The process of metamorphosis

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One day a caterpillar stops eating, hangs upside down from a twig or a leaf and spins itself into a silky cocoon. Within its protective casing the caterpillar radically transforms its body eventually emerging as a butterfly.

This is a process called metamorphosis. It's a Greek word that means transformation or change…

I am trying to look at the imposition of our latest lockdown as an opportunity for my own metamorphosis. Anything not nailed down in our house has been painted, I have had my six-monthly health check, hitting golf balls in the back yard net and reviewed our family's personal financial position.

I am trying to ensure I do not waste this opportunity and come out of the lockdown with my "life admin" buffed and polished!

There are several interesting issues that have come to light recently that I would like to share with you in this Tax Brief.

Asset succession update

I recently had a client pass away with the spouse nominated as the Executor of the Will. The client applied for Probate successfully however I was unable to directly assist in the practicalities of the ongoing administration of the Estate.

Bank account signatories or authorisations with investment advisors must be legally held by the Executor and the client could not delegate those authorities.

An Executor holds a duty to act personally in the administration of an estate. An Executor cannot delegate executorial duties under either a general or enduring Power of Attorney or fetter their discretion by leaving control of the estate to a co-executor.

Action required

A couple of lessons to be learnt here:

1. If you and your spouse are Executors of each other's Will, given your current personal circumstances is this now appropriate? Is it time to consider having someone else take on this responsibility?
2. Check who your alternate Executors are in your Will. Make sure there is a backup if you do not feel capable of taking on these duties. You can then step aside prior to proving Probate and not accept the role knowing that there's an alternative that can step in.

Your personal circumstances are constantly changing. Your asset succession strategies and documentation to implement those strategies must also adapt to meet those changing circumstances.

Succession planning for trusts

Trusts are very popular vehicles to hold investment assets.

They have great flexibility and provide significant asset succession advantages allowing the control of assets to pass to the next generation without triggering a taxable capital gain on disposal.

A recent family law case *Rigby & Kingston (No. 4) (2021)* has highlighted from a family law perspective the need to understand who controls a trust and how that control will be passed on.

Mr Rigby and Ms Kingston's marriage dissolved, with Ms Kingston's family being independently wealthy.

As part of the family law proceedings Mr Rigby unsuccessfully tried to join the Kingston family assets to the proceedings.

The Judge rejected his claim to include the family assets on the basis that Ms Kingston did not control assets held via trusts with the control of the trusts residing with her two brothers.

Key takeaways

We are always conscious of protecting assets from relationship breakdowns of the next generation.

You may consider to whom you are passing control of your trust to on your passing and question whether the transfer of control mechanism can be tightened to protect the trust assets if a spousal relationship of one of your children breaks down.

Secondly as part of your review of your 30 June 2021 trust accounts, make sure you understand which beneficiaries are owed money by your trust. This is known as an unpaid present entitlement. Such liabilities will have ramifications for the passing of assets on your death as such beneficiaries will be able to draw on those assets from the trust to extinguish the liability including an Estate.

Share buybacks – do not leave implementation actions to others

There are two significant public company share buybacks currently on offer: Commonwealth Bank of Australia ('CBA') and Woolworths. It is important that if you hold shares in these companies, you proactively consider the implications in accepting or not the buyback offer. CBA's buyback closes on 1 October 2021 and Woolworths on 15 October 2021.

Do not assume your broker will manage this for you.

Proactively analyse the implications of accepting this offer in your own personal circumstances. Both the CBA and Woolworths have offered to buy back their shares at a discount of 10-14% of market value. The final price will be determined by each Company and its likely that both buybacks will be over subscribed and therefore scaled back.

You ask yourself the question:

"Why would I participate in a buyback to dispose of my shareholding when I could dispose on the market and not suffer the discount?"

Read on!!

Taxation implications of a share buyback

Share buybacks have an unusual taxation outcome. This means that you may be able to financially improve your circumstances by accepting the buyback, notwithstanding it is at a discount to market. It is a disposal of the shares for Capital Gains Tax purposes and a receipt of a dividend for income tax purposes.

Process

The company will nominate a capital value for the shares (CBA $21.66, Woolworths $4.31). The difference between that price and the agreed share buyback price will be treated as a fully franked dividend for the shareholder. The company will nominate a tax value for the shares which will be the deemed consideration for Capital Gains Tax on the disposal of the shares. This value will be dependent on the movement in the share price between the time just before the buyback was announced and the closing date of the buyback. The capital value of the shares less your cost price will then determine whether you have a capital gain or loss on the disposal of these shares. The dividend component of the buyback needs to be returned as assessable income.

What is my cash impact of accepting the offer?

The tax consequences of the buyback play an important role in determining whether you take up the buyback.

The tax implications for you will be dependent upon:

1. What entity in your Group hold the shares
2. What is the ultimate rate of income tax for the shareholder
3. Whether you have carried forward capital losses in your group, and
4. If you hold the shares in a self-managed superannuation fund, whether you are in pension mode.

The following is an example of how the share buyback will work for both CBA and Woolworths where the shares are held in a Trust and a SMSF:

Commonwealth Bank Share Buy Back

Illustration of Taxation and cash flow Implications where shares are held by a SMSF and Trust

Assumptions		
Information provided by CBA:		
Shares trading at	$	100.00
Shares are bought back for a 14% discount:	$	86.00
Capital Component	$	21.66
Deemed Market value of shares for CGT purposes	$	35.66

Information relevant to Shareholder

	SMSF*	Trust**
Number of shares held	1,000	1,000
CGT Cost Base/Share	$ 50.00	$ 50.00
Market Value of shares	$100,000.00	$100,000.00

Shares held for more than 12 months

** SMSF is not in Pension mode therefore rate of income tax is 15% and CGT 10%*

*** Trust Distributes to Beneficiary at the 47% tax bracket*

Woolworths Share Buy Back

Illustration of Taxation and cash flow Implications where shares are held by a SMSF and Trust

Assumptions		
Information provided by Woolworths:		
Shares trading at	$	40.00
Shares are bought back for a 14% discount:	$	34.40
Capital Component	$	4.31
Deemed Market value of shares for CGT purposes	$	9.91

Information relevant to Shareholder

	SMSF*	Trust**
Number of shares held	1,000	1,000
CGT Cost Base/Share	$ 20.00	$ 20.00
Market Value of shares	$40,000.00	$40,000.00

Shares held for more than 12 months

** SMSF is not in Pension mode therefore rate of income tax is 15% and CGT 10%*

*** Trust Distributes to Beneficiary at the 47% tax bracket*

Taxation Impact

CGT Impact		
Consideration for CGT Purposes	$ 35,660.00	$ 35,660.00
Cost Base for CGT Purposes	$ 50,000.00	$ 50,000.00
Capital Loss	**-$ 14,340.00**	**-$ 14,340.00**
Income Tax Impact		
Dividend for Tax purposes	$ 64,340.00	$ 64,340.00
Imputation Credits	$ 27,574.29	$ 27,574.29
Amount returned as Income for tax	$ 91,914.29	$ 91,914.29
Income Tax Payable	$ 13,787.14	$ 43,199.71
Less Imputation Credit	-$ 27,574.29	-$ 27,574.29
Net Tax payable (refundable)	**-$13,787.14**	**$15,625.43**

Cash Flow Impact

Cash received from CBA	$ 86,000.00	$ 86,000.00
Taxation Impact – Income	$ 13,787.14	-$ 15,625.43
Taxation Impact – Utilising Capital Loss	$ 1,434.00	$ 3,369.90
	$101,221.14	$ 73,744.47
If you just sold the shares		
Consideration	$100,000.00	$100,000.00
CGT Impact		
Cost Base	$ 50,000.00	$ 50,000.00
Capital Gain	$ 50,000.00	$ 50,000.00
Tax	$ 5,000.00	$ 11,750.00
After Tax receipt from sale of shares	$ 95,000.00	$ 88,250.00

Taxation Impact

CGT Impact		
Consideration for CGT Purposes	$ 9,910.00	$ 9,910.00
Cost Base for CGT Purposes	$20,000.00	$20,000.00
Capital Loss	**-$10,090.00**	**-$10,090.00**
Income Tax Impact		
Dividend for Tax purposes	$30,090.00	$30,090.00
Imputation Credits	$12,895.71	$12,895.71
Amount returned as Income for tax	$42,985.71	$42,985.71
Income Tax Payable	$ 6,447.86	$20,203.29
Less Imputation Credit	-$12,895.71	-$12,895.71
Net Tax payable (refundable)	**-$6,447.86**	**$7,307.57**

Cash Flow Impact

Cash received from CBA	$34,400.00	$34,400.00
Taxation Impact – Income	$ 6,447.86	-$ 7,307.57
Taxation Impact – Utilising Capital Loss	$ 1,009.00	$ 2,371.15
	$41,856.86	$29,463.58
If you just sold the shares		
Consideration	$40,000.00	$40,000.00
CGT Impact		
Cost Base	$20,000.00	$20,000.00
Capital Gain	$20,000.00	$20,000.00
Tax	$ 2,000.00	$ 4,700.00
After Tax receipt from sale of shares	$38,000.00	$35,300.00

The analysis will be different if your SMSF is in Pension Mode and if the beneficiaries of the Trust are taxed at a lower rate than 47%.

Please consider if you hold these shares and proactively talk to your investment and taxation advisor to determine the best outcome for you.

If you do not hold shares in these companies still hang on to my paper as the next time a public company does a share buyback you will be well armed!

Superannuation update

Performance test for MySuper products

The first performance test for public offer superannuation funds was recently released with 13 funds failing the Regulator's performance hurdles.

It is important to note however the regulator is only testing MySuper products which accounts for 60% of public offer funds.

This means 40% of funds were not tested. Three quarters of members who will be receiving letters notifying them that their fund failed the performance test belong to two specific funds.

If you or your family hold money in public offer superannuation funds, please evaluate its performance. It might not have been tested by the Regulator.

Retirement income covenant requirement – more government red tape for SMSF's

The Federal Government has released a position paper outlining its desire to have all superannuation funds (including SMSF's) document their retirement income covenant. If legislated, this will require SMSFs to have a retirement income covenant from the 1 July 2022.

What is a retirement income covenant?

This will be a strategic document developed by the trustee outlining their plan to assist their members achieve the following objectives:

1. Maximise their retirement income.
2. Manage risks to the sustainability and stability of their retirement income.
3. Have some flexible access to savings during retirement.

Self-managed superannuation funds are already required to have a documented investment strategy. I am not sure how the extra requirement to have a retirement income covenant adds to a well-developed investment strategy as your SMSF's investment strategy should be considering the above-mentioned factors.

This will be another requirement you will need to meet as part of your annual compliance obligations as a trustee.

Watch this space for how you will need to comply with this requirement.

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As always if you require assistance with the implications of any of the matters raised in this Paper, please do not hesitate to contact me.

This advice is general in nature, and you will need to consider it in light of your own specific circumstances.

It is not legal or investment advice. For legal or investment advice you should seek assistance from suitably qualified lawyer or regulated investment advisor.

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