

Tax and Superannuation Update – Winter 2001 Edition

Option Two - back on the front burner?

Okay, so the Federal Government has scrapped the Entities Tax Regime. It is not just on the back burner. It is in the too-hard basket and is most unlikely to see the light of day again without drastic changes - whoever wins the election.

Democrat Senator Andrew Murray (the man responsible for watering down the GST) says "what a pity". He states that the ETR was one of Costello's better tax reform ideas. This is because it brought trusts and limited partnerships into line with companies. We say it didn't. It wasn't fair and was really just a structural anti-avoidance attack on trusts. Academics say the pollies and the industry have lost touch with what entities are about in the first place and they should all go back to basics. Behind this dust-cloud lurks the shadow of "Option Two". That was Ralph's other great idea. Option Two basically consists of scrapping the present system of income tax (based on the profit and loss statement) and replacing it with a tax based on the assets and liabilities statement - a sort of across-the-board Capital Gains Tax. Most of the other new business tax measures assume that Option Two already exists, so in that sense, it does.

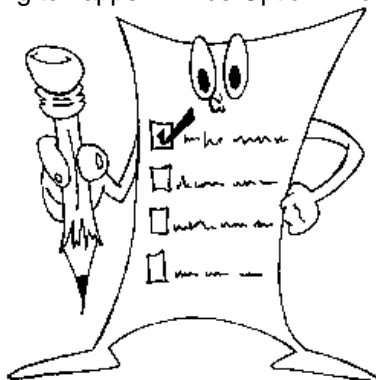
In practical terms, Option Two means that all enterprises get valued

each year. Tax is paid at a flat rate on the net increase in value of the enterprise over the year. Presumably if there is a decrease in value, that can be offset against increases in future years. This 'tax value' method is a radical departure from the present system. However, some argue that it is more fair and equitable.

Extrapolating to the individual, it is difficult to imagine the Government

letting the poor old S&W earner off the hook. After all, how do you value your kids' educational development or your own health? No doubt there is a plan though, because those in the know reckon that if there hadn't been such a public outcry against the GST, Option Two would already be a *fait accompli*.

So, maybe the Government is feeling fairly secure as it abandons its other reforms, in the knowledge that if it wins another term in office, the first thing to happen will be Option Two.



Is Option Two next on the Government's checklist?

One thing's for sure, CGT is certainly here to stay and the family home exemption is on borrowed time.

There are changes in the air. Now more than ever, you need to work with your Accountant and Adviser to ensure the Tax Man doesn't rob you. We are at War!

The cans and can not's of your Power of Attorney

Power of Attorneys are an excellent way of safeguarding your financial position in case of injury or absence. However, there are limits as to what your POA can achieve. A POA is an "economic" document. It won't allow your Donee to vote or make a Will on your behalf. However, it allows your Donee to do other things on your



Some jobs you just don't want someone else to do!

behalf like open and close bank accounts, pay debts and under certain circumstances, buy and sell land.

Making a Power of Attorney Does NOT allow your donee to:

- Vote in any government elections
- Make a Will or sign another POA
- Carry out Director Duties
- Act as a Trustee

The above are jobs that only the donee can carry out personally. For example, if the shareholders elect you as a Director, then they want you to carry out that job – not someone else.

To find out more about the different types of Powers of Attorney available, visit www.taxlawyers.com.au/manuals.

Dead people's tax returns

The ATO has requested that tax returns no longer have "EST" or "ESTATE" after the dead person's surname.

The ATO prefers "Executor For" before the dead person's full name.

If you add "Est" after the dead



Use the right format or the ATO's computer gets upset!

person's name the ATO computer spits it out. The manual process takes longer to complete.

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What happens to Dad's Testamentary Trust when Mum dies?

Mum and Dad always tried to do the right thing by us kids. They made sure we were given every opportunity to make the most of our lives. Unfortunately our Dad died when we were only young. This was tough on us all, especially Mum. Fortunately for us, Dad had made provision for us all in the form of a Testamentary Trust Will.

With the advice and help of Mum's Financial Planner and Accountant, Mum decided to set up a Testamentary Trust using Dad's insurance proceeds. The beneficiary of Dad's insurance was his estate. This enabled Mum to accept the funds into Dad's Estate and then channel them into Dad's Testamentary Trust. With the advice of her Financial Planner, Mum invested these funds from within the Trust.

The income from the investments could then be used by Mum to enable us all to get a good education and a good start in life. The flexibility of the Trust allowed Mum to distribute to us the funds necessary for our upbringing. This meant that we paid the tax on the money used for our needs and because the Trust was a Testamentary Trust we were all entitled to the full adult tax-free threshold of \$6000 per year.



Had Dad not left provision for a Testamentary Trust in his Will, Mum would be responsible for the tax on the entire income of the investments. The Testamentary Trust allowed Mum to make the most of what was really only a modest income.

But life goes on; we have all grown up and have young kids of our own. Unfortunately, Mum has become very ill and the doctors don't expect her to live much longer. Mum is only 58 and death is difficult for her and us to accept. But Mum is Mum, and she is still looking out for us kids.

3 Generation Testamentary Trust – Now more flexible than ever.

Mum told me yesterday that her Will also contains provision for a Testamentary Trust for each of us. Mum is satisfied that on her death she will be giving us yet another opportunity to make the most of our lives. However she was worried about what was going to happen to Dad's Testamentary Trust. Mum will not rest until she is happy that all her affairs are in order.

I spoke with Mum's lawyer who told me; "a trust will not fail for want of a trustee". Mum is the Trustee of Dad's Testamentary Trust while she is alive, and unless Dad's Will made specific provision for a Trustee to succeed Mum, then the Executor of my Mum's Will takes control of Dad's Testamentary Trust. Mum told me that we were all appointed as Executors, so the control of Dad's Testamentary Trust was going to the right people.

Mum died this morning. I am devastated and angry at the loss of someone who deserved better. It seems strange to me but in the end Mum was at peace with herself. Mum told me that she had had a good life and was proud of the way we had all grown up.

Mum's death has made me think about my own life. My wife and my kids. Perhaps I'll make an appointment to see Mum's Financial Planner tomorrow.

How secure is your loan?

Do you have any informal loans to family members lurking in the company closet or the trust trunk? If so, make sure they are dusted off and checked out before 30 June this year.

BECAUSE

Under the provisions of Division 7A of the Tax Act, the Commissioner may take the view that:

- the whole of the loan balance
- is in fact a distribution of profits
- to the extent of the distributable profits
- which may be deemed an unfrankable dividend
- in the hands of a shareholder of a family company or of a corporate beneficiary
- even if the loan is repaid before year end.

In forming his view, the Commissioner will ask:

- Is the documentation sufficient to support characterisation as a loan as distinct from a distribution of profits? (eg does it provide for a revolving line of credit?)
- Is the interest rate greater than or equal to the benchmark rate of 7.8%?
- Has any security been provided for the loan and if so, has it been appropriately documented?
- Is the term of the loan within the prescribed limit?
- Can the borrower's ability to repay be independently substantiated?

Note, after 1 July 2001 is too late to backdate. The loan is not regarded as an advance against anticipated future dividends – that automatically drops it into the 'deemed dividend' basket.

We recommend a comprehensive, customised Div 7A Loan Agreement *poste haste*.

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You don't have to pay tax on all of your Salary

Salary Packaging can protect you from the Tax Man. Fringe Benefit Tax makes it hard to "tax effectively" get your boss to give you benefits (rather than just a salary). Salaries get taxed in your hands.

However, There are still items you can get from your boss which neither of you pay tax on. Mobile phones, cars and laptops are all worth looking at. Of course the biggest tax savings come from contributing to Superannuation.



Are you taking the most home from work? Salary packaging could be the answer .

Do all bosses have to pay FBT? Some bosses are charities. Some charities, schools, hospitals and sporting clubs don't pay FBT. Your boss can therefore pay you in kind, rather than give you money. You don't pay tax on the items that are "packaged" in your salary. Your FBT exempt boss also doesn't pay tax on those items. This means that some of your salary is now tax free.

Your Adviser and Accountant can help you structure your salary package. A Tax Lawyer then prepares the tax effective Employment Contract. Without an Employment Contract much of the good work can be undone by the Tax Office.

Oh where! Oh where, has my Superannuation gone?

'Family Law Legislation Amendment (Superannuation) Bill 2000'

It is getting closer to the time where your estranged spouse can legally get your preserved Superannuation.

The Bill has now passed through the House of Representatives, and is well on it's way to becoming L A W law (*Except this time they mean it! -Ed*)

The key changes to the Bill are:

- The start date has been put back to up to 1 ½ years after Royal Assent. (Usually the law comes into effect once the Governor General signs the Bill.)
- A few clever people at Brett Davies Lawyers were contemplating amending the Superannuation Trust Deeds to defeat the legislation. The boys in Canberra must have heard. No law or trust deed can stop the effect of the legislation.
- A payment is still a 'splittable payment'. (To rub the salt into the wound a bit more, your Super may be paid to your spouse's new lover.)
- A 'breakdown declaration' is renamed a 'separation declaration' (*did not even need to learn the new lingo! - Ed*).
- Your Super trustee has only 4 days to acknowledge your spouses' "flag". (Different rules for Self Managed Super Funds).
- How do you value the Super? Valuations methods are going to be suggested. The court has the final say.
- Who is going to pay for all of this? Your Super Trustee can charge you a reasonable fee for all this work.

What does the Trustee have to tell your spouse?

- Your address is confidential.
- The trustee complies with any regulations to provide information to the non-member spouse about the superannuation interest.

Are there any new trendy expressions to learn?

- A 'percentage only interest'. This allows the superannuation agreement or flag lifting agreement to state the percentage split of all splittable payments.
- A 'base amount'. This is the basis of the calculation of the value of your Super.

Now more than ever, you need to consider putting in place a Binding Financial Agreement as part of your overall Financial Strategy. Talk to your Adviser today about this new aspect of risk management.



Is your Ex after a chunk of your Super?