



Provisioning within a Will and Estate Shrinkage

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Overview

Wills contain a number of provisions which can assist an Accountant or Financial Adviser to advise the Client within their expertise and scope of engagement to ensure that a Will maker's wishes to benefit intended beneficiaries can be completed with the correct quantum of Assets and liquid funds as well as prevent unnecessary Estate Shrinkage. Estate Shrinkage may occur due to delays, disputes, debts, expenses or unnecessary taxes, that could have been prevented.

What follows is an overview of the issues a Financial Adviser or Accountant should highlight to the Client in reviewing a Will in order to correctly structure Financial Products or advise on unnecessary Estate Shrinkage.

These provisions represent the minimum clauses required for the preparation of a valid and effective Will and are discussed below.

Name and Address of the Will Maker

The full name and current address of the Will maker together with the occupation and date of the Will may reveal when the Will was last executed and the currency of the Will.

Furthermore significant changes to the residency and occupation may reveal changes to the needs and objectives of the Will maker.

Revocation of Previous Will

It is usually the intention of a Will maker that a later Will revokes the contents of an earlier Will. If this is the case, the Revocation clause of the Will should clearly state any previous Will that is to be revoked.

One of the more common problems encountered with a simple Will is failure by the Will maker to revoke previous Wills. This leads to ambiguity as to whether the later Will was intended to revoke all or part of the earlier Will.

The following wording is sufficient:

I revoke all previous testamentary acts.

If it is not the intention for a later Will to completely revoke an earlier Will, this should be clearly stated. In events where Will makers have assets in different parts of the world, a separate Will must be prepared to deal with assets in each different country. In this scenario, the revocation clause in both Wills would need to be carefully drafted to ensure that the such Wills can coexist.

Executors and Trustees

Payment of Debts and Testamentary Expenses

The Executor's obligation is to identify and meet all debts of the Estate up to the value of the Estate. These debts and liabilities take priority over



the distribution of the Estate to the Beneficiaries.

Consideration should therefore be given to review how all the Debts can be funded to meet the Will maker's objectives, in respect to any Beneficiaries.

The Will maker's life insurance proceeds do not need to be applied to meet liabilities of the Estate unless expressly provided for in the Will, or the debts and liabilities are not exempt. A Financial Adviser should ensure that the Will clearly sets out the Will maker's wishes in relation to the use of life Insurance for the payment of Debts and Liabilities.

Powers of Executors and Trustees

The powers that can be exercised by an Executor need to be appropriate for the Will maker's particular circumstances and needs and objectives. Hence if the Will maker wishes that their Business is to be sold at an appropriate price then such powers need to be expressly stated in the Will. Otherwise the Executor may not be indemnified from Estate Assets. Secondly, liquid funds need to be available to run the business whilst awaiting sale. Should funds not be available the Business may be sold for a lower value or a liquidated fire sale value.

Special Requests

A Will maker is able to provide directions in their Will relating to matters such as:

- funeral arrangements
- disposal of your body (for example, burial or cremation)
- The content of your funeral service.

The inclusion of these requests provides assistance to the

Executor in planning the nature and content of the funeral service. Such requests are not generally binding on the Executor because they are usually expressed as a wish rather than as a binding direction.

Nevertheless it is a good idea to discuss these matters with the Will maker and family members so they are aware of the Will maker's wishes in advance. Furthermore liquid funds maybe needed to provide for such special requests.

Distribution of Assets

After the Executor has paid all debts and liabilities of the Estate, the remaining assets, termed 'the residue', can then be distributed to nominated Beneficiaries in the form of specific gifts or the remaining Estate to be distributed to nominated Beneficiaries.

Specific gifts should be created for their existences and that the values of the gifts are in line with the intention of the Will maker and the needs of the Beneficiaries. Furthermore check that the balance of the Estate can meet the Will maker's wishes for the Residual Beneficiaries should also be considered.

In both instances of a specific gift recipient or a residual Beneficiary recipient depending on the needs of the Will maker extra funding may be needed.

A Will specifies how and when the assets of an Estate are to be distributed.

It is these clauses that the Executor will rely on when distributing the assets of the Estate, whether they are personal chattels, real-estate assets or share or cash investments.



Gift of Investment Assets

Extreme care should be exercised when making a specific gift of investment assets to a beneficiary. A specific gift of this nature assumes that the asset will still be in existence at the date of death. However, circumstances change. Further, the investment asset may be subject to a liability. The treatment of such a liability can also create uncertainty during the administration of the estate.

Ademption

Consider the following instruction:

I give to my son Peter all of my interest in the property at 14 Good Street, Badplace, provided he survives me.

While a bequest clause such as the above appears simple and non-contentious, to a non-lawyer a change in the Will maker's circumstances may significantly alter the distribution of such a gift.

Hence, if at the Will maker's death the Will maker no longer owned the property at Badplace, the gift fails (it is 'adeemed'). Peter in the above example would not receive the property by way of gift.

A number of events may affect the substance of an Estate and bring about an Ademption. The property may have been sold during the lifetime of the Will maker, compulsorily acquired by a third party or altered in a material way so as to change the nature of the property. In most cases, the proceeds of sale of the property disposed of can't be traced through the estate and are distributed to those of your beneficiaries entitled to the residuary estate.

Usually this outcome is unintended and is caused by a failure to update the Will to reflect a change in circumstances.

In some states and territories, sale proceeds can be traced through the Estate if the Asset was disposed of by a legally appointed administrator or power of attorney prior to death. This does not protect a gift that fails because of the actions of the Will maker during his or her lifetime.

In gifting specific investment assets, an Ademption can be avoided in a number of ways:

- Update the Will as circumstances change. However, this is not always possible and practical. If an asset is disposed of and the Will is not changed immediately, any subsequent loss of capacity will make it impossible for an alteration to occur;
- Alternative Provisioning by including a clause in the Will that provides an alternative distribution in the event that the asset no longer exists at the date of death. This may be a gift of cash through Life Insurance in lieu or a sum equivalent to the net, sale proceeds of the asset; and
- Refraining from specifically gifting specific assets to a beneficiary.

Assets that maybe Encumbered

In the absence of a contrary intention in the Will, an Asset given to a Beneficiary that is subject to a debt or encumbrance remains subject to the liability in the hands of the Beneficiary. If it is the intention of the Will maker that the gift be received free from debt, the Will should clearly specify this. Use of



the words 'free of all liabilities and encumbrances' should be specified in the **gift clause**.

Furthermore the provision of liquid funds maybe needed to ensure that such Assets may in fact pass through the Estate to Beneficiaries free of any encumbrance.

Specific Gifts and Capital Gains Tax

In gifting specific investment assets in the Will there is a need to be aware that not every asset is treated in the same way for capital gains tax purposes.

There may be assets within a Will maker portfolio that are not subject to a capital gains tax liability because they were purchased by the prior to the introduction of capital gains tax on 19 September 1985, or because the asset is the main residence. Other investment assets that hold may not be exempt from capital gains tax and may pass to a beneficiary with a latent capital gains tax liability attached.

The specific gifting of investment assets with different capital gains tax status may bring about unintended inequality between beneficiaries.

Personal Chattels

It is common for Wills to contain gifts of household articles and items of sentimental importance.

The principle of ademption also applies to personal chattels. However, given that personal chattels are usually worth significantly less than investment assets, the consequences are often less dramatic.

Specific gifts of personal chattels included in the Will are binding on the Executor.

The alternative to gifting chattels in the Will is to prepare a separate list of wishes that accompanies the Will. If this list is in existence and signed at the same time as the Will then it forms part of the Will and is also binding on the Executor. However, if a Will maker updates the list on a regular basis without updating the Will the list will not be binding on the Executor.

When considering the two alternatives, it is a balancing act between certainty and flexibility. Gifts contained within your Will are certain, but are more difficult to alter as this requires an amendment to the Will. A separate list allows frequent and flexible alteration but does not possess the same binding force.

If your Client wants to guarantee the enforceability of a gift of a family heirloom or other personal chattel, the gift should be included in the Will.

If your Client is making specific gifts of personal chattels, the chattels should be described in great detail so as to avoid confusion. Your Clients may consider taking photographs of the chattels and storing the photographs with their original Will.

Your Client may also consider including a formula in their Will for the distribution of personal chattels such as a selection in turn by beneficiaries or the purchase of the chattels from the estate for market value.

The following is an example of a clause making reference to a non-binding list of personal chattels:

I give my personal and household chattels as defined in the statute



governing the administration of wills and probate ('my chattels') to my Executors, and it is my strong wish that my Executors distribute my chattels in accordance with any list I may leave stored with my will or among my private papers and signed by me, PROVIDED THAT if I fail to leave such a list, or to the extent that any of my chattels are not listed or distributed, they will be distributed in accordance with the succeeding clauses of this Will.

Provisioning for Guardians and Minor Children

If your Clients have young children or may have them in the future, Wills should appoint guardians to take the care and responsibility of the children should both parents die prior to the children turning 18.

What follows is an overview of factors to consider in the provision of funding solutions on death.

The appointment of a guardian is usually included in the Will as a safeguard in the event that both parents die before the children are 18 years old. The appointment of a guardian may also avoid the possibility of disputes between family members. However the court has an overriding discretion to appoint or remove a guardian.

It is the guardian's responsibility to make the important 'life decisions' on behalf of the children. The guardian must ensure that the children are adequately housed, clothed and educated. This may mean that the children reside with the nominated guardian but this is not necessarily the case.

It is not uncommon for a Will maker to be more concerned for the welfare of their children than the distribution of their financial assets. For this reason, uncertainty surrounding the appointment of an appropriate guardian is often a stumbling block to the finalisation of a Will.

The appointment of a guardian is potentially complex. There are a range of personal, financial and legal issues that need to be addressed. The fact that the appointment of a guardian is brought about by death places an additional stress on those involved.

In selecting a guardian or guardians, your Clients should attempt to appoint one or more people who:

- Are prepared to accept the responsibility. They should meet with the proposed guardians and discuss with them the nature and extent of the role and your wishes should the guardians be called upon to act
- Are of a similar age to the Clients and are young enough to assume responsibility for the children should they be required to act in the future. The ages of your children at the time of making the Will are relevant to this decision
- Hold similar social, religious and cultural views to the Client.

Where the guardian is not also the appointed Executor, the guardian will be required to liaise with the Executor in making decisions about the expenditure of the estate on behalf of the minor beneficiaries.

In this respect adequate funding should be available not only for the children



Beneficiaries advancement, maintenance or education but also for the needs of the guardian.

Guardianship Clauses

The following example of a guardianship clause may assist you in planning:

Appointment of guardians

In the event that I die leaving children under eighteen (18) years, I appoint [names] of [address] to be their guardian/s. It is my wish that my Executor exercises his powers so as to ensure that any person caring for any of those children (whether as guardian or otherwise) does not suffer, in the course of such care, a financial burden or loss.

In drafting the Will the Client should include instructions to the guardians as to how the children are to be raised. Consideration may need to be given to the following:

- Where they should live;
- Where they should go to school;
- Maintaining contact with other family;
- Ongoing use and occupation of the family home by the guardians, including the terms of this occupation. For example, are the guardians required to pay rent to live in the home with your children?
- Use of estate funds to modify the guardian's home for the purposes of accommodating the additional children. If the Will does not specifically allow for this, an order of the court will need to be sought consenting to the expenditure;

- Desire to keep the children together if applicable.

Court orders may take up considerable time and expense. Consideration would therefore need to be given to ensure that there are adequate funds available for the appropriate guardian.

Timing of Gifts

Generally, a Beneficiary cannot take his or her entitlement from an estate until they turn 18.

However, a Will maker can delay the gift for a longer period if they think it necessary. This is particularly the case where one of the Beneficiaries is to receive a substantial cash amount and the Will maker does not wish them to take ownership of the gift until they are old enough to manage it.

For example, a Will maker may choose to delay the gift until your beneficiary turns 21 or 25 or older. Alternatively, they may elect to stagger the release of the gift from the estate over a number of years, (for example, one-third at 18, one-third at 21, and the balance at 25).

To avoid Beneficiaries calling for their entitlement upon attaining the age of majority but before reaching the control age specified by the Will maker, the distribution should be conditional upon the beneficiary attaining the specified age.

If a gift to a Beneficiary is delayed for a period of time, it will be necessary for the Executor to hold the Beneficiary's entitlement on trust until the Beneficiary attains the specified age.

By delaying the gift, it does not prevent the funds from being applied for the benefit of the Beneficiary should the



need arise. The Will should give the Executor the power to use the income and capital of the entitlement for the ongoing maintenance, education, advancement or benefit of the Beneficiary. A common example of such expenditure is the payment of school fees on behalf of the Beneficiary.

The following is an example of a specific clause enabling an Executor to make applications of the income and capital. If no such provision is included, the Executor will be required to act in accordance with the legislative provisions dealing with the application of income and capital which are often more restrictive.

Maintenance, education and advancement

My Executor will have the following powers:

To apply for the maintenance, education, advancement or benefit of a beneficiary the whole or any part of the capital and income of that part of my estate to which the beneficiary is entitled or may in future be entitled. For the purposes of this subclause, my Executor may make payments (without seeing to their application) to the parent, guardians or care giver of the beneficiary and accept the receipt of the payee as an absolute discharge.

Disclaimer of an Estate Interest

A Beneficiary of the Will can refuse to accept a gift made to them. In considering whether to accept or disclaim a gift, a beneficiary should be aware of the following:

- The disclaimer must be of the whole gift and not only part

of it. However, where a beneficiary receives multiple separate gifts, one gift can be disclaimed and another accepted.

- A gift made jointly to multiple beneficiaries must be disclaimed by all beneficiaries to be effective.
- A disclaimer is “deemed” to be a gifting of assets for Centrelink purposes. This means that the normal deprivation rules apply and the disclaimed assets will still be assessed for the assets test for the deprivation period.
- A disclaimed gift will be treated as if the beneficiary had not been left a gift. The Will should be read carefully, and the ultimate outcome of the disclaimer understood, before the interest is disclaimed.
- A disclaimer is potentially subject to stamp duty and capital gains tax.

Estate Equalization and Adjusting Beneficiary Entitlements

An adjustment clause may need to be included in the Will that takes into account benefits received by one of the Beneficiaries from sources outside the Estate. Some of these non-Estate Assets may be distributed directly to a person who is also nominated as the Beneficiaries. This may not bring about the outcome a Will maker intends, and an adjustment may be required. Trust allocations and superannuation death benefits are two examples that may require adjustment.

Trust Allocations

While the unallocated assets of a discretionary trust do not form part of a personal estate,



a Will maker should deal with unequal balances in the allocated funds of the trust. These balances are called 'loan accounts'.

The existence of loan accounts in a Family Trust results from the use of a trust as an income-splitting vehicle. The income of a trust is taxed at the marginal rate of the beneficiary who receives it by way of distribution, subject to rules dealing with unearned distributions to minors. Unequal loan allocations may exist because the trustee of a discretionary trust has distributed additional trust income to one beneficiary on a lower marginal rate for tax purposes.

Inequality arises because once the trustee allocates the trust income, the person to whom the income is allocated becomes legally entitled to the allocation. The allocation is recorded as a liability in favour of the Beneficiary in the accounts of the trust. If the same person is also receiving an equal entitlement to the estate distributed via the Will, they are receiving benefits over and above other Beneficiaries who do not have loan account balances, or have smaller balances within a trust.

Superannuation

There may be tax advantages in paying a superannuation death benefit directly to one of deceased member's dependant children to the exclusion of others where the chosen child is a Death Benefit Dependant for taxation purposes.

A lump sum superannuation death benefit paid to a superannuation dependant who is also a Death Benefit Dependent for taxation purposes is tax exempt. By allocating the superannuation death benefits

to a child who is a tax dependant, the overall taxation liability on the distribution of the death benefit may be eliminated. However, as with unequal trust allocations, allocating superannuation death benefits to a child who is tax dependent has the potential to advantage one Beneficiary over another.

The Will should include an adjustment clause to take account of superannuation death benefits received directly by a Beneficiary. In the absence of an adjustment clause, the Executor will not have the power to adjust for superannuation paid directly to one of the Beneficiaries of the Will.

As well consideration should be given to extra funding to ensure that the offset meets the equalisation requirements of the Will maker.

Gifts and Loans

An adjustment to a Beneficiary's entitlement under a will may also be necessary where the Will maker has made additional provision for a Beneficiary during their lifetime.

If it is the intention for a gift or loan to be regarded as an advancement on the Beneficiary's inheritance, this should be clearly set out in the Will. 'Where the intention of the gift or loan is to be in addition to a beneficiary's inheritance, the Will should specify this and expressly forgive the loan or confirm the gift. To avoid dispute, an agreement in writing prepared during the lifetime setting out the details of the transaction should be stored with the original Will.

Gifts to Charity

Charitable giving is an objective of many Will makers.



It is an opportunity to contribute to the work of a Client's favourite charity into the future. In considering a charitable bequest, the Client should be aware of the potential tax consequences of a charitable gift.

The Income Tax Assessment Act has two concepts relating to charities:

- Tax exemption
- Tax deduction.

Some organisations are tax exempt, and therefore the organisation pays no income tax on its activities. Some organisations are deductible gift recipients (DGRs), and therefore gifts made to such organisations are tax deductible for the donor. A number of charitable organisations qualify as both tax exempt and tax deductible. Other organisations, such as churches and religious organisations, are tax exempt only and are not DGRs. The nature of the gift and the taxation status of an organisation will affect the taxation consequences of a bequest.

Gifts to Tax Exempt Organisations

When an asset passes from an estate to a tax exempt organisation, the Income Tax Assessment Act deems that the gift immediately prior to death for market value. This is referred to as a CGT Event K3, and the estate becomes liable for capital gains tax ('CGT'). This will not be relevant if the asset was acquired prior to the introduction of CGT on 20 September 1985 or if the asset is cash.

Therefore, if it is an intention to make a gift to an organisation that is tax exempt, it would be preferable

to make the gift in the form of cash, if there are cash reserves available. If the gift other assets that are subject to CGT, such as shares or real estate, this may reduce the value of the gift or the value of gifts made to other beneficiaries.

There is a notable exception to the principle that gifts made to tax exempt organisations should be made in cash. If the gift in your Client's Will is under the Cultural Bequests Program, the gift is exempt from CGT. The Cultural Bequests Program is administered by the Federal Department of Communications, Information Technology and the Arts. Essentially the program encourages gifts of significant cultural items to public art galleries, museums and libraries by giving donors a tax deduction for the market value of their gifts.

The gift can take any form other than an interest in land or a building. In addition, the property must be accepted by the institution receiving it for inclusion in a collection that it is maintaining or establishing. It is recommended that the Will maker wishes to make a non-cash, charitable gift in the Will should first make contact with the intended recipient to discuss the nature of the gift and then seek advice about the likely tax consequences.

Gifts to Tax Deductible Organisations

The tax consequences of a gift to an organisation that is also a DGR are different. The Income Tax Assessment Act allows for a capital gain arising from a testamentary gift to be disregarded provided the gift would have been deductible had it not been a



testamentary gift. Therefore, if the intended organisation that benefits is a DGR, provided the requirements of the Income Tax Assessment Act are satisfied, the Estate will not be liable for the payment of CGT liability arising from the making of the gift.

When nominating a charity as a Beneficiary in the Will, the full and correct name of the charity that it is intended to benefit should be stated. Difficulties can arise where the reference to the charity is vague and there is more than one organisation of a similar name.

The Client should also include a power in the Will for the Executor to pay to an organisation that represents the successor to the nominated organisation, or another organisation that is likely to satisfy your charitable objectives. This ensures that the Executor will be able to complete the gift.

Furthermore it is important to specify in the Will that the receipt of the secretary; treasurer or other authorised representative of the organisation is a sufficient discharge to the Executor.

Summary

A Will is made up of many elements; some of which have been highlighted. To ensure that a Client's Will contains the necessary clauses to deal with the circumstances, specific estate-planning advice should be sought. This is particularly the case where control a family trust or have significant superannuation, or where a Client wants to give away specific assets to beneficiaries. If a Client has children aged 18 or younger, the Will should clearly outline who their guardians should be in the event of their death.

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