

Family SAPEP Case Study - Four Generations Down



1. The Traditionalist Generation

John Smith is 83 years old and has just had a mild stroke and is now out of the hospital. His wife Sally, aged 78 is in early-stage dementia (2 years) and no longer has mental capacity. John has been looking after Sally full time. They live in Glen Iris in Melbourne and their home is paid off and valued at \$1,250,000. John also has an investment property in the Gold Coast which is valued at \$650,000 with no mortgage.

John and Sally's son Bruce who is aged 55 lives nearby – he has had an up and down life, a battle with drugs, alcohol and sex addiction plus going bankrupt twice, divorced twice and in a two year defacto relationship with Shirley, aged 28 who helps John out around the house and cooks dinner for both of them. Bruce is retired and living in a rented house – has \$250,000 in Westpac Super and gets \$2,000 per month support from John for doing odd jobs around the house. Bill is their eldest son – aged 59 who lives in Perth and works as a director of a mid-tier mining company and is wealthy. Bill has John and Joan's enduring power of attorney and is the executor of his Will - which was completed in 2008.

The main source of income for John and Sally, apart from the rent on the investment property is the Smith Family Super Fund which has John and Sally as the only members and trustees. Their accountant is not aware of Sally's problem as John has been keeping it secret. They have both been signing off accounts and tax returns since she was first diagnosed two years ago. The fund has \$2.5M in assets - \$1.8M in John's account-based pension (20% tax-free component) and \$700,000 in Sally's account-based pension (30% tax-free component) both established in 2007 by their accountant at the time. Neither has a reversion.

The fund is running on a deed from 2005. John has been the major investor in the fund and has been 80% invested in CBA, NAB, Telstra, and ANZ stocks to get franked dividend income. There is a \$1,000,000 capital gain on the shares and cash dividends fully franked for 2021 were \$80,000.

John tells you Bruce has been nagging to get into his Dad's SMSF with Shirley who has \$20,000 in an industry-based superannuation fund. *Should Bruce come into the Smith Family Super Fund?* Bill is worried about Bruce having power over the family's super.

John wants to make sure that if something happens to him Sally is looked after for the rest of her life – maybe even home care. His last Will gives all of his estate to Sally and then to to Bill, except for \$100,000 to Bruce as John and Sally had saved Bruce's bacon so many times. Sally's Will is the same.

Last year he investigated getting home care for both himself and Sally as she has been getting a lot harder to manage. He was shocked to find out that specialised help costs \$45 per hour or \$110,000

per annum. He has also been looking at the Noel Miller aged care facility in Glen Iris which has specialised aged care and dementia services.

After John's stroke Bill has flown in and decided to sort things out. He has found your name and has booked an appointment. The appointment goes well and you get on well with both John and Bill. John has said he wants all of his assets to be split equally between the two boys but is worried about Bruce wasting the money. He thinks Bill should be in control and give Bruce money when he needs it.

John seems sprightly seeing he has just had a stroke and Bill is very determined to sort things out and will pay your fees directly.

What are some of the issues that you see?

Capacity

Bill wants to take control of the fund with John. He also wants John to promise to get domestic help and has suggested that Bruce and Shirley enter into a formal arrangement with John and Sally to look after their parents – creating a list of duties for a set fee of \$5,000 per month. He also wants John to set down a list of financial amounts that he can put into an SMSF Living Will so that he is guided if John passes away or loses his mental capacity. He does not want Bruce to be able to challenge any measures that he puts in place for his father and mother. In terms of the Will, Bill is worried that if John pre-deceases Sally (highly likely as Sally's mother lived to 98), then what happens with Sally's Will?

What are some of the questions and arrangements that you would suggest to Bill and John?

Aged Care

Bill has got John to agree to move into the Noel Miller Retirement facility in Glen Iris if he has another stroke. They will sell the home and use the proceeds to acquire an apartment in the facility. The facility provides full Alzheimer's support and care for its residents. One of John's neighbours moved there when it was first opened in 2003 and John likes it. Sally even used to play Canasta with some of the residents there. However Bill has been in touch with the managers and there is a long waiting list – there is an apartment which can be acquired now for \$450,000 – the manager is happy to lease it from John at \$500 per week if John was not using it.

How should they pay for it? Can a downsizer contribution be made for John and Sally with the remaining proceeds from the sale of the family home?

Auto-reversionary pension

Both pensions are very basic and probably in breach of the trust deed and SIS Regulations plus there are CGT problems on death. Answer the following:

Can an auto-reversionary pension be commenced for John with an income to go to Sally if she is alive and then to the boys equally?

- Complete the relevant documentation for the pension?
- Can an auto-reversionary pension be completed for Joan as she is mentally incapacitated with terms and conditions the same as John's?

- What are the taxation consequences for the various recipients of John's pension which is 20% tax-free and 80% taxable components?

What happens with Sally's non-reversionary pension? Can her EPOA make a change?

Estate Planning

What is going to happen with the Wills? Bruce has a legal mate who is a "no Win, no Fee" lawyer who has promised to help him get access to his parents estate. Remember John told Bill that he is to get all of his estate except for \$100,000 which is to go to Bruce but Bruce and Bill are to share the super equally.

SMSF Estate Planning

What strategies apply to the fund for the following:

1. Bill, John's son has \$650,000 in his SMSF which he holds with his wife – should Bill become a member of the fund? But see more on Bill's own SMSF below.
2. Bill has heard that a binding death benefit nomination should be employed to ensure that Bruce will not challenge the equal payment of any remaining capital death benefits to the two boys equally.

2. The Baby Boomers

Bill Smith is so impressed with your skills with his parents he has decided to switch his accounting and structuring to you.

Bill is the high flyer in the family and has children from his first marriage – David aged 25 finishing his last year of engineering and Simon – aged 22 who lives with his mother – Fran and is intellectually disabled. Bill still pays for David to go through engineering and pays Fran \$4,000 per month to care for Simon.

Bill is married for the second time to Cathy – aged 40 who manages her father's business. She does not get on with Bill's children which causes Bill grief. Cathy was a criminal lawyer many years ago and knows her way around the law.

Bill has currently been headhunted and has struck a deal with his new company – Petreus Gold Ltd – a company listed on the ASX, to come on board as MD with the company selling him \$2.5M in shares at market value of 10c. Bill doesn't have the money but the company said they would lend him \$2.5M at an interest rate of 5%. He is on \$250,000 per annum and 1 million options at 1c if certain performance hurdles are met. Bill has had advice from one of the big four accounting firms to get these shares and options into the family trust. Bill only went over after exhaustive research and believes the shares will go to \$1 within the next five years particularly with new patented exploration techniques that the company is using.

Bill has an SMSF, the Smith Family Super Fund with Cathy also a member. Cill Nominees Pty Ltd is the trustee of the SMSF with Bill and Cathy as directors and Bill holding all the shares. Bill's accumulation balance is \$650,000 – all taxable components while Cathy's is \$350,000. They are invested in cash – Bill has not had time to invest – being too busy with work.

Outside of superannuation Bill has a portfolio of 6 properties that he has accumulated over the years, all in his own name, with the following table detailing these properties:

Property	Cost	Market Value	Income pm
Claremont apartment	\$250,000	\$300,000	\$1,600
Fremantle apartment	\$250,000	\$325,000	\$1,200
Broadbeach apartment	\$600,000	\$825,000	\$2,000
Noosa apartment	\$600,000	\$825,000	\$2,000
Karratha townhouse	\$350,000	\$300,000	\$3,000
Potts Point apartment	\$600,000	\$1,600,000	\$2,000
Total	\$2,650,000	\$4,175,000	\$10,200

The total debt on the properties – secured over the entire portfolio is \$1.3M.

Bill's Will, created during his last marriage, provides for his two boys to get 60% of his assets and his ex wife 40%. Cathy gets nothing and she believes she is entitled to all of it as Bill was a broken man when she first met him fifteen years ago after his divorce from Fran.

Advise Bill on the following:

The transfer of the shares and options of his employer into his SMSF and consider the following:

- The impact of the sole purpose test:
- The in-house assets test
- How section 67A applies and what is the best way to structure the loan from the employer and also the options packages in the fund

Advise on the trusteeship of the fund.

Can Bill transfer the properties into the SMSF?

Property management background

- He employs a PA to look after the properties directly rather than hire a property manager. He has had some bad experiences previously and most of the tenants are executive rentals.
- He has established a long-term business plan seeking to acquire a new property every two years – looking for 8% growth and income yield, secure executive rentals, and diversified across WA and Eastern seaboard. Both the Noosa and Broadbeach apartments are holiday rentals.
- His next investment is going to be a commercial property – probably for use by his wife's company in the Pilbara. The expected rental yield will be 12-15%.

Can the properties be transferred into his SMSF as business real property and if so what are the tax and duty consequences?

Estate Planning

What is your advice on the Will? Is it valid, can he change it? How do you protect from a challenge by Cathy which will leave the boys destitute?

SMSF Estate Planning

Bill wants to leave the properties in the fund to his eldest son David and the shares in a trust of some sort for his disabled son Simon.

1. Advise on the best SMSF and other estate planning structuring for David and Simon; and
2. Should he keep everything separate from Cathy?

3. Generation X Case Study

Cathy Smith – aged 40 is Bill's wife and currently runs a mining services company that purchases large mining equipment and leases it out to mining companies in the Pilbara. This business is her father's who is 68 years of age but has been diagnosed with pancreatic cancer. Her other brother lives in Bali and has never been interested in the business BUT has been told many years ago by his Dad that the business will be his when he dies. Cathy's mother passed away many years ago.

The business has several Caterpillar trucks on the books of the company and with any lease, all repairs, outgoings, maintenance, and other costs are met by the hirer who generally has a team of mechanics looking after their fleet.

The company Mining Services (WA) Pty Ltd has \$5M in cash and expects a significant profit this year. She has been contacted by one of her hirers who needs a new Caterpillar 797 F Mining Truck and will enter into an expenses-paid lease of \$90,000 per month. The banks are willing to lend her the \$5M needed to acquire the truck.

Cathy has \$350,000 in the Smith Family SMSF – all invested in cash. She has come to you and knows about being able to use business real property in an SMSF. She asks can her company buy the truck in the MS (WA) and then can she transfer this to the SMSF as there could be a good tax saving.

Advise on the following:

SIS Act 1993 Investment Rules

Which rules prevent Smith Family Super Fund from acquiring any business equipment from the related company?

Acquiring the Truck in the Fund

How is it possible for the Smith Family Super Fund to acquire the Truck in the fund?

Advise on the following:

1. Can the truck be acquired directly into the SMSF?
 1. Who would provide the finance and at what rate and term?
 2. Section 62 – the running of a business in an SMSF

3. Who would be the lessor and the lessee?
4. What are the taxation consequences for the fund and should Bill – aged 53 be used as he is close to his TRIS?

SMSF Investment Strategy

What would be the fund's investment strategy for the truck? In addition what should be done with the \$90,000 per month cash that is generated from lease?

Estate Planning

Cathy has a 14-year-old daughter – Sarah, from a prior relationship who lives with her and Bill. She wants her to be looked after in the event of her death but does not want to see her former partner get any of the money. There is no doubt that if she dies that Sarah would live with her partner and his current 21-year-old wife. At this time she and Bill keep their finances separate and so she wants all of her super and company assets to go to Sarah.

1. Advise on the best SMSF and other estate planning structuring for Cathy; and
2. How can she secure the estate for Sarah and protect it from her ex-partner and your wife?

4. Generation Y

Bill has sent David to you for general structuring advice before he gets a role with BHP Billiton as a mining engineer. Based on previous graduates by age 30 he should be earning \$350,000+ per annum. He expects to do a lot of overseas secondments.

He has no super at present but Bill, at your suggestion has put him into the fund as a member to obtain TPD insurance – just in case something happens. He has decided to give David a helping hand and wants to transfer the Noosa property into David's name and has arranged for a line of finance of \$200,000 which Bill will lend to the fund to acquire the Noosa property on David's behalf.

Advise on the following:

Membership

Can the Smith Family Super Fund accept David as a member?

Can the proposed sale/contribution be done? Advise on the following:

Is the transaction allowed under section 67A?

1. Bill would like to provide a low-interest loan - what rate and term should he use?
2. The property needs \$20,000 of repairs and a new kitchen fit-out which will cost \$35,000 but increased rent considerably. How should these expenses be financed?
3. Should life insurance be taken out on David's life and who would be the beneficiary?

SMSF Investment Strategy

1. Should the property be held in a segregated account in the fund? What would the investment strategy look like?
2. David intends to contribute as much as possible to superannuation. Given his young age, what is an appropriate investment strategy for this young member?

Estate Planning

After you set up David's account in the fund and life insurance of \$1M, his plane falls out of the sky in the Pilbara. As yet you have not got around to estate planning. The Trustees are using a LightYear Docs trust deed with a special purpose corporate trustee.

1. What happens with the outstanding debt owed by the fund to Bill? and
2. Bill does not want to take the Noosa property out of the fund what is the best course of action? And
3. David does not have a Will so what is the process of intestacy?