



This article discusses Wills that give life interest in property to a beneficiary, and capital gains tax implications generally.



A. LIFE INTEREST

Most of us know the importance of writing a Will. It is only the responsible thing to do for one's family or loved ones before one passes away. Unless a Will is contested, the distribution of assets according to the Will is easier and faster than in the case of intestacy ie. a situation where one dies without a Will..

A lesser-known fact about a Will is that it can be a tool aimed at protecting your assets, addressing family breakdowns and taxation consequences. One example is a life interest or estate granted by a testator in respect of a landed property, or even another property. The entitlement to reside at the property will usually be subject to conditions, such as to maintain the property in good condition and to pay bills and other outgoings of the property.

If the property is no longer suitable for the aging life tenant's needs, he or she may even request that the property is sold to pay the refundable accommodation deposit in an aged care home.

A life interest could also be the income from the landed property or another asset that can be enjoyed for the lifetime of the life tenant. For example, a concerned husband could ensure that upon his death, his wife who is a housewife could stay on and also derive an income for her lifetime from the family home.

The most common example is the case of a couple who are in their second marriage, often with children from their previous marriages. The couple each has previously acquired assets which they wish to ensure their respective children can inherit. Bearing this in mind, such of their assets are kept separate, with the exception of the family residence.

Another example is where a couple has acquired substantial assets during their marriage and when one spouse passes away, granting a life interest in their primary residence to the surviving spouse. The surviving spouse moves on gets a new partner or spouse. A life interest will ensure that the surviving spouse can enjoy the benefit of the asset of the life interest without it becoming a part of the surviving spouse's estate. So, upon the death of the surviving spouse, the asset goes back to the intended beneficiaries, usually the couple's children. When the life tenant dies or sells the property or asset or formally surrenders the property or asset, it is distributed to the (remainder) beneficiaries in accordance with the Will.



WILLS AND ESTATES PART 2 – CREATING A LIFE INTEREST IN PROPERTY & CGT IMPLICATIONS

B. RIGHT TO OCCUPY

The life interest in a property is not to be confused with a 'Right to Occupy' which is another way of ensuring the other person has a roof over his or her head after one's death. This right to occupy does not come with the right to rent out the property or receive any income from the property or request the sale of the property. This is a suitable provision if one merely intends to provide accommodation for someone for a specified time only. Once the period ends or if the latter can no longer live on the property, the right ceases.

C. HOW DO WE CONFER A LIFE INTEREST?

In most cases, couples hold a property as joint tenants, that is, each of them owns equal entitlement and interest in the property and more significantly, upon the passing of one joint tenant, the surviving joint tenant acquires the deceased joint tenant's interest in the property automatically. To grant a life interest, one has to alter the property ownership structure to that of tenancy-in-common. The effect would then be that should an owner (under tenants-in-common) pass away, his or her share of the property passes in accordance with the provisions of his / her Will. The share in property owned under tenants-in-common can be transferred independently.

Owing a landed property under tenants-in-common allows a spouse (first spouse) to grant a life interest to the surviving spouse (second spouse) over his or her share of the property, while the second spouse still owns the remaining share. Then once the second spouse has died, the property passes in accordance with the first spouse's Will, and the remaining share in accordance with the second spouse's Will, to their intended beneficiaries.

D. TAX IMPLICATIONS

Taxation, especially capital gains tax (CGT), can be complicated. See particularly sections 100-120 Income Tax Assessment Act 1997 (Cth) also known as ITAA97. Seeking the advice of a tax advisor or a lawyer is recommended. Material from the Australian Taxation Office (ATO) also provides good guidance.

There are currently no inheritance or estate taxes in Australia. However, it is worthy to note that CGT or income tax may apply in certain circumstances. If a deceased leaves behind his or her main residence, the executor or administrator does not pay any CGT if the property is sold within two years of the deceased's death, assuming that a power of sale is present.

Where a life interest in property is granted, it ceases upon death of the life tenant. There is no capital gains tax payable by the life tenant and also by the ultimate beneficiaries who sell the property after that. However, if a life tenant surrenders his or her life interest, for reasons such as the maintenance of the property becoming too onerous, he or she may be liable to pay capital gains tax as the ATO sees the surrender as a disposal of a CGT asset; the disposal being in the form of change of ownership in the life interest from the life tenant to the ultimate beneficiaries.

What the life tenant could do then is to act quickly and disclaim his or her life interest following the initial grant, to avoid the CGT. If at the onset, the Will is drafted such that the 'Trustee and Executor' and the life tenant can agree to end the life interest before the death of the life tenant, the life interest can be treated as ending pursuant to the terms of the trust and the CGT can be avoided.



If you inherit an asset, do consider these tax implications:

- a) capital gains tax may apply if you dispose of the asset inherited from a deceased estate unless an exemption applies; and
- b) income tax applies as usual to any dividends or rental income from shares or property inherited.

E. EXEMPTION FROM CAPITAL GAINS TAX

To ascertain if an inherited property is exempt, one has to look at factors including the date of death of the testator, the date of acquisition of the property by the testator, the date of inheritance by the beneficiary, the date of disposal of the beneficiary, whether the testator occupied the property as a main residence prior to his death, whether the testator was a foreign resident while holding the property and whether the beneficiary has been a foreign resident as well.

If the testator acquired the property before 20 September 1985 and no major improvements or additions have been made to it since, the property is fully exempt from CGT. Alternatively, no CGT is payable if the beneficiary inherits the property after 20 August 1996 and prior to death, the testator used it as his non-income producing and main residence and the beneficiary then disposes of it within two years of the death of the testator.

F. CONCLUSION

The making of a Will is about balancing the needs of those you wish to provide for. This is why if you are making a Will, it is important that you speak to an experienced lawyer who will be able to give you the best advice on how to provide for your loved ones in a manner that is true to your intentions whilst minimising the likelihood of misunderstanding and disputes.

Comasters can advise clients on their
Wills and Estates.

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