CASE STUDY

Session 4: Multi-Generational Planning

Disclaimer

© TAG Financial Services Pty Ltd, 2020. All rights reserved. Without limiting the rights under copyright reserved above, no part of these notes may be reproduced or utilised in any form or by any means, electronic or mechanical, including photocopying, recording, or by information storage or retrieval system, without prior written permission from TAG Financial Services Pty Ltd.

Disclaimer: These notes are intended to be a guide only. You should not act solely on the basis of the information contained in these notes, because many aspects of the material have been generalised and the superannuation and taxation laws apply differently to different people and circumstances. Further, taxation laws change frequently and there may have been changes since the notes were written.

Therefore, TAG Financial Services Pty Ltd expressly disclaim any and all liability to any person, whether a purchaser or not, for the consequences of anything done or omitted to be done by any such person relying on part or the whole of the contents of this publication.

None of the comments contained in these seminar notes are intended to be advice, whether legal or professional. Do not act on the information contained in the seminar notes without first obtaining specific advice regarding you and/or your client's particular circumstances from a suitably qualified legal, taxation or superannuation professional.

While all endeavours have been made to ensure the accuracy of the content at the time of preparation, TAG Financial Services Pty Ltd accepts no responsibility for any inaccuracies contained herein.

These materials represent the author's interpretation of the law as it stands at September 2020.

Background

Karl (62) and Marion (60) Towns have been married for 36 years. During their marriage, they have had three boys, Anthony, Andrew and James.

In 1987, Karl and Marion established their family removal business, Outta Towns, and have continued to run it to this day. Over the years, all three kids have been involved in the business. In more recent years, Anthony has increasingly become more involved in the business as Karl and Marion have gotten older, whereas Andrew and James have taken different paths and are no longer involved at all.

Towns Family Trust	Karl (62) & Marion (60)	KM Towns Superannuation Fund	Towns Investment Trust
Business “Outa Towns” $1,000,000	**Family Home (Marion’s name)** $1,700,000	**Cash & Shares** $365,000	**Cash term deposits & listed shares** $137,000
	Commercial Property (Marion’s name) $1,400,000 Acq. 1987 for $160,000	**Commercial Property** $950,000 ($400k cost)	
		Bentleigh Residential Property $600,000 ($350k cost)	
		Clifton Hill Residential Property $800,000 ($600k cost)	

The business is run via the Towns Family Trust. Recently, they have declined an offer to acquire the business from an upstart, large scale removalist business, Big City Removals, who had offered $1,000,000.

Separately from the Towns Family Trust is the Towns Investment Trust. This trust holds invested assets in cash, term deposits and listed shares totalling $137,000. Karl and Marion wanted to ensure that they could maintain as much flexibility and liquidity outside of super in case their business needs called for it.

Marion also owns a commercial property, which the business operates from. The property is worth $1,400,000 and was acquired in 1982 for $160,000.

Karl and Marion's family home, owned by Marion, is worth approximately $1,700,000. Karl and Marion have expressed a desire to sell their family home of 32 years and move closer to the beach when they retire.

Karl and Marion also have a self-managed superannuation fund, the KM Towns Super Fund. As at 30 June 2019, the Fund balance sheet was as follows:

Asset	Value (Cost)	Yield
Cash	$220,000	0.7% pa
Listed shares	$145,000 ($135,000)	3.5% pa
Residential Property – Bentleigh	$600,000 ($350,000)	2.2% pa
Residential Property – Clifton Hill	$800,000 ($600,000)	2.4% pa
Commercial Property	$950,000 ($400,000)	5.5% pa
Total Assets	**$2,715,000 ($1,485,000)**	**$91,265 pa (3.36%)**

Karl and Marion's respective member balances are as follows:

Member	Taxable	Tax-free	Total
Karl	$950,000	$450,000	$1,400,000
Marion	$865,000	$450,000	$1,315,000

As both Karl and Marion were still working at 30 June 2017, their transition to retirement pensions that had previously been established, became accumulation phase income streams as at 1 July 2017. They each had two pensions. One entirely comprised of the taxable component and the other, entirely comprised of the tax-free component.

It was decided at the time that they would cease their pensions as they did not personally need the cash, and maintaining the income streams was not going to present a tax benefit to their entire family group by doing so.

Predicament

Karl and Marion schedule a meeting with their trusted adviser. They call this meeting as, quite embarrassingly, they are trying to manage growing tensions between Andrew and James, and Anthony.

As Anthony is increasingly involved in the family business, Andrew and James have become jaded and their relationship with their brother is increasingly tense and distant. Given Andrew and James' lack of involvement in the business, it is Karl and Marion's desire to have Anthony inherit this business once they have both passed away.

They have previously discussed this with the adviser, in that while they believe they may come to an agreement in the future and sell the business to Anthony, Karl and Marion are most likely to hold onto the control and ownership of it for the rest of their lives. It is mainly for this reason, that they declined the recent offer on their business.

They advise that they have recently visited a solicitor and re-drafted their Will. They want to ensure that each child is looked after equally, whilst also ensuring that Anthony can inherit the business.

The Family tensions have frustrated Karl and Marion to the point that they want to escape it all and are ready to start travelling the world. They determine that they want to retire and cede control of the operations of the business to Anthony and come to you as their adviser to consider the tax planning opportunities as well.

You look over their asset base, and after consideration of their tax needs, their desire to hold a more passive role within the business, and to eventually cede control to Anthony via their Estate, you suggest to them the opportunity to restructure their group assets in order to provide a “clean skin” for Anthony to operate out of.

The current trust structure was established early in the business’s life, and after review of the Deed and legal consultation, the three children will retain equal control in a “successor appointor” role should Karl and Marion pass away. Fearful of the control issue that may present itself, it was agreed that a restructure was needed to ensure control of the business rests with Anthony.

They obtain a business valuation which provides them with a value of $1,200,000. Relieved in some respects that their recent knock back of a sale was the right financial move, the adviser considers the capital gain impact due to the restructure, being:

Business Valuation: $1,200,000
Cost Base: $76,000
Capital Gain: $1,124,000
15-year exemption: $1,124,000
Taxable Gain: $0

As both Karl and Marion are aged over 55, they do not need to make a contribution to super, however, it is recommended that they do so for the purposes of maximizing their retirement wealth, in a predominately tax-free environment.

Their adviser checks with the ATO and can confirm that neither Karl nor Marion have previously used any of their CGT caps, and so each have up to the $1,515,000 limit available.

Karl and Marion decide to in-specie transfer the property, as they can use Small Business Concessions to remove the gain on this as well. Accordingly, the property is transferred in in-specie as follows:

CGT Cap $400,000 (Karl)
CGT Cap $400,000 (Marion)
Non-Concessional $300,000 (Karl)
Non-Concessional $300,000 (Marion)

As the asset value is $1,400,000, the adviser decides to retain some of the lifetime Small Business Caps in case of future business sale, and use all of Karl and Marion's available non-concessional cap.

This is important as, post the transfer of property, the next Total Superannuation Balance update for both members will report superannuation in excess of $1,600,000 each. As a result, neither Karl nor Marion will be able to make a non-concessional contribution. Essentially, this is their last chance to do so, while the Small Business Contribution is not limited by their Total Superannuation Balances (TSB).

After the transfer of the property into super, the Fund is now positioned as follows:

Asset	Value (Cost)	Yield
Cash	$220,000	0.7% pa
Listed shares	$145,000 ($135,000)	3.5% pa
Residential Property – Bentleigh	$600,000 ($350,000)	2.2% pa
Residential Property – Clifton Hill	$800,000 ($600,000)	2.4% pa
Commercial Property	$950,000 ($400,000)	5.5% pa
New Property	$1,400,000 ($1,400,000)	5.5% pa
Total Assets	**$4,115,000 ($2,885,000)**	**$168,265 pa (4.09%)**

You now bring to Karl and Marion's attention, the imbalance of wealth in their asset mix, between business ($3,550,000 – which they want to go to Anthony) and non-business ($3,602,000) assets.

While Karl and Marion indicate their wishes are quite simple, you explain to them the risks of their assets, given they want Anthony to inherit and control every asset in relation to the business. You remind them that the value of the assets held in relation to the business (i.e. the business itself and the business premises in the SMSF) is $3,550,000, while the non-business assets are valued at $3,402,000.

A desire to see their wealth split equally would indicate that Anthony, James and Andrew would each inherit assets to the value of $2,384,000.

You stress to them the importance of not leaving a mess behind, and arrange a meeting with Karl, Marion and their lawyer to discuss the asset mix and these risks. Before the meeting is held, it is cancelled. Karl and Marion have decided to head overseas.

They decide it is too much to think about at the moment and they will deal with it when they return.

They ask for a quick idea of what they could implement now, in the days before they fly off. You suggest an easy mechanism, knowing the Fund has certain cash levels, is a withdrawal and re-contribution strategy.

Make a non-concessional contribution to the children

Under this alternative, Karl and Marion could add (up to) two children to the Fund, given they are unable to contribute a non-concessional contribution for themselves.

They could use the remaining investment assets in the trust and make an in-specie contribution (net of any capital gains taxes). This would provide an additional cash buffer for the fund for several years into the future.

Karl and Marion could supplement this over time with contributing their "surplus" pensions into the Fund as well.

Karl and Marion decide to add Andrew and James as members of the Fund. They do so, as in their eyes this will help them to even out future inheritances (with Anthony inheriting the business) and keep things simple.

The adviser then suggests additional options, being:

Do Karl and Marion simply re-contribute the surplus pension each year as a non-concessional contribution (for James and Andrew), or do they look now to act and make additional contributions up to James and Andrew's non-concessional cap of $300,000 each.

Unsure how to fund this, the adviser explains that the repeated withdrawal and re-contribution of monies would suffice this strategy. It would help reduce the balances Karl and Marion have in the Fund and start the transfer of some of the retirement wealth to James and Andrew.

The value of this re-contribution strategy, transferring wealth across generations, is the savings it represents on death benefit payments down the road, it is explained.

The current Fund composition being as follows:

	Tax – Free $	Taxable $	Total $
Karl			
Pension (54.76% tax-free)	903,540	746,460	1,650,000
Accumulation	176,750	148,250	325,000
Marion			
Pension (57% tax-free)	934,800	705,200	1,640,000
Accumulation	179,146	140,854	320,000

A re-contribution strategy would need to provide sufficient room under the non-concessional caps to allow the contribution of surplus cash on an annual basis. It is agreed that Karl and Marion would undertake a re-contribution strategy to the sum of $400,000 - $200,000 for each child. This would leave room for an additional $200,000 over the three-year period to deposit any surplus cash available.

They decide to treat for accounting purposes the withdrawals as follows:

- Firstly, from Karl's accumulation balance
- Then the remainder from Marion's accumulation balance.

This treatment was considered in order to keep matters simple and allows for Karl to now only hold assets in retirement phase.

The above strategy results in the removal of $181,263 in taxable components, and the re-allocation of $400,000 in wealth to James and Andrew. The present-day value of the death benefit tax savings is $30,815. Karl and Marion implement the strategy.

As a result, Karl and Marion's wealth is now as follows:

Business value - $1,200,000
Superannuation - $3,935,000
Home - $1,700,000

However – now $400,000 of the Superannuation balance is now in the names of Andrew and James – therefore the Superannuation balance that belongs to Karl and Marion is now only $3,535,000.

Danger Strikes

Karl and Marion decide to tick off another bucket list item and travel to South America. There they visit the Amazon and other natural wonders. During their stay in Argentina they decide to enrol in tango lessons.

During a particularly physical section of the tango, disaster strikes, and Karl suffers a massive stroke, and dies. Marion, in a compromising position at the time of the stroke, is paralysed.

Anthony contacts you to inform you of the events. He asks to call a meeting for the family, who decide to put aside their differences for the time being.

Collating the numbers, at the time of death, and considering the re-contribution strategy implemented a few years earlier, Karl's pension balance is $1,620,000. The adviser checks the pension commencement documents and TBAR reporting, noting:

- TBAR commencement value of $1,600,000
- Pension commencement documents were executed with the pension as a reversionary pension, reverting to Marion.

The Fund value and composition at death is as follows:

Member	Account type	Balance
Karl	Pension	$1,620,000
Marion	Pension	$1,640,000
Marion	Accumulation	$250,000
James	Accumulation	$200,000
Andrew	Accumulation	$200,000

As his pension is reversionary and given Marion has used her entire Transfer Balance Cap, Marion will now need to commute her pension, to receive the reversionary income stream.

	Amount	**Available**
Transfer Balance Cap balance	$1,600,000	$0
Commutation of income stream	($1,620,000)	$1,620,000
"Commencement" of reversionary death benefit income stream	$1,620,000	$0

After the required manoeuvring and given Marion's declining health and the fact her living costs have plummeted, you discuss the future planning of the Fund and managing the future costs of an estate.

The adviser does his sums, and after all the manoeuvring, the Fund is comprised of member balances as follows:

Member	Balance	Tax-free / Taxable
Marion – Pension	$1,620,000	54.76% tax free
Marion – Pension (original)	$20,000	57% tax free
Marion - Accumulation	$1,865,000	$804,439 taxable
James	$200,000	$200,000 tax free
Andrew	$200,000	$200,000 tax free

You discuss with the family the likely death benefit costs which would arise because of the superannuation remaining until her death. The total taxable dollars attributed to her balance are $1,545,927. As a result, the total death benefit tax exposure now sits at $262,808.

The cash balance of the Fund has dwindled given the continual spending by Karl and Marion – but those days are now over.

Cash	$20,000
Listed Shares	$35,000
Residential Property - Bentleigh	$650,000 ($350k)
Residential Property – Clifton Hill	$820,000 ($600k)
Commercial Property	$990,000 ($400k)
New Commercial property	$1,420,000 ($1,400k)
TOTAL ASSETS	**$3,935,000**

The years pass and Marion's health deteriorates further. Even with the tragedy of their fathers' passing and their mothers' ill health, Anthony, Andrew and James still have their differences.

The Fund has implemented a further withdrawal and re-contribution strategy, and the balances are now split as follows:

Member	Balance	Tax-free / Taxable
Marion – Pension	$1,640,000	54.76% tax free
Marion - Accumulation	$1,435,000	$641,905 taxable
James	$456,000	$400,000 tax free
Andrew	$456,000	$400,000 tax free

Whilst it had been planned, Marion and Karl never revisited their estate plan with their adviser, as they had cancelled the meeting prior to the fateful holiday. Now, Marion's condition is such that any changes to the Will, will be difficult to execute.

The boys independently express their concern at her failing health, and ask you as their adviser if there is anything that can be done to help remove the exposure they have to the payout of her death benefits tax, which now looms as $235,253 (based on the taxable component of her benefit being $1,383,842).

Anthony is particularly keen as, given his understanding that he will inherit the business and the business premises, he will not receive cash as part of his inheritance and will find it difficult to finance his share of the tax.

The adviser considers the possibility of a lump sum of property out of the Fund. He does not consider the application of stamp duty, as he is advised that under Victorian law there is no duty levied on an in-specie transfer to an SMSF member, where there is sufficient member balance, and the member has satisfied an appropriate condition of release. He therefore is left to contemplate the options based on the following capital gains (based on the fund being approximately 40% in pension mode).

	Cost	Market	Capital Gains Tax
Residential Property - Bentleigh	$350,000	$650,000	$187,000
Residential Property – Clifton Hill	$600,000	$820,000	$13,200
Commercial Property	$400,000	$990,000	$35,400
New Commercial property	$1,400,000	$1,420,000	$1,200
Listed Shares	$30,000	$35,000	$300

The adviser discusses with the trustees (being James and Andrew) and they decide that transferring the Clifton Hill property and the new property is the prudent way to go.

They will also sell all the listed shares, which will help fund the costs of the project.

As a result of the in-specie transfer, a total of $2,240,000 of Marion's member balance will be withdrawn from the Fund. The assets will be transferred to her personal name.

The adviser does the sums and determines it would represent $1,006,087 in taxable component having been withdrawn from the Fund, saving the children from $171,035 in death benefit taxes.

Remaining in the Fund will be a small cash balance, the remaining shares, plus the original commercial property (rented to Anthony's business) and Bentleigh property.

They decide to retain the two properties with the largest unrealised capital gain to limit the amount of tax they will need to pay.

Soon after the transfer, Marion dies. After a period of mourning, the three boys come and visit the adviser.

Assets are now:

	Estate	Super
Family Home	$1,700,000	
Residential Property - Bentleigh		$650,000
Residential Property – Clifton Hill	$820,000	
Commercial Property – rented to Anthony's business		$990,000
Commercial Property – rented to Anthony's business	$1,420,000	
Listed Shares		$5,000
Loan to Anthony for business	$1,200,000	
Less Accumulation accounts for Andrew and James in SMSF		($912,000)
GRAND TOTAL	**$5,140,000**	**$733,000**

The adviser provides them with a copy of the Binding Death Benefit Nomination, which was last updated numerous years ago when Karl and Marion updated their Trust Deed.

The adviser notes that Marion only nominated Karl to receive her death benefit, and now turns to the Trust Deed to assist Andrew and James to determine their next course of action.

Anthony, meanwhile, as Executor of the Estate, begins work with the solicitor to obtain probate. He informs his brothers and they get together to look over the Will. As Anthony is the sole Executor, Andrew and James are relieved that they do not need to put in any effort in managing the estate.

Anthony lays claim to his brothers for the commercial properties to be transferred to him as per his mum's wishes. He believes that her Will gives him the mandate to request this as it leaves all assets associated with the business to him. He is in the process of liquidating all her personal assets to pay out the remainder of the estate to his siblings.

His siblings, meanwhile, are required by the Trust Deed to pay out the death benefit to a dependent.

The adviser directs all three siblings to recent court cases surrounding similar issues, which were resolved with the role of executor being superior to one's personal claim/wishes. In this light, it is not positive news for Anthony, as that case law would support Anthony's claim on a death benefit only in his capacity as Executor, and bars him from making a personal claim.

Obviously (Anthony believes), the intent of Karl and Marion was clear. Further, it was clear that an imbalance would arise in their estate that they never wanted to address with their adviser.

The haphazard approach to the management of the wealth transfer of all their assets is evident. While the tax consequences have been considered, this does not cleanly correlate to the intent of the Will.

The control of the superannuation fund, and the lack of focus on the binding death benefit nomination, has also created avenues for both confusion and manipulation,
and all parties, Andrew and James as trustees attempting to pay a death benefit, and Anthony as Executor, have not had the affairs considered in a simple manner, which ultimately may lead to a costly result should they all decide to "dig in".