Avoiding the 'L' Shaped Inheritance®

We have all heard of something going 'pear' shaped. Inheritances face a real risk of going 'L' shaped, and almost everyone has a story of a friend or relative who has had the misfortune to experience this.

An 'L' shaped Inheritance® is one that was meant to go to certain people in the Will, but ended up in the hands of someone else.

HERE IS AN EXAMPLE:

John and Sally are in their 40s and have two teenage children, David and Samantha. Unfortunately Sally dies leaving all of her estate to John. Her estate comprises her half share in the family home, shares and cash that she inherited from her own parents of $500,000 and superannuation and life insurance valued at $200,000. Her total estate is worth $1M. John has assets of $600,000. Five years later John meets Elizabeth and they marry. Elizabeth has three children of her own from her former marriage. Elizabeth comes into the marriage with assets totaling $300,000. John and Elizabeth make Wills leaving everything to each other and then to the five children in equal shares. John dies ten years later. Seven years later Elizabeth is wanting to change her Will to leave all of her estate to her three children.

In a nutshell, Sally's $1M inheritance, which she would have wished to go to her own two children, has effectively gone to people that she did not even know, namely Elizabeth and ultimately Elizabeth's own three children. Sally's parents inheritance of $500,000 has also gone 'L' shaped. While Sally's children can bring a family provision claim to call back some of this lost inheritance, they will spend a lot of money in legal fees trying and even if successful, they are likely to get a much smaller portion of their mother's and father's estate.

Does this story sound familiar? The cases coming before the Courts are full of stories like this. The situation becomes even more likely when dealing with blended families. It has been estimated that 70% of inheritances will not reach your grandchildren, having gone 'L' shaped somewhere in between.

The rise in blended families, divorce and the increase in the size of estates (due to increased

property prices and superannuation) have all conspired to make 'L' shaped Inheritances® a more common occurrence than ever before.

Avoiding the 'L' shaped inheritance®

How can we avoid our inheritances going 'L' shaped? Estate First Lawyers have a number of strategies that we use to minimise significantly the risk of this taking place. Not all of these strategies will suit all of our clients or are available in all States, and we need to select the combination of tactics used carefully depending on your particular situation.

PLACING ASSETS IN JOINT NAMES

Placing assets in joint names can be a cost effective planning tool, as joint assets do not pass into the Estate, but to the surviving joint owner. For property, the asset must be stated to be held 'as joint tenants'. This means that a person who has missed out on inheriting the asset cannot easily make a claim for it in a Family Provision Application. For more information see our Factsheet on '**Attacks Against Your Estate Plan (Family Provision Applications)**' .

Assets that fall into a deceased person's estate can be attacked by certain dependants in a family provision application in all Australian states. Assets held in joint names do not automatically fall into the estate where they can be attacked in this way (although in New South Wales, jointly held assets may be subject to a notional estate order which may mean a jointly held asset can successfully be attacked). Care should be taken when adopting this strategy, as transferring assets out of your sole name into joint names means that you are giving away rights to part of your property now and may also trigger additional costs such as transfer duty and capital gains tax liabilities. Seek our estate planning advice and also the advice of your accountant on the taxation implications before taking any steps to do this, as some transfers have concessions or even exemptions from these additional costs.

It is important to note that this strategy does not solve the problem once the joint owner dies, and may result in an 'L' shaped Inheritance® at that time (as the asset may then be exposed to any claim against the surviving owner's estate).

BINDING NOMINATIONS AND SUPERANNUATION

Superannuation balances these days can be very high, particularly if there is life insurance within the superannuation policy. Most people do not realise that your Will does not determine who your super will go to. It is the super fund trustees who make this decision according to the rules of the particular super fund's governing rules (legislation and trust deed) and they often have the discretion as to who to pay the superannuation to from a selection of superannuation dependants (determined under super legislation including spouse, children and stepchildren) or to pay it into the estate (where it would then be governed by your Will, but would also be open to attack by someone making a family provision application against your estate after your death).

You can take this discretion away from the trustees if the fund offers Binding Death Benefit Nominations (BDBNs) or Reversionary Pension Nominations (RPNs). A BDBN or RPN can be made in favour of a superannuation dependant directly. Doing so will avoid the death benefit being paid to your estate (provided that the nomination is valid at the time of your death and hasn't lapsed). This strategy avoids any other eligible person being able to successfully claim

the superannuation directly from the super fund. It can also be an effective strategy to reduce the risk of claim against the estate (to a lesser extent in New South Wales, where a notional estate order may result in the superannuation being called back to satisfy a successful family provision application against the estate, regardless of the BDBN or RPN).

Be careful, however because many BDBNs that are offered lapse after three years and must be renewed to remain effective. RPNs are usually non-lapsing, but can only be made to certain beneficiaries, and your choice may have financial ramifications. You also need to consider the tax implications of your nomination, as certain portions of your superannuation are taxed in the hands of some beneficiaries (such as your adult children, for example). See our Fact Sheet on '**Estate Planning for Superannuation**' for more information.

We recommended seeking our further advice regarding your superannuation nominations as part of your overall estate planning strategy.

USE OF TESTAMENTARY TRUSTS IN WILLS

The use of a testamentary trust in a Will, where drafted appropriately, can ensure that the trust fund passes down the generational line to those beneficiaries that you wish it to go to. A trust fund is controlled by a trustee but that trustee does not own the assets and instead holds the income and capital of the fund on trust for the beneficiaries, which can for example, be your children and grandchildren. In that example, if your child dies, the trust assets do not pass under their Will (for instance to their spouse) but remain as a trust for your grandchildren. Testamentary trusts have the added benefit of offering some asset protection against divorce and bankruptcy – other culprits that lead to 'L' shaped Inheritances®, and also provides tax planning flexibility for the beneficiaries.

See our Fact Sheet on **Testamentary Trusts** in Wills for more information.

Use of Family Trusts

Assets held in family trusts do not form part of your estate. In states such as Queensland and Victoria, this means that assets held in a family trust are protected from any family provision application that may be brought against your estate after your death. In New South Wales, assets held in a family trust are not part of the estate that can be automatically claimed, but may still be available for a notional estate order after your death.

You can set up a family trust while you are living and place assets into it (as opposed to a testamentary trust, which is established in your Will and does not become available for use until you pass away). You can then pass control of the family trust to the persons you wish to be the trustees of the trust after your death. Care has to be taken before establishing a family trust as it is critical to establish the trust correctly at the outset to ensure that the control of the trust is properly structured and suitable for your needs, as well as ensuring that the control of the trust can effectively be passed down to your intended beneficiaries on your death.

You also need to be aware of the tax and stamp duty consequences of transferring certain assets into the trust. We can advise you in this regard.

See our Fact Sheet on **Family Trusts** for more information.

Other Estate Planning strategies

At Estate First lawyers, we understand the nature and risks of family provision claims, because we work with these cases on a daily basis. We can best advise you, for instance, as to the appropriate percentages to leave to various dependants that will discourage a claim being made by them after your death. Many clients want to provide for each of their dependants, for instance, their second spouse and their children from a previous relationship, but get the percentages 'wrong' in terms of not providing adequately for them, thereby increasing the risk of a family provision claim after their death.

Use of Mutual Wills (Inheritance Agreement)

Mutual Wills agreements have also become very popular with our clients, whether they are in first marriage/relationship situations or blended families (i.e. where one or both have children from previous relationships, and may also have children with one another). These agreements place an obligation on the partners to ensure that they provide an inheritance to certain people when the surviving partner dies, such as to the children of the first partner to die.

These documents need to be carefully drafted and tailored to meet your family's unique circumstances, as there is no such thing as a 'one size' fits all approach.

See our Fact Sheet on **Mutual Wills (Inheritance Agreements)** for more information.

The consequences of getting it wrong

Had Sally, in our example above, adopted some of the strategies above, her inheritance may not have gone 'L' shaped, and her children and grandchildren could have enjoyed their inheritance from their mother.

Family provision claims are very expensive and they are often funded from Estate assets, which means that your overall wealth can be significantly diminished in the event that a claim is made against your estate after your death. They are also very damaging to ongoing relationships between your loved ones after your death. They are to be avoided at all costs.

In our increasingly complex financial and relational world, there is no substitute for good estate planning now to avoid a later 'L' shaped Inheritance® happening to your family. Please contact us on 1300 132 567 or email us at **info@estatefirst.com.au** to discuss how we can help you with this.

Note: For persons resident in NSW or with property/assets in NSW, some of these strategies may not be as effective. In New South Wales, the Court may make an order (called a 'notional estate order') which can result in assets within your power and/or control that are not in your estate being called upon to satisfy a claim against your estate. This may include your superannuation, assets held in a family trust which you control and assets held jointly with another person. See our Factsheet on '**Attacks Against Your Estate Plan (Family Provision Applications)**' for more information.