Q&A MONEY PLANNING & BUDGETING ASK AN EXPERT

What's the most effective way to make a charitable donation?

By Noel Whittaker
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Illustration: John Shakespeare

I have a higher-than-usual gross income this year because I realised some capital gains. My accountant suggested making a $75,000 charitable donation to offset the capital gains tax (CGT). How can I donate the money effectively?

Consider establishing a sub-fund in a public ancillary fund. You will get an immediate tax deduction to offset your gains but the flexibility to distribute the funds to charity over time.

You can claim a full deduction for the funds contributed to a sub-fund (immediately or spread over five years). Each year, at least 4 per cent of your sub-fund's balance is distributed to charities recommended by you. Meanwhile, the balance is invested, accruing tax-free gains for charity.

A sub-fund is useful if you're not sure which charities to support, prefer a longer-term legacy through a (smaller) regular flow to charity instead of a one-off lump sum, or you want to change which charities benefit each year. It also consolidates your tax record keeping – one tax receipt for the donation into your sub-fund covers all its giving.

Giving isn't all about tax though. I have a sub-fund in the Australian Philanthropic Services Foundation and it's immensely satisfying. Research shows that giving money to charity makes you happy!

As an avid reader of your newsletters and books, I have a question regarding tax-free and taxable amounts in accumulation and pension phases. One of my super funds has advised that all earnings from the investment will go into my taxable component while leaving my tax-free component unchanged. If this is true it has tax implications for my beneficiaries. The other fund credits the earnings proportionally. The former is in accumulation mode – the latter in pension mode. Would greatly appreciate clarification.

The key lies in the fact the two funds are in different stages. When a superannuation fund is in accumulation mode all earnings are added to the taxable component. However, when earnings from the assets are funding a retirement pension account, they will be split between a tax-free component and a taxable component based on the percentages of the components on the commencement of the pension account.

You said recently that if the beneficiary is a spouse, or a dependent, the entire proceeds of the deceased's superannuation would be tax-free – for a non-dependent there is a death tax of 15 per cent plus Medicare levy on the taxable component. These payments can be made in specie or in cash. Do you know if this death tax applies to a married couple who are legally separated, but not divorced, one of whom has a self-managed super fund (SMSF) and the other not?

Superannuation expert Monica Rule explains that for a lump sum death benefit to be received, entirely tax free, by a "death benefits dependant" the person would need to be

the deceased's spouse by marriage, a de facto partner (including same sex partners), or a former spouse.

Under the superannuation law (SISA), a death benefit can be paid directly to a "dependant" who is a deceased's spouse by marriage or a de facto partner. A former spouse cannot receive a death benefit directly from an SMSF. However, they can receive it via the deceased's estate if the deceased's superannuation is paid to the deceased's legal personal representative, who then distributes the death benefit in accordance with the deceased's will.

So, in the example given, the spouse who is legally separated but not divorced is still a spouse by marriage. Therefore, they can receive a death benefit directly from a superannuation fund as well as receive the lump sum entirely tax free. But, if they were divorced, although the person is still entitled to the lump sum death benefit entirely tax free, the person would not be able to receive it directly from the deceased's superannuation fund.

My elderly mother lives in the family home independently and is in good health. It is her only major asset. She wishes to leave the house to my sister, myself and my son, who is a minor. I expect and hope my mother will be with us for many years to come, however, if my son inherits his third of the house as a minor I wonder about tax implications?

As the property is your mother's residence it will pass to the beneficiaries free of capital gains tax at its value at the date of death. Given that it is somewhat unsatisfactory to be a part owner of a property, your son's best course of action if he is an adult when the share of the house is left to him may well be to sell it tax-free, and use the proceeds as a deposit on a place of his own. I suggest you speak to a solicitor to ensure the will covers bequests to a minor – you do not want a situation where one beneficiary is a minor and the executor is arguing with the family about the sale of the property.

Noel Whittaker is the author of Making Money Made Simple *and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making financial decisions. Email: noel@noelwhittaker.com.au*

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