taxed on it either. There is a trap here, if you are over 60 without a spouse or dependants (children under 18yrs). If you die your beneficiaries will have to pay tax of 16.5% on some, even all of the money they receive from your superannuation fund. Whereas if you had taken it out during your lifetime you would have received it tax free and have been able to pass it onto them through your will tax free. There is all sorts of talk at the moment about leaving a signed withdrawal form for your beneficiaries to lodge before informing the authorities of your death. Hopefully, the government will make this situation a bit more reasonable before 1st July, 2007.
This should concern you even if you have a spouse as you may be both killed in the one accident.

CGT 50% Discount & Deceased Estates

A reader was concerned that she would have to hold onto the shares she inherited from her father for 12 months from the date of death to claim the capital gains tax 50% discount. The discount is available when

assets are held for longer than 12 months but in the case of a deceased estate the 12 month holding period starts from the time the deceased bought the shares. Not the date of death. Refer Section 114-10(6) and TD 94/79.

If you are the beneficiary of a deceased estate you should make sure you know the market value, at date of death, of any assets held by the deceased before September, 1985 and the market value of their principal place of residence at the date of death. For post September, 1985 assets you should ascertain the cost base to the deceased as this will become your cost base.

Bequeathing Your Shares Through a Life Tenancy or Trust

We call it the 45 day rule. In order to be able to claim the franking credit that comes with most dividends you must have held the shares for at least 45 days. This can be a problem if you received the franking credit through a trust ie you don't hold the shares or a fixed interest in the trust. Small investors need not worry because they can claim up to $5,000 in franking credits before being caught by this rule.

Creating a Life Interest (Life Tenancy) in shares you own means that you leave the income stream from the shares to a beneficiary for the rest of their life (the Life Tenant). When the Life Tenant dies the shares are given to another beneficiary (the Remainderman). A will that leaves a life tenancy interest in shares would normally set up a testamentary trust to hold these shares. A deceased estate holding a life tenancy will pass the 45 day rule but if the estate is wound up and a testamentary trust set up to hold the shares the rule is not passed by the life tenant as they do not have an interest in the assets of the trust only the income.

On 20th March, 2006 the government announced they were going to change the law to fix this problem and it would apply retrospectively back to 1st July, 2002. As at 16th October, 2006 a bill covering this problem had not even been submitted to Parliament.

In the meantime we recommend that you do not leave a large amount of shares in this way. If you are executing an estate at the moment it may be worth delaying finalising it if there is a life tenancy on a large amount of shares that are likely to generate more than $5,000 in franking credits per beneficiary. Another option, if the beneficiaries are related, is to make a family trust election so that the franking credits can be claimed. The media release did say that testamentary trusts that make a family trust election to overcome this problem will be entitled to revoke it once the changes to the law go through. Remember this is all based on a media release so there are no guarantees.

Beneficiaries of a testamentary trust that is discretionary (ie each year the trustee can decide who gets what) are also caught by the 45 day rule if a beneficiary receives more than $5,000 in franking credits. The media release did not state any intention to fix this. Accordingly, large portfolios of shares should not be held in a testamentary trust unless it can make a family trust election.

Small Business Concessions and Death

If you have a business that qualifies for the simplified tax system or the net assets of the business and its associates??? is less than $6million, you may qualify for concessional taxation treatment when you sell the business. But will these concessions apply if you die before selling the business. For example will the trustee of you estate, if they continue to operate the business and then sell it, be entitled to the same tax concessions you would have been?

This is an area of tax law that has very little to rely on in the way of ATO rulings and case law. So we have to look at the words of the legislation. There seems no legislative impediment to the trustee of your estate utilising the 15 year exemption

Death & Taxes and the Defence Forces

If you die in the Defence Force, you are released from any unpaid liability for tax on Defence Force pay and allowances. Not something to get too excited about as the tax has probably been deducted correctly from your pay anyway. Section 265A 1936 ITAA.

Inheriting a Rental Property Trick

If you inherit a house that was a rental property of the deceased and he or she purchased after 19th September, 1985 it probably has a large capital gain attached to it. If you are in business or can think of a business you would like to dabble in, move the business into the rental property. This will make the rental

property a small business active asset which qualifies you for additional CGT concessions if you elect to operate the business in the simplified tax system or you and associates have net business assets of less than $6,000,000.

As long as more than12 months has passed since the deceased purchased the property you will qualify for the 50% CGT discount when you sell the property. As a result of moving a business into the property you will qualify for further 50% discount if the property is considered an active asset (refer section 152 1997 Act). To be an active asset the inherited house needs to be used in your business for at least half the time you own the house or 7.5 years whichever is the shortest. The period starts from the time you inherited the property not from the time the deceased purchased it so it will not be hard to use it in the business for half the time you own it.

By the time you utilise the 50% CGT discount and the 50% active asset discount you are left with only 25% of the gain taxable. If you are over 55 years old you can utilise the retirement exemption to receive the remaining 25% tax free. If you are under 55 and you don't want to pay tax on this remaining 25% you can roll it over into another active asset for your business or contribute it to a superannuation fund until your are 55. Note this contribution will not be taxable in the hands of the superannuation fund.

Will Preparation – Gifts to Charities

Leaving money or assets to a charity that is a tax deductible gift recipient, in your will can be more tax affective with good planning. Division 30 will deny your estate a deduction for the gift unless it is to a Cultural Bequests Program, public library, art gallery etc. A distribution from you estate is not normally considered a donation as such. It gets even worse if you leave an asset to a charity that is simply exempt from tax but not a tax deductible gift recipient, in this case you would have to pay the CGT, in your Date of Death tax return.

Clear as mud? Let's look into the tax ramifications of each possible method. For example if you had $20,000 worth of BHP shares and $20,000 worth of Rio Tinto shares. Keeping it simple, assume both parcels were purchased in 1995 for $10,000 each so there is a capital gain of $10,000 involved in each parcel. If you want to bequeath the BHP shares to the local community association which is tax exempt but not a deductible gift recipient then according to section 104-215 of the 1997 ITAA the tax must be paid on the capital gain (in the Date of Death return) before the shares go across to the exempt association because once in the association's hands they will not be subject to tax. The alternative is for the estate to sell the shares first then give the proceeds to the community association. Tax here can be avoided but only with very careful planning by the executor of your estate. The shares should not be sold until all other matters in the estate are finalised then the estate would be in a position to make the community association presently entitled to the capital gain, which means that the community association is the one who pays the tax on the gain and as it is exempt no tax would be payable. If the shares are sold before the estate can be finalised it would be the estate that would have to pay this tax which is the difference between your cost base and the selling price or market value if not arms length. Providing this is done within the first 3 years after you die the estate will be entitled to the same tax rates as if you were alive ie the tax free threshold and stepping up of the tax rates as income increases. This usually means the gain does not attract a very high tax bracket but zero tax is always much better.

Section 104-215 also catches the Rio Tinto shares which we will say, for the sake of argument, you intend to leave to the RSPCA. As the RSPCA is an exempt body your Date of Death tax return would have to include any capital gain on the Rio Tinto shares, except for the operation of section 118-60 which states that if the beneficiary is a tax deductible gift recipient then the requirement of 104-215 is ignored. So all is well if you transfer the Rio Tinto shares in specie to the RSPCA but what if the estate sells them first to transfer the cash. As stated above a bequest to a tax deductible gift recipient is not tax deductible because it is not a donation. If your will simply requires the RSPCA to receive $20,000 and the estate sells the Rio Tinto shares to pay this amount then it will have to pay the CGT, something that would not happen if the shares were transferred in specie. Again if your executor organises for your estate to be in its final stages just before the sale of the shares the RSPCA can become presently entitled so no tax would eventuate Another way of making the RSPCA presently entitled is to specify in your will that they are to specifically receive the proceeds of the sale of your Rio Tinto shares.

. In short something as simple as the order of events in the process of winding up your estate can make quiet a difference to the tax payable so it is worth getting professional advice for the executor and taxation advice when preparing your will. Section 104-215 might have been intended to prevent CGT being avoided by leaving assets to tax exempt bodies but all it has really achieved is catching the unwary.

Cunning readers would now be thinking how about if I leave the Rio Tinto shares to my high income earning daughter specifying she is to donate the proceeds of the sale to the RSPCA. You see section 128-10 states that providing the beneficiary isn't tax advantaged (ie exempt) the transfer of the asset to that beneficiary will not attract CGT. She may have to pay tax on the capital gain when she sells them to make the donation but she would be entitled to the 50% CGT discount and then get a tax deduction at her full marginal rate for all the proceeds of the sale, not just the gain. The trap here is that if your will specifically stated that a donation must be made then your daughter would not be considered the true beneficiary under section 128-20 so the rollover relief from CGT when transferring the asset to her would not be available. You can only explain to her before you die what a clever idea that would be. Even better still, what if the estate sells the asset to give her an amount you set in your will. In this case the estate would have to sell early in its administration because you wouldn't want your daughter to be presently entitled and to this end you would not want to specify that she receive the proceeds of the sale of a particular parcel of shares. The estate would be taxable on the proceeds instead her and if the sale takes place within 3 years of your death then the estate could utilise the 50% CGT discount and adult resident tax rates so probably pay less tax then your daughter. She could then receive the distribution of cash donate it to the RSPCA and the taxman would give her a nice fat refund cheque because you organised your affairs so well. Though she should be careful, if the donation is large, she needs to spread it over a few years rather than use up her tax free threshold and be wary that a donation cannot create a carried forward loss. Again you cannot specify in your will that she makes the donation.

Police Credit Union and Deceased Estates

It is no longer necessary to obtain the granting of probate to execute a deceased estate. This was a concession introduced years ago so that simple estates did not have to incur the legal costs. Most banks have a limit of $50,000 to $80,000 before they will ask for probate to be granted to release the deceased's funds. Probate by the way is going to the courts to verify the will.

The police credit union is not so considerate. If you have as little as $15,000 invested with them they will require you to incur the legal costs of having probate granted. This is even the case if the funds are going to the widow. In a recent case the police credit union refused to release funds to the widow of the deceased even though she had been his wife for over 50 years, all the deceased's children signed to say they wanted the money to be paid to their mother, the will specified she was the beneficiary and the executors where the children. Imagine being a pensioner, losing your husband and not being able to access his meagre savings of $15,000 to pay for funeral costs simply because you could not afford the legal fees to have probate granted. I wonder what happens when they can't afford probate? Who gets to keep the money?

Death Carried Forward Capital Losses

Any capital losses you have accrued in your life time die with you. Not even your estate can use them. So it is worth considering triggering a capital gain before your death to use them up. Even if you put the proceeds back into another investment at least the cost base for your heirs will now be closer to the market value at the date of your death.

Warning, do not sell pre CGT assets to achieve this. Firstly, they will not trigger a capital gain against which you can offset your losses and secondly pre CGT assets are always best to keep as long as possible because there will be no CGT liability on any gain in your life time.

50% CGT Discount and Death

There has been a fair bit of misinformation about this topic lately, even the Financial Review reported it wrongly. It is the question of whether a beneficiary of a deceased estate has to wait 12 months from the date of death before they qualify for the 50% CGT discount on the sale of an asset owned by the deceased. In

most cases they do not have to, if 12 months has expired since the deceased acquired the asset, the only exception is an asset that was acquired by the deceased before 20th September, 1985 which was not a dwelling.

Section 128-15 states that any post 19th September, 1985 assets received from a deceased estate are received at the deceased's cost base and section 115-30 says that you are deemed to have acquired the asset on the same day as the deceased. So providing the deceased, the estate and yourself have in total held the asset for more than 12 months you do not have to worry in relation to any post 19th September, 1985 assets.

Section 128-15 also states that the deceased's home and any asset acquired prior to 20th September, 1985 are inherited at the market value at date of death. Section 115-30 adds that these assets are also deemed to be acquired at the date of death. But section 118-195 allows the estate or a beneficiary at least 2 years in which to sell a dwelling that was a pre 20th September, 1985 asset in the hands of the deceased or the deceased's home at date of death, with no CGT consequences.

Accordingly, the 12 months from date of death only becomes an issue if you are inheriting an asset that was acquired by the deceased pre 20th September, 1985 and is not a dwelling and up to 2 hectares of adjacent land. Even then considering these pre 20th September, 1985 are inherited with a cost base of the market value at date of death then it is unlikely, considering selling costs, that there will be much capital gain anyway.

Guardianship of your Children

I had an interesting conversation with Karen McGlinchey who, incidentally, advertises her legal firm on our home page. She said that it is common for a couple to go into all the details of their Will but when asked about guardianship they can't decide and as a result the Will is quite often never completed.

As a former foster carer this alarmed me. To think that parents can be so irresponsible to risk that their children, in a state of shock from losing both their parents, be dragged from their home to be processed by officials and placed in foster care while the courts sort it out. While I have met a lot of lovely foster carers, some places are very rough and it is always a struggle to keep siblings together.

The most common excuse I hear is that things could change for the person appointed or the children's needs may change. Consider appointing a person who may not necessarily be the one who will care for your children ie a parent that maybe too old. But that person has the right to decide what happens and just keep them up to date with your wishes.

Next time your family gets into the car have a look at the seating arrangement. If you had a head on collision the children in the back are a lot more likely, than both parents in the front, to survive, especially the baby in the capsule. Please do it now.

Estate Planning with Two Post CGT Houses

Very similar to our favourite trick for people living in a Pre CGT home to cover their holiday home with their main residence exemption instead.

This trick is for readers with a holiday house or rental property they are prepared to live in (for a while) in that was purchased after 19th September, 1985 and the same with their home. You may not want to sell either one and you may prefer to spend most of your time in the one you have covered with your main residence exemption all the time you have owned it. The temptation is that if you sell it now all the capital gains will be tax free and if you then move into the holiday home and it is still covered by your main residence exemption when you die then your heirs will inherit the holiday home with no capital gains tax liability up to its market value at your date of death. If you still own both when you die, your heirs at best can choose which one to cover with your main residence exemption.

So the trick is, if you still want to keep and live in your original home, is to sell it to your children. For one dollar if you like. Their cost base will be the market value at the date of the transfer and it will no longer be covered with a main residence exemption unless they live there so this is something to do late in life. You will still need to pay stamp duty at the market rate. Then you move into the holiday home and establish it as your main residence. Section 118-145 allows you to move back into the home your heirs now own but continue to cover the holiday home with your main residence exemption. If the holiday home is then used to produce income you can only cover it with your main residence exemption for six years before you will have to move back in and reset the 6 year clock. But if it is a holiday home that never earns income the 6 year

limit does not apply so you can cover it with your main residence exemption for an infinite period while you live in your old home that is now owned by your heirs. If the holiday home is sometimes used as a rental then you have to add up these periods and once they total six years you will need to move back in and reset the 6 year clock but any gaps in between, when it is not used to produce income do not affect the 6 year count.

CGT Cost Base Of Inherited Property

Asset acquired by the deceased before 19th September, 1985 and the deceased's home at date of death are inherited with a cost base of their market value at date of death. All other assets are inherited with the same cost base that the deceased would have used if he or she sold the assets on the date of their death, reference section 128-15(4).

Section 128-15(5) allows you to increase this cost base by any expenditure the estate has incurred on the property between the date of death and you receiving the asset, for example rates on land.

ID 2004/425 further includes in the cost base of an asset the legal fees for sorting out the rights to that asset. Further section 110-25(6) would include the beneficiaries legal costs in dealing with the estate as it includes in the cost base of an asset expenditure incurred to "establish, preserve or defend your title to the asset".

ID 2001/729 specifically includes probate in the asset's cost base, though it would need to be apportioned between all the assets of the estate.

IT 2622 looks at who will pay the CGT if the estate sells the asset. Generally it would be the estate and this is not a bad outcome because in the first 3 financial years after death the estate will be taxed as a normal adult taxpayer, for example, qualify for the tax free threshold. After the 3 years are up it will probably be taxed at 19% but at worse it may be taxed at the maximum rate, currently 46.5%. If it is the final year of the estate when the CGT event takes place then IT 2622 provides an opportunity to have the beneficiaries taxed on the capital gain rather than the estate, if that provides a better tax outcome.

ATO Discretion To Extend 2 Year Rule on Deceased Estates

Section 118-195 allows the beneficiaries of a deceased estate up to two years from date of death to sell the deceased's home and any pre 19th September, 1985 dwellings, with absolutely no CGT consequences. But, under the letter of the law, one day past the 2 year mark (this is based on settlement date not contract date) and CGT will apply to any gain over the market value at date of death, plus holding and selling costs.

The section has now been amended to allow the ATO discretion to extend this period for sales that happen in the 2008/09 financial year and all following years. If you know of an estate that has already paid CGT under these circumstances, the estate should apply for an amendment to the tax return. As the law has been changed there is no limit on the number of years back the amendment can be but of course it cannot apply to capital gains on which a contract was signed before 1st July, 2008.

It appears this change was brought about after a submission was made by the law society that legal complications can prevent the beneficiaries from being able to sell the property within the 2 year period. So while there are no guide lines yet on how the ATO will apply this discretion, it does appear that the best argument would be that it was not possible to sell the property because of legal problems.

The actual changing to the wording of the legislation is to add "or within a longer period allowed by the commissioner".

Transferring Shares to the Beneficiaries of a Deceased Estate

The executor of a deceased estate can make a huge difference to the value of the estate by simply considering the beneficiaries' individual circumstances. For example before an executor distributes shares owned by a deceased to the beneficiaries the CGT consequences need to be considered. The first step would be to calculate the capital gain associated with each parcel of shares. Even if the shares are not going to be sold this is very important as the beneficiaries still need to know their cost base.

If the shares were purchased by the deceased before 20th September, 1985 they are inherited with a cost base of the market value at the date of the deceased's death. This means that they can be sold now for with minimal capital gains tax. Or they can be passed to a beneficiary in specie and that beneficiary will only

ever be liable for CGT on the gain from the date of death, the beneficiary does not inherit any ongoing tax bill. Obviously the beneficiary that gets these shares is truly getting a legacy of the face value of the shares.

On the other hand a beneficiary who inherits shares acquired by the deceased after 19th September, 1985 will inherit the deceased tax bill as well so their true legacy is less than the face value. To fairly divide the estate it may be necessary to take this into account.

With some careful planning the executor can maximize the benefit received by each individual by considering their tax bracket and asking them whether they intend to sell the shares or not.

If a beneficiary intends cashing in the shares then consider selling them within the estate and distributing the cash instead. For the first three financial years after the deceased's death the estate is treated like an adult for tax purposes so it will get approximately $18,500 tax free and then be taxed at 19% up to $37,000 etc but with no Medicare levy payable. So it is quite likely that the estate will pay less capital gains tax than the beneficiary. If the beneficiary intends to keep the shares then think about the tax bracket they are likely to be in when they sell the shares. If it is high then they will get the most benefit from inheriting the pre 1985 shares or shares that were purchased post 1985 but are now worth less than the price the deceased paid for them. Beneficiaries in a lower tax bracket are going to be less affected by inheriting the deceased's unrealized capital gain.

When planning your estate it is important to give your executor the flexibility to sell or distribute in species and to decide which actual shares go to which beneficiary even if the overall value they receive is defined by the will. It is also important that your executor knows where to access information about the cost base of your shares including any dividend re investment programs you have participated in.

Are Any Of Your Heirs Living Overseas?

When your heirs are given specific assets from your estate section 128-10 states that this transfer is free of CGT except when the asset is transferred to a super fund, exempt taxpayer (unless they are a tax deductible gift recipient) or a foreign resident for example your heir lives overseas. This means if you transfer a rental property in specie (direct transfer not the sale proceeds) the estate will have to come up with the funds to pay the CGT accumulated on the property at death, which will considerably reduce the amount available to pay your residual beneficiary. This even applies if the property is located overseas.

So if one of your heirs is likely to be living overseas when you die it may be worth planning to leave them cash, Pre 20th September, 1985 assets or the home you are living in as theses will not be subject to CGT. Leave your heirs who are residents of Australia your rental properties and other investments purchased after 19th September, 1985.

To be fair in the dissection of your estate you need to take into account the CGT liability attached to any post 19th September, 1985 assets because when your heirs eventually sell them they will have to pay CGT not only for the gain during the period they owned them but also for the gain accumulated in your life time.

Death of SMSF Member During Pension Phase

Effective from the 1st July, 2012 a superannuation fund will not automatically be pushed back into accumulation stage immediately upon the death of the last member to take a pension. This is an important change for SMSFs with their assets tied up in property or long term share investments.

Until now there has always been the worry that if the assets are sold while the member is alive the capital gain will be tax free but when the remaining pension member dies the fund is immediately pushed out of pension phase so when assets need to be sold to pay out the death benefits their gain will be taxed at 10%.

Now the fund is allowed to remain in pension stage until the pensioner's death benefit is paid out of the fund. No delay tactics though, there is still the requirement that the death benefit be paid as soon as practicable after the member's death.

Life Interest In Shares – Deceased Estates

When your spouse is not a parent of your children you may be concerned about providing for your spouse's future in the event of your death but still leaving the bulk of your assets to your children. This is where a solicitor might recommend a life tenancy for your spouse with the assets eventually going to your children when your spouse dies.

This article only covers the situation for shares. So you would be looking to make sure your spouse received the dividend income but when he or she died your children would receive the shares. I have heard a few stories recently when the children have had to pay CGT upon receiving those shares but unfortunately I have not been privy to the details of the estate. This of course disturbs me so here is some ammunition for our readers to ask the questions if they, as the eventual beneficiary (remainderman), of the shares are presented with a CGT bill when they receive their shares from a deceased estate. Of course it is really the estate that would pay the CGT bill but the money will come out of remainderman's distribution. Legal and personal representative, executor and trustee can be considered the same for the purposes of this article.

The first point is section 128-15 (3) ITAA 1997 note the reference to your estate refers to the person who originally died leaving the shares to a life tenant (life interest):

> Any *capital gain or *capital loss the *legal personal representative makes if the asset *passes to a beneficiary in your estate is disregarded.

Leaving a life interest in your shares means that your executor will be holding them in trust for the life tenant until he or she dies, at which time the trust is wound up and the shares transferred to the remainderman (probably your children). A trust created by your will is called a testamentary trust. The next point is from ATO practice statement PS LA 2003/12

> 2. This Practice Statement informs staff that the Commissioner will not depart from the Tax Office's long-standing administrative practice of treating the trustee of a testamentary trust in the same way that a legal personal representative is treated for the purposes of Division 128 of the ITAA 1997, in particular subsection 128-15(3).
> 3. Accordingly, subject to the operation of CGT event K3 in section 104-215 of the ITAA 1997 (about assets passing to a tax-advantaged entity), any capital gain or capital loss that arises when an asset owned by a deceased person passes to the ultimate beneficiary of a trust created under the deceased's will is disregarded.

If that isn't enough for you how about this example in TR 2006/14

> Example 1: equitable life and remainder interests created under will - no dealings with interests - life tenant dies
> 121. Jarrod died on 1 February 2000. At the time of his death he owned shares in Australian public companies which he acquired after 19 September 1985. Jarrod's will provided that the shares were to be held on trust with the income to be paid to his sister Lauren for life and the remainder to his children, Jessica and Harry.
> 122. Lauren died in February 2005. During the period from 1 July 2004 to the time of Lauren's death, dividends that had been derived by the trust were paid to Lauren. Lauren's estate was also entitled to a portion of the dividends paid to the trustee after her death by virtue of the relevant state law regulating the apportionment of income. Jessica and Harry were entitled to the remainder of the dividends paid to the trustee during the 2005 income year.
> 123. The trustee transferred the shares to Jessica and Harry in June 2005.
> 124. When Jarrod's estate was administered CGT event E1 happened in relation to the shares. However any capital gain or capital loss was disregarded under section 128-10. The trustee acquired Jarrod's shares for his cost base/reduced cost base: subsection 128-15(4).
> 125. When Lauren died, CGT event C2 happened to her life interest. Again, any capital gain or capital loss Lauren made from that event is disregarded under section 128-10.
> 126. There are no CGT consequences for the trustee or Jessica and Harry when the trustee distributes the shares to them in satisfaction of their remainder interests. CGT event E7 in section 104-85 does not happen because of the exception for a trust to which Division 128 applies - that is, the trust assets being disposed of by the trustee were owned by Jarrod when he died and are passing to Jessica and Harry under section 128-20.[10] Jessica and Harry acquire the shares for the trustee's cost base and reduced cost base. They are taken to have acquired the shares on the day that Jarrod died - subsection 128-15(2).[11]

Now there are some situations that could give rise to a different outcome, nevertheless don't accept it, get professional advice, Some of these reason could be:

1) The trustee has bought and sold shares. In this case the new shares would not be entitled to the rollover under section 128-15(3) and the estate would be liable for any CGT on the shares that it sold.
2) The life tenant did not die but instead surrendered their right.

Basically the same applies when the spouse is left a life tenancy in a home, the children should not have to pay CGT when the property is transferred to them. This is reinforced in regard to dwellings in section 118-195 ITAA 1997. There is an exception to this rule, in the very rare case that the life interest creates a legal interest on the title. I don't believe this is possible in the case of shares so that side of the argument has not been presented here.

In short the reason some estates may pay CGT on the transfer of assets to the remainderman is because the people involved in administering the estate only refer to section 128-15 and see that it does not cover the

transfer from a testamentary trust to a beneficiary. This is quite correct but they are obviously unaware of the concessions granted by the ATO in PS LA 2003/12.

If all this makes you think that a life interest is a good idea. Please don't, if at all possible, as it creates more problems than it solves and can result in your children being considered to have a lower cost base than the value of the asset when you died.

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