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Why tax and estate planning is critical (as opposed to tax or estate planning)

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In holistic estate planning it is invariably the case that tax awareness has a critical role to play.

A blunt example in this regard relates to transfers of assets under a will and the capital gains tax (CGT) exemption that can be available pursuant to division 128 of the Tax Act.

For example, there is a CGT rollover available under division 128 where the receiving beneficiary becomes the owner of the asset under:

- the will, or that will as varied by a court order (see section 128-20(1)(a)); or
- a deed of arrangement where the beneficiary entered into the deed to settle a claim to participate in the distribution of the estate and no consideration was given (see section 128-20(1)(d)).

Background to recent decision

The decision of Re O'Hara-Tucker [2022] VSC 572 ("O'Hara-Tucker") starkly highlights tax and estate planning nuances; which are often magnified where there are cross border beneficiaries.

Relevantly from a tax perspective, a beneficiary based in the UK was personally entitled to in-excess of $3M from the estate of an Australian willmaker.

The UK beneficiary had lost capacity (due to dementia) prior to the distributions being made under the Australian will and the likely beneficiaries of the estate of the UK beneficiary were concerned to manage UK inheritance tax. As set out in the decision, UK inheritance tax:

- is payable by any individual domiciled in the UK on their worldwide assets, which also takes into account lifetime transfers for seven years prior to death;
- allows an individual a nil band amount of £325,000 (on which inheritance tax is not payable);
- for amounts above the nil band limit, the rate of inheritance tax is 40%.

The tax liability was estimated at being more than £450,000.

Deed of variation

Deed Purporting to act under an enduring attorney appointment made by the relevant Australian tribunal, the ultimate beneficiaries in O'Hara-Tucker applied to the court to vary the Australian will

to have the entitlement of the UK beneficiary instead distributed equally between eight newly settled discretionary trusts (one for each of the 8 adult children of the UK beneficiary).

The strategy was driven by the argument that a discretionary trust in the UK also has a nil band rate of £325,000, and provided that the distribution to each of the trust was less than this amount, no inheritance tax would ultimately be payable.

The advice from the UK advisers recommended a deed of variation to the Australian will to achieve the UK tax planning and (it is assumed) fall within the Australian CGT relief outlined above.

Court decision

In denying the request to vary the will, the court confirmed in O'Hara-Tucker:

- the tribunal appointing the attorney for the UK beneficiary specifically mandated (for reasons not stated by the tribunal, however presumably due to the way in which the application was crafted, possibly to meet requirements from a UK perspective) that the variation of the will was to be by way of a 'Deed of Family Arrangement' - approved by the Supreme Court;
- however, the court only had the power under the relevant legislation to approve a compromise of a will (eg due to a challenge against the estate) - here the proposed transaction was not a 'compromise', as there was no dispute to be resolved, and no concessions to be made by any interested parties. Instead, the proposal was to simply give away beneficial interests that had arisen to the inter vivos trusts, that had already vested in interest in the UK beneficiary personally pursuant to the will;
- the alternative argument, raised during the trial, that the interest of the UK beneficiary could be assigned to the trusts by the attorney may have been correct at law. In particular, the decision in Re Tracey [2017] 2 Qd R 35 confirms that an 'administrator (or attorney) is authorised to do, in accordance with the terms of the administrator's appointment, anything in relation to a financial matter that the adult could have done if the adult had capacity for the matter when the power is exercised';
- here however the assignment argument was predicated on the effectiveness of the deed of variation to the will. Again it was noted that the attorney did not have the ability to enter into the deed of variation without the consent of the Supreme Court, which as set out above, was not able to be granted. Therefore any purported assignment by the attorney was held to also fail.

Planning issues for advisers

Although not relevant to the ultimate decision in O'Hara-Tucker, some other aspects that appear important to note in relation to both tax planning and structuring of estate plans in similar factual situations include:

- There were dating errors in a number of the trust deeds in O'Hara-Tucker that arguably created unnecessary distractions;
- similarly, a number of the trust deeds appeared to erroneously list the primary beneficiary, thereby causing conflict in interpretation of the deed, as compared to the stated objectives;
- the argument (raised at trial) to simply assign the interest of the UK beneficiary to the trusts does not appear to fall within the CGT rollover relief under division 128, and therefore would have likely triggered a CGT liability;
- at least in relation to deceased estates, it appears that both an equitable assignment and a direction to the trustees or executors to hold a beneficiary's interest on trust for another party are practically the same;
- an attorney has the ability to terminate a trust for an incapacitated beneficiary and require the transfer of the trust property to the adult beneficiary (ie invoke the rule in Saunders v Vautier [1835] All ER 58 ("Saunders"). Under the rule in Saunders 'an adult beneficiary (or a number of adult beneficiaries acting together) who has (or between them have) an absolute, vested and indefeasible interest in the capital and income of property may at any time require the transfer of the property to (them) and may terminate any accumulation');
- the importance of a robust enduring appointment document (with additional powers such as permitting conflicts of interest transactions and without any unnecessary limitations, such as requiring court approval) cannot be underestimated - even where the appointment is made via tribunal application (as opposed to the principal making the appointment while retaining capacity);
- in addition to the overseas and Australian tax position, the stamp duty rules need to be considered to the extent the underlying Australian assets are dutiable. While each state has different rules in this regard, it is often the case that even if there is CGT rollover relief, there will not be a stamp duty exemption on variations to distributions otherwise mandated by the will; and
- CGT event K3 can operate to trigger CGT where assets that are not 'taxable Australian property' pass to a non-resident directly following the death of the asset owner (which may well have also been triggered in the case here), with the time of the CGT event being just before the date of death of the asset owner (and therefore a tax impost that must be included in the tax return to the date of death of the willmaker, see section 104-215(3)). As explored in this Bulletin previously (for example see 2014 WTB 19 [754] CGT event K3 can generally be managed by ensuring an asset does not pass directly to a non-resident beneficiary (for example by ensuring and Australian resident testamentary trust is the receiving vehicle)Lessons from