# Tax equalisation clauses in wills – devil is in the detail

***- by Matthew Burgess, Director, View Legal***

Many tax and estate planning specialists argue tax equalisation provisions in wills are rarely appropriate.

The case of *Todd v Todd & Ors* [2021] SASC 36 further reinforces a number of the issues in this regard.

**Case summary**

Relevantly, a key clause in the will provided that the assets be "*divided between (the beneficiaries) in such a manner so as to ensure that as at the finalisation of the administration of my estate all of my said children have received an equal value of bequests under this my will*".

In question was whether the accumulated (latent) CGT liability attached to each of the key assets should be taken into account in determining the value of the individual bequests or alternatively ignored.

The will itself was unclear on the approach to take and the Court confirmed the cases were similarly confused, and indeed possibly in conflict.

The Court did however confirm the following general principles.

- Whether the incidence of CGT should be taken into account in valuing a particular asset varies according to the circumstances of the case, including the method of valuation applied to the particular asset, the likelihood or otherwise of that asset being realised in the foreseeable future, the circumstances of its acquisition and the evidence of the parties as to their intentions in relation to that asset.
- If the Court orders the sale of an asset, or is satisfied that a sale of it is inevitable, or would probably occur in the near future, or if the asset is one which was acquired solely as an investment and with a view to its ultimate sale for profit, then, generally, allowance should be made for any CGT payable upon such a sale in determining the value of that asset for the purpose of the proceedings.
- If none of the circumstances referred to in the dot point above apply to a particular asset, but the Court is satisfied that there is a significant risk that the asset will have to be sold in the short to mid-term, then the court, whilst not making allowance for the CGT payable on such a sale in determining the value of the asset, may take that risk into account as a relevant factor, the weight to be attributed to that factor varying according to the degree of the risk and the length of the period within which the sale may occur.

- There may be special circumstances in a particular case which, despite the absence of any certainty or even likelihood of a sale of an asset in the foreseeable future, make it appropriate to take the incidence of CGT into account in valuing that asset. In such a case, it may be appropriate to take the CGT into account at its full rate, or at some discounted rate, having regard to the degree of risk of a sale occurring and/or the length of time which is likely to elapse before that occurs. Arguably, this last point is a practical example of "The Vibe" principle, popularised in the movie The Castle.

**Decision**

In this case, the Court held there was nothing to support an argument that "value" should notionally bring potential future CGT liabilities to account. Furthermore, the will evidenced no intention that the process of ascertaining the equal value of bequests required the taking into account of the future potential taxation liability.

It was also held to be incorrect to say that a property bequeathed to a person in the highest bracket of income tax payable for a given year would have a higher value than had it been bequeathed to a person who had nil taxable income. This is because such a proposition ignores the fact that CGT liability in respect of a property only arises when (and if) that property is disposed of, and only then will the resultant tax payable (if any) be able to be determined.

**Practical issues**

Practically, there are a myriad of reasons why tax equalisation clauses are rarely appropriate, for example:

- often a client will only want to take into account the tax position in relation to a particular asset (eg, superannuation). This can lead to significant imbalances in relation to other assets in the estate – most classically, a family home which, like superannuation, can often be received tax-free by a beneficiary;
- while there are embedded tax attributes in relation to certain assets, there can also be embedded tax attributes with the recipient – for example, if a beneficiary is a non-resident at the date they receive the asset, this can trigger a completely different tax outcome as compared to a beneficiary who is an Australian resident. Often these issues will change radically between the date of drafting the will and the date of death;
- where assets are to pass via a testamentary trust, this can cause a wide range of potential tax differentials, many of which may be unknown for a significant period of time;
- similarly, to the extent that there are assets held in related entities (for example, family trusts or private companies), there may be a wide range of potential tax ramifications which again may be unknown for a significant period of time;

- the calculations in relation to the net position of each beneficiary can potentially be limitless – eg, additional payments made to one beneficiary to compensate for the fact that they received assets that may have a latent tax liability may themselves cause a further tax liability, which then would trigger a further payment, which of itself would cause a further tax liability; and
- most clauses in this area are also crafted with reference to precise tax provisions at a particular moment in time – there is a material risk that those tax rules will have changed by the time the will actually comes into effect.

**Conclusion**

In light of the above difficulties, it is therefore normally preferable to simply set out directions in the memorandum of directions to the trustees of the estate to ensure that they seek specialist advice at the point of administering the will to ensure that the optimal legitimate tax outcome is achieved for the estate (and therefore the underlying beneficiaries) as a whole.