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USING TESTAMENTARY TRUSTS IN BLENDED FAMILIES

Television Education Network
Blended Families Conference
Sydney 2014

The Estate Specialists

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About the Authors

Greg Welden LLB GCLP

Born in Adelaide, Greg Welden was educated at Pooraka Primary School, and later Nailsworth High School. He graduated in 1993 and from here commenced his Law Degree at Flinders University. Admitted to the Supreme Court in 1998.

The early years of his career were spent in Port Augusta where he developed a solid grounding in all facets of the Law. He returned to his home town of Adelaide in 2007, where, working in both small and large firms, he was able to develop his passion for Estate Law. Today, Greg shares with clients an intimate knowledge of all facets of Estate Planning and Estate Administration, including complex asset protection strategies, business succession planning, complicated Probate matters in all circumstances, estate administration and litigation including Inheritance Claims and Probate Disputes.

As a member of the Law Society of South Australia he actively participates on the Succession Law Committee and regularly provides seminars to members of the public, community groups, professional bodies including other solicitors and has written articles in publications for solicitors dedicated to Estate Planning.

Jason Coluccio BLAWS BA GDLP

Born, raised, schooled and still living in the Western suburbs of Adelaide, Jason Coluccio, graduated in 1996 and from there commenced his Arts degree at Adelaide University.

Working in multiple areas of the law, from Family to Criminal and then Commercial Litigation and Estate Planning, Jason continued to develop his passion for Commercial and Estate Law. He has successfully instructed in major Criminal matters in the Supreme Court, whilst also dealing regularly with and appearing within the Magistrates jurisdiction. Jason has attended to Full Court Appeals and has experience in complex commercial matters.

Jason shares with clients an intricate knowledge of all facets of Estate Planning and Administration, including complex asset protection strategies, business succession planning, complicated Probate matters, estate administration and litigation including Inheritance Claims and Probate Disputes.

Jason regularly provides seminars to members of the public, community groups and enjoys the opportunity to share his knowledge and passion for the law with the community.

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Using Testamentary Trusts in Blended Families

Introduction

Australia is on the threshold of a significant transfer of wealth between generations. Over the next 15-25 years, the value of wealth transferred between generations will be measured in the hundreds of billions of dollars[1].

In addition to this tsunami of intergenerational transfer of wealth that approaches, the complexity of wealth structures and associated government legislation (both Federal and State) make a considered and professionally prepared estate plan more crucial than ever.

The incidence of remarriage, particularly amongst persons whose previous marriages were dissolved by divorce is ever increasing. Divorced persons often enter into one or more domestic relationships after their marriage has been dissolved. Often spouses have children by former marriages or relationships and it is common for new children to be borne between their union (often with large age disparity).

A growing proportion of the population choose a trust structure as the means to distribute their estate, usually on the basis that it provides not only significant tax savings and greater flexibility with distributions but, a trust structure also affords some protection to chosen beneficiaries.

A testamentary trust enables a testator to adopt the trust structure so that the testator can design and control the manner in which the estate is to be distributed.

The testamentary trust is ideal for this and therefore blended family situations.

The testator may have a desire that the wealth that has been accumulated through hard work over many years remains available for successive generations.

The purpose of this paper is to discuss a range of estate planning related topics particularly connected to the use of a testamentary trust Will in situations where there is a blended family in order to assist the professional in better guiding clients through the estate planning process. This paper is not intended to be exhaustive of the issues that can, and should, be taken into account. Experienced professionals will understand that whilst there are very many similarities, no two estate plans are identical.

[1] An educated but none-the-less stab in the dark.

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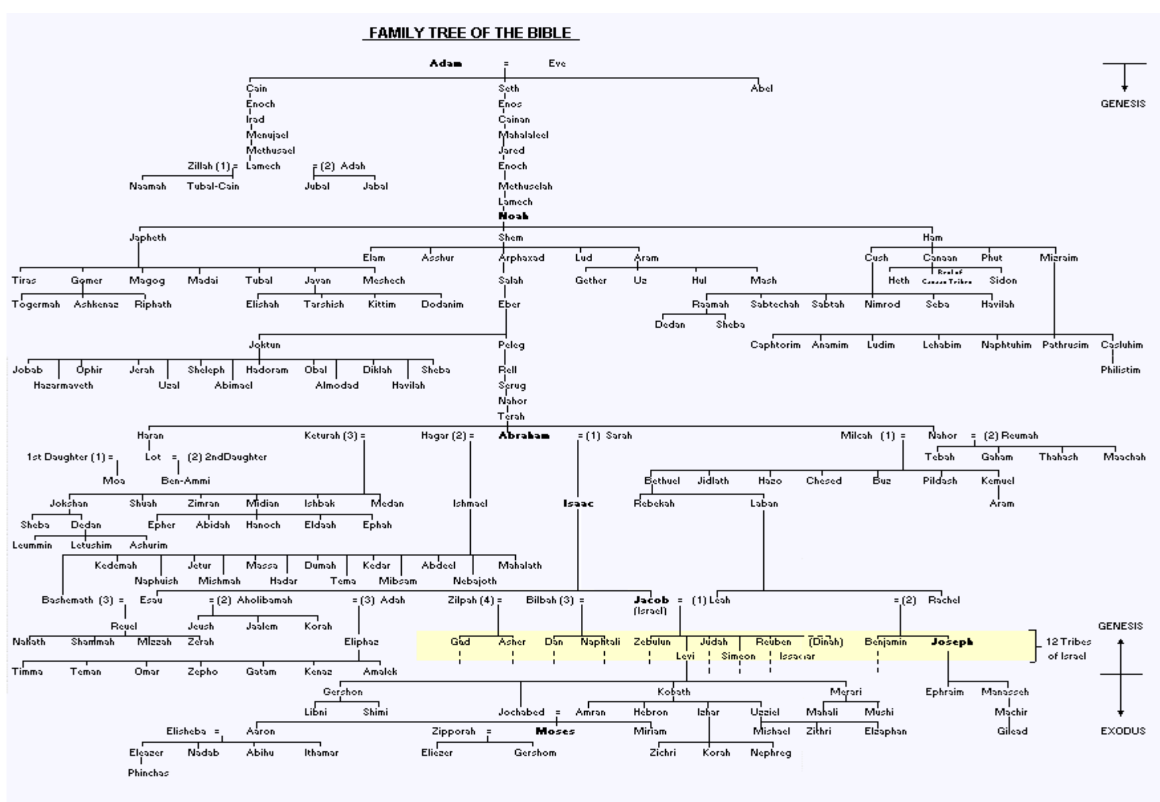
Blended Family

When advising clients in planning for the disposition of their estate, clients should always be advised about the ability of a spouse or spouses, whether former or current, and children from former and current relationships to mount a claim against the estate.

This task becomes more treacherous when considering clients who fit into the loosely grouped category of a 'blended family'.

Blended families are sometimes complex, as where there is more than one former partner, or children of more than one partner or marriage. Where the relationships are complex, the testator should consider preparing a family tree.



The possibilities and dynamics are endless! A joy and a burden for the estate planning lawyer.

The reason that clients from blended families need to be advised about a family tree should be obvious from the above. In a blended family situation, tensions often occur when a spouse dies, leaving children of a previous relationship and children of the relationship extant at the date of their death. Those tensions, which often lead to litigation, arise in a myriad of circumstances but the most common seem to be;

- Where children of the previous relationship receive no/little benefit under a will;

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- Where children of the previous relationship receive all of the estate and the surviving spouse or partner and the children of that relationship receive nothing/little, and;

- Where the testator provides for all relevant persons of the current relationship including spouse and children from that union, but makes no provision for the former spouse or children of that previous relationship.

A testamentary trust may be designed to cope with a testator who may or may not have a former spouse or partner as well as a present partner, and children from a former relationship as well as children of a present relationship.

Using testamentary trusts for some of the beneficiaries but not all, may be of benefit and may satisfy what, if any, moral obligation a testator owes to such familials.

In the blended family situation, the testator is able to draft one set of provisions to apply if the testator's spouse or partner survives and a different set to apply if the spouse or partner does not survive the testator.

Another key feature of testamentary trusts when used in blended family situations is the ability of the testator to not only provide for a current spouse or partner, perhaps with a right of residence and sufficient income for their short term and long term needs, but the preservation of assets and wealth for residual beneficiaries is a key ability/feature of the testamentary trust.

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What is a testamentary trust?

A testamentary trust is a trust that has been established by Will or by law. The terms of a testamentary trust are set out in the Will of the testator, the testator being the equivalent of the settlor of an inter-vivos trust. A testamentary trust comes into existence not when the testator signs the Will, but when the testator dies, though some or all of the trust property may not be transferred to the trust until later.

In South Australia, the rule against perpetuities has been abolished, and so a trust may operate in perpetuity. However, in all other Australian jurisdictions the rule against perpetuities operates, and the maximum length of time for which a testamentary trust can possibly operate is 80 years, however, legislation is not uniform[2]. It is common place in South Australia that a vesting date of 80 years is established in any event.

Why are testamentary trusts used?

The testator will include a testamentary trust in their Will for one (or both) of two main motives. Firstly, to take advantage of the potentially significant tax effectiveness that a testamentary trust can offer and secondly, to provide significant asset protection to a beneficiary (should they need or want it), perhaps protecting a beneficiary from themselves, or from a third party.

There are some quite significant opportunities available with such a device, for example;

- Assets held in a testamentary trust are not assets of any individual and accordingly, the Family Court are less likely to make an order requiring the disbursement of funds held in a testamentary trust. Depending on how the trust is drafted, such assets can be exempted from being considered as a resource of one of the parties for the purpose of any family law dispute;

- The ability to deal with assets in a way which might protect pension entitlements of a surviving spouse or children;

- Protecting family assets from the creditors of beneficiaries. Potential beneficiaries facing bankruptcy should ideally not receive a share from an estate as it is likely to disappear into the hands of others;

- Income tax concessions, particularly for beneficiaries under the age of 18 years;

- Some possible capital gains tax advantages;

[2] Legislation in VIC, QLD, TAS, and WA permits trust instruments to simply specify a fixed duration for the trust, up to a maximum of 80-years. In NSW and ACT, the traditional perpetuity period has been abolished and trust instruments are now simply required to specify any term up to 80 years - Perpetuities and Accumulations Act 1985 (ACT) s 8(1); Perpetuities Act 1984 (NSW), s8. The rule has been abolished in South Australia, where trusts are not required to have a perpetuity period - Law of Property Act 1936 (SA) as amended by the Law of Property (Perpetuities and Accumulations) Act 1966 (SA).

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- Similarly, a testamentary trust can be an effective means of providing for a spouse when concerned that the spouse may remarry and divert family assets to the new family or, as sometimes happens, use the family assets in risky or unprofitable ventures at the suggestion of the new spouse. It is this feature that is particularly for blended families.

- The protection of wealth being lost or wasted in the hands of a spendthrift or other problem beneficiary. In a testamentary trust funds can be left in the control and legal ownership of the trustee to be dealt with by distribution of income or assets on a needs basis. Thus the capital is preserved and the income applied more effectively over time.

Testamentary trusts are not without their own problems.

All too frequently these days, estate planning lawyers push clients into testamentary trust Wills without fully explaining some of the practical disadvantages that come with them, which in general terms are;

- They are inherently complex documents with all of the various rights, obligations and powers contained within the will document itself. Irrespective of the potential value of estate being contemplated, an individual client's ability to *know and approve* of its content must be borne in mind or risk the will being deemed invalid after the death of the testator. If the testator has limited education or understanding or appreciation of complex terms, irrespective of their financial wealth, an abridged version of a testamentary trust, or none at all, may be wise;

  In *Re Lewis Barrett (deceased)*[3] the South Australian Supreme Court was asked to rectify a Will including a testamentary trust. The deceased had a number of Wills prepared by the same lawyer, in 2000 both the deceased and his wife had Wills prepared including testamentary trusts, after his wife died in 2002 the deceased made changes to the Will in 2005 and in 2009. Subsequently, the solicitor who prepared the Wills noticed some omissions in the terms of the testamentary trust including there was no power to amend and no appointor, the solicitor, of her own volition prepared a new Will and attended at the home of the deceased (obviously not dead at that time) to execute the Will – he was however, terminally ill. The solicitor told the deceased it was substantially the same and broadly what the terms of the trust were.

  The application for rectification failed on the basis there was no knowledge and approval of the Will that had been signed.

- Choosing who should act as trustees can be a difficult and problematic question. Ideally, there ought to be two trustees if only to enhance the protection that the testamentary trust affords against creditors or former spouses. Finding a suitable co-trustee is not an easy task. Some lawyers will readily accept that role without properly understanding the implications it can entail down the track when the client dies.

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[3] [2013] SASC 150

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- There is always the risk of a change in laws concerning the taxation of trusts. It is an evolving area of law (as Family law, Bankruptcy etc is also) and would carry that risk of changing legislation for trust estates that were intended, nay created, to exist for many years.

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Taxation Advantages

Testamentary trusts and income tax

The ability to distribute net income of the trust to minor beneficiaries contribute greatly to the trustee's capacity to administer the trust in a tax effective manner.

While the net income of a trust will be taxed in the hands of any presently entitled beneficiary, the way that such beneficiaries are taxed on that income differs considerably according to whether the trust is an inter-vivos trust or a testamentary trust.

Where a trustee of an inter-vivos trust makes a distribution to a minor beneficiary (who has no other income), no tax will be applicable on the first $416 per annum and at the highest rate of tax at 45% on any amount in excess of $1,308[4].

This penal rate of tax for distributions to minor beneficiaries does not apply to testamentary trusts, which are specifically exempted from the operation of Div 6AA by the effect of sec 102AG(2)(a). The effect of this section is that a trustee of a testamentary trust can distribute trust income to a minor beneficiary, and the first $18,200 will be tax free. If the low income tax offset is available, the effective tax-free threshold for distributions from a testamentary trust to a minor beneficiary becomes $20,452.

The powers to make distributions to minor beneficiaries gives great power to save income tax. A minor beneficiary of a testamentary trust is taxed as if they were an adult, and so the trustee can take advantage of the significant tax free threshold available to each and every minor beneficiary, particularly if they have no other income.

It isn't the fact that the testamentary trust ensures the concessional tax treatment of minors but by being income of a particular type or source, an ordinary family discretionary trust cannot produce this result.

Section 102AG imposes close to maximum tax rates on trust income derived by minors unless the trust income is excepted trust income.

> 102AG(1) *Where a beneficiary of a trust estate is a prescribed person[5] in relation to a year of income, this Division applies to so much of the share of the beneficiary of the net income of the trust estate of the year of income as, in the opinion of the Commissioner, is attributable to assessable income of the trust estate that is not, in relation to that beneficiary, excepted trust income*.

[4] Div 6AA ITAA 1936

[5] a person who is under 18 on 30 June is a prescribed person in that year (unless also excepted person e.g. certain pensioners, full-time employed, married)

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102AG(2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount;

(a) is assessable income of a trust estate that resulted from:

(i) a will, codicil or an order of a court that varied or modified the provisions of the will or codicil;……..

(d) is derived by the trustee of the trust estate from the investment of any property:

(i) that devolved for the benefit of the beneficiary from the estate of the deceased person;………[6]

Minors who are beneficiaries of the testamentary trust can receive income from assets transferred into the trust pursuant to the Will and from any substituted or borrowed assets, for example pursuant to any arm's-length borrowing, investment, sale and purchase and so on.

The original assets given to the testamentary trust may be viewed as the seed assets but the actual property held by the trustee can vary over time. The benefit of the testamentary trust is not confined to the assets owned by the deceased or by the deceased estate during administration.

Whilst the taxation benefits are not confined to blended families, the ability to maximise wealth in the estate and provide for minor beneficiaries in this way gives testators great flexibility especially as stated earlier, there is a common trait that children from blended families anecdotally substantially differ in ages and as such, there can be real advantages had in the asset or income base to younger beneficiaries in a blended family situation.

Capital Gains Tax

The capital gains tax rules relating to the transfer of assets from a deceased estate, or to beneficiaries, are basically these;

- There is no deemed disposal of assets on death (other than if left to a charity or if they are non-taxable Australian assets left to a non-resident beneficiary);
- The trustee of the estate, or the beneficiary, is deemed to have acquired the relevant assets as at the date of death;
- The cost base is deemed to be the market value of the asset if it was acquired by the deceased before 20th September 1985; or

[6] The full text of section 102AG ITAA 1936 is annexed to this paper – you actually should read it!

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- Where acquired on or after that date, it is deemed to have been acquired at its cost base;

Losses, however, die with the owner of them. They should be utilised before death otherwise they are lost. Gains on assets in an estate, where held in a testamentary trust could however be allocated by a trustee to a beneficiary with losses against which the gains could be offset.

Main Residence CGT exemption in the context of testamentary trusts.

The Main Residence exemption applies to a dwelling acquired by the beneficiary of a deceased estate provided;

- it is disposed of within 24 months after the date of death,

- or from the date of death, if the dwelling was the principal residence of the spouse of the deceased;

- or from the date of death, the dwelling was the principal residence of the beneficiary acquiring it.

It needs to be understood in this context that a testamentary trust established under a testator's Will, represents a legal entity or relationship quite separate from the estate of the deceased testator.

The applicability of the continuing Main Residence CGT exemption to a trustee of a testamentary trust as opposed to a trustee of the deceased's estate has been dependent on the Commissioners thus far favourable interpretation.

Accordingly, the subsequent disposal by a trustee of a testamentary trust of the deceased's main residence (in circumstances where that dwelling has from the date of the deceased's death until the ownership interest ends being occupied as a main residence by the deceased's spouse or an individual who had a right to occupy the dwelling under the deceased Will) is likely to qualify for the CGT main residence exemption relief.

This can be useful when planning the distribution for a blended family, to provide for the residence of a spouse but maintain some control over it. Clearly, in such blended family situations, as in any family law dispute/action, it is imperative that real estate assets are held as Tenants in Common to prevent your client's interests in any real estate being extinguished at their death due to survivorship. When advising client's from blended families, if the main residence subject to the CGT exception is an asset held as Joint Tenants, that they should consider severing the Joint Tenancy in favour Tenants in Common and the granting of Life Estates to each other.

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Income streaming

A testamentary trust is otherwise subject to the operation of ordinary general law and taxation laws. Accordingly, where the trustee of a testamentary trust has the discretion to distribute different types of income to different beneficiaries, ie income streaming, the trustee may do this so as to ensure maximum tax effectiveness of the income distributions.

An example of this benefit is the ability of a trustee to allocate the net capital gain component of the trust's net income to beneficiaries with realised capital losses as it is these beneficiaries who can then use their capital losses to offset the distributed capital gain.

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Asset Protection

How a discretionary testamentary trust can offer asset protection

The basic mechanism by which both testamentary and inter-vivos trusts achieve asset protection is by separating ownership of the trust assets from the beneficiaries of the trust by giving it to the trustee.

A discretionary testamentary trust cannot offer absolute asset protection.

Asset protection is a compromise. The degree or level of asset protection which a discretionary testamentary trust offers will turn on the specific ways that the powers and rights of the trustee, appointor, independent trustee and beneficiary are divided up and allocated within the trust.

The degree of control which the testator wishes to give to a beneficiary greatly affects the level of asset protection available. Furthermore, the level of asset protection which the law will allow has evolved over time and will presumably continue to do so.

Protecting a beneficiary from others

It is a genuine concern, particularly among elderly testators who have been responsible for generating the major wealth of a family, that in the event of their death, their spouse or more particularly their child be protected from losing inherited assets to an ex-spouse in the event of a family law settlement.

From this perspective the blended family may in fact be the next generation, those receiving the inheritance. If the primary beneficiary of the testator's estate has been divorced and entered a new relationship and there are grandchildren to different partners, the testator is likely to want to protect their wealth from dissipating in possible future relationship breakdowns.

Where a testator expects that the asset protection offered by the discretionary testamentary trust will be tested, the trust must be particularly carefully structured to give sufficient asset protection.

The testator usually wants to give a primary beneficiary who is, for example, a mature adult child access and the ability to enjoy the inheritance freely, and at the same time, seeks to protect that beneficiary from losing their inheritance through their own bankruptcy or divorce. This testator is in a difficult position, and so is the advising solicitor. The testator wants the primary beneficiary to have total flexibility and control over how the trust is operated, and at the same time wants to secure total protection from creditors and ex-spouses.

These two goals are simply irreconcilable.

The best possible outcome can only be a compromise.

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Bankruptcy and asset protection

As the law currently stands, the asset protection given by a discretionary testamentary trust is stronger in relation to bankruptcy than in relation to family law. This is certainly the case where the primary beneficiary is merely a beneficiary and it is perhaps true even where the beneficiary undertakes the role of appointor as well as being beneficiary. However, the asset protection might well be lost if the beneficiary is also trustee[7].

Limits of asset protection in relation to family law claims by former spouse or partner of a primary beneficiary

A combination of increased powers given to the Family Court by legislation[8] and an evolving readiness on the part of the Family Court to look through or bust a trust where the Court considers the trust to be the alter ego of a divorcing spouse, has significantly eroded the protection offered to beneficiaries of discretionary trusts in family law settlements.

The Family Court nowadays robustly exercises a power to bust a trust in ways that Courts in other areas of law have not come close to.

Although most of the case law relate to inter-vivos discretionary trusts, the principles and reasoning applied by the Family Court to those trusts could apply equally to discretionary testamentary trusts.

Automatic disqualification clause

An automatic disqualification clause provides that upon separation a party who would otherwise be an appointor or trustee of the trust is automatically disqualified from those positions. This disqualification is by default expressed to be permanent. A non-permanent disqualification may not be genuine. The disqualified party still remains a beneficiary.

The clause not only permanently disqualifies a party as appointor and trustee, but also permanently disqualifies the party and their spouse or former spouse as beneficiaries. This clause is offered for those seeking to raise asset protection to a higher level in the hope of making it less likely that the trust will be considered a financial resource.

The reasoning is as follows;

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[7] Sec 5 *Bankruptcy Act* 1966 (Cth) defines property as "*Real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property*."

[8] In particular Part VIIIAA *Family Court Act* 1975

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If the primary beneficiary (or some other beneficiary) becomes vulnerable either to creditors through bankruptcy, or to a spouse or partner through marriage or relationship breakdown, it is important to protect the trust assets. This can be done only by taking all control of the trust away from the person facing the marriage breakdown or bankruptcy.

For this reason a beneficiary in such a situation becomes an ineligible office bearer and is removed from the offices through which the beneficiary can exercise control. The office of trustee and the office of appointor. The removal is permanent because permanent removal shows that the intention to remove control from the beneficiary is serious and genuine – and there can be no inference that ultimately control will be returned and the person later enjoy the trust property as property or as a financial resource.

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Superannuation

Considerations relating to superannuation

As superannuation benefits of a testator are considered to be non-estate assets, a testator will need to be guided on and ultimately decide whether superannuation is to pass directly to a beneficiary or into the testator's estate and whether or not a binding death benefit nomination should be used to give effect to that decision.

Where testamentary trusts are being included in a will because the testator wishes to provide for a vulnerable beneficiary such as a disabled child, the question whether superannuation is best held in the trust created in the will, or excluded from the estate so that the benefits are paid as an income stream from superannuation will depend at least partly on taxation issues.

Defined benefit and accumulation superannuation funds distinguished

The rules of all superannuation funds vary according to the trust deeds of the fund, which are themselves subject to the overriding superannuation law being the *Superannuation Industry (Supervision) Act* 1993 (SIS Act) and *Superannuation Industry (Supervision) Regulations* 1994 (SIS Regs).

An accumulation type superannuation fund consists of the superannuation guarantee contribution from the members employers, as well as whatever voluntary contribution the member makes and what earnings the fund generates. Examples include retail superannuation funds, industry superannuation funds and self managed superannuation funds.

A defined benefit superannuation fund is a fund that upon retirement pays a member a defined benefit based on various factors such as years of service, salary and contributions. Examples of defined benefit schemes include the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme as well as military funds such as Defence Force Retirement and Death Benefits Scheme.

Most defined benefit superannuation schemes will not allow a member who has retired and commenced a pension to direct how their benefits will pass on death instead the pension benefits will pass in accordance with the rules of the fund. As an example the rules of the Public Sector Superannuation Scheme and Commonwealth Superannuation Schemes provide that in the case of a default pension, 67% of the pension of the deceased member will pass to the deceased members spouse or partner (the balance of the pension being effectively lost where there are no dependent children).

Blended family situations where there is no way to remove reversionary pension or payment to a spouse through the operation of the Superannuation Trust Deed (ie South Australian State Government Superannuation Fund as a prime example), so therefore when advising clients who have suffered a marriage breakdown they must

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be advised to consider pulling out of such a superannuation scheme to ensure that a former spouse does not receive the benefit.

It is important to understand the predetermined nature of these schemes when a person considers their estate planning.

Payment of superannuation benefits

Superannuation benefits can be paid directly as a lump sum to a super dependent (and to a tax dependent, they can also be paid as an income stream), and benefits so paid never form part of the estate of the deceased member.

This has advantages. It provides a valuable asset protection, superannuation benefits can be directed to a super dependent without being liable to a potential family provision claim[9] and the superannuation benefits are protected from estate creditors.

Receiving superannuation benefits as an income stream can have significant tax benefits. For example, if a member is over aged 60 and receiving superannuation benefits in the form of an account based pension, the member will pay no tax on either the earnings of the benefits in the fund or on the pension payments made from those earnings.

If the member dies leaving a disabled child, the child (being both a super dependent and a tax dependent of the deceased) would be able to take a reversionary pension from the deceased, which would (just like the pension the deceased had been receiving) be tax free both on earnings in the fund and on pension payments.

By contrast, if, on the member's death, the benefits were to be paid as a lump sum to the member's estate and funnelled through a testamentary trust for the disabled child, the benefits, or income from those benefits, would be taxed like any other inherited asset in a testamentary trust.

Where a superannuation death benefit lump sum is paid to the legal personal representative of the deceased (for example, the executor), the applicable superannuation death benefits tax will depend on whether a tax dependent of the deceased has benefited, or is likely to benefit from that lump sum.

The taxable component of the death benefits will be made up of amounts that have been taxed in the super fund (taxed element) as well as amounts that have not been taxed in the fund (untaxed element). An example of the latter is proceeds of a life insurance policy held in the fund. Where the death benefit is taxable, the taxed element will be taxed at the maximum rate of 15% and the untaxed element will be taxed at the maximum rate of 30%.

A person is a dependent of the deceased if, at the time of their death, they;

- Were their spouse or domestic partner including a same-sex spouse,

[9] That is, in all Australian jurisdictions except New South Wales, which has notional estate provisions.

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- Where a former spouse or former de facto spouse,
- Where a child of the deceased under 18 years of age,
- Relied on the deceased for financial maintenance at the time of death, or
- Any other person with whom the deceased had an interdependency relationship just before death.

An interdependency relationship exists between two people where;

- They have a close personal relationship, and
- They live together, even if they are not related by family, and
- One or each of them provides the other with financial and domestic support and personal care.

There are sometimes difficult issues concerning whether a person is a beneficiary and especially whether an interdependency relationship existed.

The difficulty for the will maker is that their circumstances will change before they die and unexpected consequences can arise such as an unintended person being entitled to the super.

If by way of example separation takes place where there is a spouse and a child of the union and the existing death binding nomination nominates each of the existing spouse and child to receive 50% each as a binding death nomination, and that person dies without changing the nominations the following will happen;

- If the binding death nomination is a valid nomination the trustees of the superannuation trust will have no discretion and must pay the monies in accordance to the nomination;

- Despite the breakdown in marriage the former partner will receive 50% of the death nomination for herself and in the instance that the child is a minor the former partner will also receive the other 50% on behalf of the child likely with no strings attached;

- Clearly as these are superannuation monies they do not form part of the deceased estate and therefore any dispute can only go to the Superannuation Complaints Tribunal but recourse is extremely unlikely.

As we can see in most circumstances it would not be the testator’s intention that the former partner would receive 100% of the death benefit.

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Choice of Positions

The roles of trustee of a testamentary trust and the legal personal representative of the deceased estate must be distinguished. Even where the offices of legal personal representative of a deceased estate and trustee of a testamentary trust happen to be held by the same person, the two roles are separate and distinct.

The functions and duties of an executor are different from the functions and duties of the same person who becomes trustee when the estate is administered. So in a complex estate it is possible for an executor to hold executorial functions in relation to some assets, and at the same time the trustee for different assets and for different beneficiaries.

This is important in practice, because where an executor of an estate incurs gains or losses, these will be attributed to the estate, but upon becoming trustee of a trust, such gains or losses will be attributed to the specific beneficiaries of the trust.

The following positions are present in most, if not all, testamentary trust Wills.

Executor – an important functionary and role for the administration of the estate and in the context of testamentary trusts.

Trustee – this may or may not be the executor, and might be a natural person or a company.

Primary Beneficiary – this will be the person to whom the trust property would have passed had the estate assets been given absolutely by the testator rather than made the subject of a testamentary trust.

Appointor – this is the person who holds the power to appoint a trustee of the trust. The usual practice is for the office of appointor to be transferable to another person or persons by deed or will.

Independent Trustee – this person holds consent powers to which some powers of the trustee are subject. In particular, the trustee may be required to obtain their written consent to make a distribution of income or capital, or to end the trust. An independent trustee may also stand in as a trustee of the trust in circumstances where an automatic disqualification clause has been used and the trustee is removed as a result.

Choice of Executor

The choice of executor is always an important decision when drafting the Will, however, where a Will contains testamentary trusts, this decision can be of even greater importance. This is because most testamentary trust Wills place an important range of powers and discretions in the hands of the executor. The executor will have to administer the estate, and, in addition, will have an ongoing relationship with the beneficiaries of the trusts created by the will. This ongoing relationship between

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executor and the primary beneficiary flows from some powers that might revert back to the executor, for instance, if a trustee or appointor of the trust becomes an ineligible office bearer.

Who is the Appointor?

The power of the appointor is greatly augmented by the fact that the appointor will always hold the power not merely to appoint a trustee, but in particular to appoint themselves as trustee or even as sole trustee of the trust, and this means that in effect the offices of appointor and trustee can be combined into one person at the discretion of the appointor.

The appointorship is a crucial trust office in the appointor's power to appoint the trustee or trustees, including the power to appoint herself or himself, can be said to give the appointor the keys to the trust.

Subject to the expressed intentions of the testator, unless the primary beneficiary is a minor at the time, the initial appointorship of each trust could be the primary beneficiary themselves, who can appoint another appointor to act with or instead of themselves.

Another alternative is to confirm in writing the inherent powers of the Supreme Court to dismiss a trustee of a trust[10]. If a Primary Beneficiary is concerned a current Trustee is acting unlawfully, fraudulently or acting beyond the scope of powers provided to them by the trust deed, they may apply to the Supreme Court to dismiss the Trustee and appoint another. The Supreme Court has an inherent jurisdiction (inherited from the Chancellor and the Court of Chancery in England) to change the trustee.

The Trustee

Function and powers of the trustee

The trustee is the legal owner of the trust property, and has the fiduciary duty to manage the trust property for the benefit of the beneficiaries, of whom the trustee may be one.

The trustee holds all the powers which relate to the management of the trust property. This means that no beneficiary or other officer of the trust can direct the trustee as to how to exercise their powers. The trustee, as a holder of fiduciary power, has autonomy in relation to the exercise of that power. So, no beneficiary or officer of the trust can require the trustee to make any distribution.

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[10] For example Section 36 of the *Trustee Act* 1936 (SA) gives the Supreme Court a statutory power to replace or remove trustees and appointing new trustees, on application by the trustee or a beneficiary.

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Controlling the trustee

On the face of it, the trustee appears to be all powerful, however, the trustee is a fiduciary, and must act in accordance with the restraints which being a fiduciary imposes. The trustee is constrained by the fact that they can always be removed from office by the appointor.

Choosing the right trustees – selection of appropriate trustees for a discretionary testamentary trust

Testator's can appoint one or more trustees and the choice of appropriate executors/trustees is an extremely important factor in the preparation of a Will and in the context of a testamentary trust, the decision as to who is appropriate to act as trustee to control the trust is a crucial part of the decision-making process when establishing the testamentary trust under the terms of a Will.

A natural person, professional adviser or a professional trustee can be appointed in relation to a Will and it is wise for any such appointment to also cater for the appointment of a second level of trustees to act in the event of the first named trustee being unable to act or continue to act for any reason. Usually the testator's spouse or adult children are appointed in this fashion, but sometimes an independent trustee is thought to be more appropriate or an independent trustee is appointed along with the main beneficiaries under the Will.

Choice of trustee may be influenced by the type of testamentary trust involved

Often the appropriate choice of trustee will ultimately turn on the purpose for which the testamentary trust is being established.

If asset protection is important then it is vital that the beneficiary concerned be able to resign will be deemed to have resigned automatically if he/she should ever be affected by bankruptcy event.

In the asset protection context, the appointment of an independent trustee/appointor for a testamentary trust to act jointly with the primary beneficiary of the testamentary trust, may assist in frustrating and preventing a trustee in bankruptcy from attempting to access the testamentary trust assets via the control of positions in consequence of a future bankruptcy event.

In the matrimonial context, the appointment of an independent person to act as one of the trustees and appointors of a testamentary trust is often also considered useful where a testator is concerned to endeavour to protect (as far as it is possible to do) the assets contained in a testamentary trust to be established for his/her beneficiary, in the event of a future breakdown of a beneficiaries' marriage or where a testator's surviving spouse may choose to remarry or enter into a defacto relationship. The Family Court does have power to give directions to independent trustees/appointors of testamentary trusts, but is usually limited to directions relating to property of the party's marriage.

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In the case of a mentally disabled beneficiary or a spendthrift/at risk beneficiary, the role of trustee of the testamentary trust is often filled by third party who is likely to be sympathetic to the views of the testator whilst at the same time can be expected to act objectively and in the best interests of the beneficiary concerned. Accordingly, sometimes it may be appropriate to appoint a professional trustee (e.g. a solicitor, accountant or a trustee company) to manage the trust funds in a professional and impartial manner in order to prevent conflicts of interest.

With a blended family, where often there may be a range of the previous scenarios being relevant, the need for independent trustees is very high, whereby taking control away from the beneficiaries will be seen as a tool to prevent breakdown of communication in the future.

Should solicitors act in such a role?

Appointment and removal of the trustee

The appointor may choose to appoint as trustee someone other than themselves for various reasons. The appointor may not wish to act in the office, or may prefer to have a professional trustee. Appointing a company to be trustee may have an asset protection function, and it may give continuity to the office holder.

Professional trustee companies may, in certain circumstances, be an attractive choice as it creates significant asset protection, a high level of fiduciary prudence, continuity and to a large degree, certainty of cost.

An option that may be available for some legal firms is to create a corporate entity for the sole purpose of acting in the capacity as trustee of testamentary trusts drafted by that firm. The current Partners of the firm are shareholders and directors which meet to discuss and deal with trust assets. As one Partner retires and another joins, the transfer of shares and appointment of new Directors takes place.

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Types of Trust

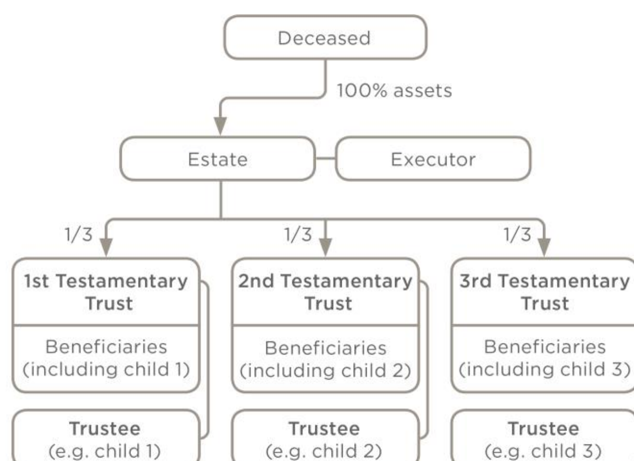
Discretionary trust

A discretionary trust is trust in which the eligible beneficiaries have no absolute entitlement to the income or capital property of the trust, but rather the trustee exercises the power to select which beneficiaries (if any) are to receive income and/or capital of the trust.

A testamentary trust can adopt any trust form ranging from trusts which are fixed as to the payment of income or capital or the establishment of a life interest to trusts where the trustee has a discretion as to payment of capital and income to beneficiaries and from trusts with only a single beneficiary to those with a wide class of beneficiaries.

Many Discretionary Testamentary Trusts

Separate testamentary trusts created under a Will provide the necessary independence perceived as necessary for each adult child or grandchild (if applicable) of a testator who is due to benefit thereby allowing each beneficiary to deal with and control their inheritance according to their own wishes.



This is perfect in the Blended Family scenario whereby we do not wish to blend assets from set of children with another. This enables a testator to provide for all their children and spouses without the need for them to rely on each other.

One Trust to Rule Them All

A true discretionary testamentary trust would combine all of the trust assets and nominate a wide range of beneficiaries which would include all of the children and grandchildren (and spouses, former spouses, siblings and so on). Operating in

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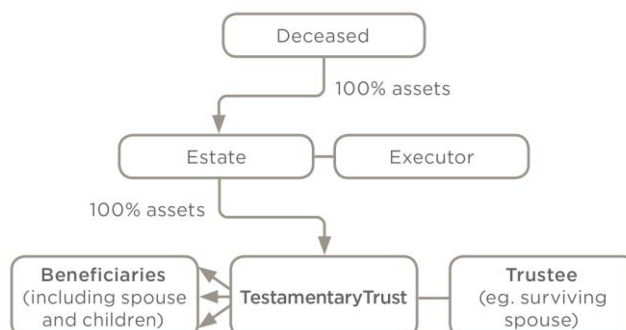
identical terms to an inter-vivos family discretionary trust no one beneficiary has any specific entitlement to the trust assets or income. The Trustee continues to have the discretion to apply capital and income on a needs basis.



In a Blended Family situation, the use of the single trust is rarely advocated as the testator does not wish to blend all beneficiaries into a single trust as the control of that trust becomes all important and the discretionary nature means that there is an ability for beneficiaries to miss out completely on receiving any benefit through maladministration or malfeasance in the trust.

Superannuation Proceeds Trusts

A superannuation proceeds Will trust refers to a trust created in a Will, the purpose of which is to ensure that a superannuation death benefit lump sum will not be subject to superannuation death benefits tax. If the executor can show that the person who received or was likely to receive the benefit of the lump sum was a death benefits dependent, (referred to as a tax dependent of the deceased), the superannuation death benefit lump sum will not be assessable income and so will not be subject to superannuation death benefit taxes[11].

In other words, all the superannuation lump sum paid to a tax dependent is tax-free. If some benefit from the lump sum passes to people who are not taxed dependants, that portion will be subject to applicable superannuation death benefits taxes. Therefore, if the primary beneficiary of the trust is a tax dependent and the other beneficiaries are not tax dependent, it may be difficult to show that only the tax dependent benefited from the superannuation death benefit lump sum.

However, if the Will contains a provision allowing the executors to hold the superannuation lump sum in a superannuation proceeds Will trust as a separate or sub trust of the discretionary testamentary trust which limits beneficiaries to tax dependants of the deceased, beneficiaries will be able to establish that the ultimate

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[11] Section 302 – 60 *ITAA 1997* provides "*A superannuation lump sum that you receive because of the death of a person of whom you are a death benefits dependent is not assessable income and is not exempt income.*"

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recipients are taxed dependents, and hence superannuation death benefits taxes will be avoided.

In a Blended Family situation, where there may be two distinct categories of beneficiaries, with the new spouse falling into the category of tax dependant, it may be advisable to use this structure to allow for more total monies within the trust to enable a testator to provide for all members of a Blended Family.

The superannuation proceeds Will trust is usually a separate or sub trust of a standard discretionary testamentary trust.

Special Disability Trusts

Special disability trusts have been available since 20th September 2006. The conditions which a trust must meet in order to be recognised as a special disability trust are set out in *Social Security Act 1991*[12] and *Veterans Entitlements Act 1986*[13].

Where a trust is recognised as a special disability trust, family members and carers are able to make contributions to the trust for the current future care and accommodation needs of a family member with a severe disability. The conditions imposed on special disability trusts are strict and narrow.

There must be only one principal beneficiary, who must meet the requisite level of disability which has quite a high threshold level. The purpose of the trust must be for the accommodation and care needs of the principal beneficiary[14], the trust must have a trust deed that contains the prescribed clauses as set out in the model trust deed, the trust must have an independent trustee, or alternatively have more than one trustee, immediate family members of the principal beneficiary are able to make contributions to a special disability trust, and a total combined amount of $500,000 can be gifted to the trust, without impacting on the donor in relation to their own Social Security means test (that is, the gifts will not count as deprivations against the donors). For the principal beneficiary, there is an assets test exemption of $626,000 as of 1st July 2014[15] which is indexed annually.

The terms of the model trust deed have changed over time, and presumably will continue to change. Indeed, there is already a deed of variation of special disability trust which must be adopted by those special disability trusts which came into effect with the first model deed, if they wish to take advantage of concessional changes that have become available since the first model deed.

[12] Part 3.18A
[13] Div 11B
[14] Although $11,000 per annum may be used discretionally.
[15] A main residence exemption is in addition to this amount.

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Lineal Descendant Trust

A lineal descendant trust is simply a testamentary trust where the testator restricts the ability of the trustee to benefit only his or her children and grandchildren excluding any spouse of the children or grandchildren. The main attraction with lineal descendant trusts is that it reduces the risk of exposure of assets to claim in the event of a matrimonial breakdown as it is hardwired in a particular way (rather than the uncertainty of a discretion) although it should always be borne in mind that the wide powers of the Family Court these days would undoubtedly see a discretionary testamentary trust benefiting a spouse as a financial resource to be taken into account in a property settlement. The capital at least is protected in this situation though.

In a blended family scenario particular care needs to be taken with the terminology and identification of beneficiaries. A true lineal descendant trust might exclude an existing spouses' children as they are not related to the testator as, death breaks the step relationship. As such structure must be used sparingly and with great attention to the client's needs.

Fixed trust

A fixed testamentary trust is a trust for a specific defined beneficiary or beneficiaries.

A fixed testamentary trust may be used for beneficiaries with identifiable concerns such as mental incapacity or for spendthrift or alcoholic/drug addict beneficiaries. For example this would allow the trustee to distribute income only to such a beneficiary during that particular beneficiaries lifetime with the capital of the trust then held for another group of remainder beneficiaries contingent upon the occurrence of certain specified events, usually the death of the income beneficiary or perhaps their remarriage or entry into a new domestic relationship.

Alternatively the trust may be fixed in the context of allowing specified individual to occupy a dwelling thereby receiving the Main Residence CGT exemption but preserving the capital for other particular beneficiaries.

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Capital Reserve Trusts

The testator may wish to ensure that the capital component of the estate is not run down or dissipated as a consequence of a relationship breakdown of the beneficiary.

This type of trust is suitable for increased protection in the Family Court, as an option for a main residence where surviving spouse has bankruptcy risks or particularly where testators wish to limit the entitlement of a beneficiary and direct where the capital ultimately passes which is very useful with blended family situations. Clearly, there are situations involving Blended Families that would suit a Capital Reserve Trusts.

Some careful drafting may be required for things such as how and when capital may be accessed. Capital access may be desired in circumstances where there may be adverse taxation consequences, including CGT consequences, as a result of the type of trust created. The main use is for the family home to be lived in, should there be consideration for future needs of a spouse including other forms of accommodation such as nursing homes or retirement villages.

Protective trusts

This type of trust is typically used when it is inappropriate for beneficiaries to be involved in the control or management of finances. A protective trust is independently controlled, drafted to priorities the needs and comforts of the beneficiaries.

Priorities for protective trusts, accommodation and support services like finding suitable accommodation can be a major difficulty, but can make an enormous difference to a vulnerable person's quality of life. Similarly support services can be a major ongoing expense for many vulnerable people. Many professional trustees have been and are opposed to spend money on recreation and entertainment without specific authorisation under the terms of trust, it is often usual for the trustee to be given examples of what sort of quality-of-life expenditure can and should be incurred if surplus funds are available, for example recreation, holidays and travel.

Optional trusts

Flexibility is important for all trusts other than those where the objectives is to prevent or limit the flexibility and access by an individual beneficiary. One handy option is not to use a Testamentary Trust at all or to pass assets to an existing trust.

It is always useful, particularly for spouses, to not include, or specifically exclude, minor items such as furniture, contents, clothes, daily drive, particularly if the spouse or intended beneficiary does not have the option to bypass assets out of the testamentary trust.

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Summary and Conclusion

Blended Families specifically, and death are not passing issues – they will continue to consume a great portion of the legal discourse in the forthcoming years and decades.

For legal practitioners, it is essential that they understand the interplay between the two, as the size of the transfer of wealth set to take place in this time frame will mean that any errors or mistakes may result in catastrophic financial losses for your client – and yourself.

Like most things in life, Blended Families and the events surrounding the breakdown of marriages and death – do not take place in a vacuum. Accordingly, careful and detailed questions of your client's need is required to ensure that their testamentary intention are captured and reproduced in their documentation.

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INCOME TAX ASSESSMENT ACT 1936 - SECT 102AG

Trust income to which Division applies

(1) Where a beneficiary of a trust estate is a prescribed person in relation to a year of income, this Division applies to so much of the share of the beneficiary of the net income of the trust estate of the year of income as, in the opinion of the Commissioner, is attributable to assessable income of the trust estate that is not, in relation to that beneficiary, excepted trust income.

(2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:

(a) is assessable income of a trust estate that resulted from:

(i) a will, codicil or an order of a court that varied or modified the provisions of a will or codicil; or

(ii) an intestacy or an order of a court that varied or modified the application, in relation to the estate of a deceased person, of the provisions of the law relating to the distribution of the estates of persons who die intestate;

(b) is employment income;

(c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary:

(i) by way of, or in satisfaction of a claim for, damages in respect of:

(A) loss by the beneficiary of parental support; or

(B) personal injury to the beneficiary, any disease suffered by the beneficiary or any impairment of the beneficiary's physical or mental condition;

(ii) pursuant to any law relating to worker's compensation;

(iii) pursuant to any law relating to the payment of compensation in respect of criminal injuries;

(iv) directly as the result of the death of a person and under the terms of a policy of life insurance;

(v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;

(vi) directly as the result of the death of a person by an employer of the deceased person;

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(vii) out of a public fund established and maintained exclusively for the relief of persons in necessitous circumstances; or

(viii) as the result of a family breakdown (see section 102AGA);

(d) is derived by the trustee of the trust estate from the investment of any property:

(i) that devolved for the benefit of the beneficiary from the estate of a deceased person;

(ii) that was transferred to the trustee for the benefit of the beneficiary by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the date of the death of the deceased person; or

(iii) being a verifiable prize in a legally authorized and conducted lottery and being a prize of which the beneficiary is the beneficial owner; or

(e) is derived by the trustee of the trust estate from the investment of any property that, in the opinion of the Commissioner, represents accumulations of:

(i) assessable income derived by the trustee during a year of income in relation to which this Division applies, being assessable income that, in relation to the beneficiary, is excepted trust income;

(ii) assessable income derived by the trustee during a year of income in relation to which this Division does not apply, being assessable income that would, in the opinion of the Commissioner, have been excepted trust income in relation to the beneficiary if this Division were applicable in relation to the year of income during which the assessable income was derived; or

(iii) exempt income derived by the trustee to which subparagraph (i) or (ii) would, in the opinion of the Commissioner, apply if that exempt income had been assessable income.

(2A) Paragraph (2)(c) or subparagraph (2)(d)(ii) does not apply unless the beneficiary of the trust concerned will, under the terms of the trust, acquire the trust property (other than as a trustee) when the trust ends.

(3) Subject to subsection (4), if any 2 or more parties to:

(a) the derivation of the excepted trust income mentioned in subsection (2); or

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(b) any act or transaction directly or indirectly connected with the derivation of that excepted trust income;

were not dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction, the excepted trust income is only so much (if any) of that income as would have been derived if they had been dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction.

(4) Subsection (2) does not apply in relation to assessable income derived by a trustee directly or indirectly under or as a result of an agreement that was entered into or carried out by any person (whether before or after the commencement of this subsection) for the purpose, or for purposes that included the purpose, of securing that that assessable income would be excepted trust income.

(5) In determining whether subsection (4) applies in relation to an agreement, no regard shall be had to a purpose that is a merely incidental purpose.

(5A) In the application of paragraph 102AF(1)(b) for the purposes of the application of paragraph (2)(b) of this section in relation to a beneficiary of a trust estate, payments made for services rendered or to be rendered shall not be taken to be employment income unless the services are rendered or to be rendered by the beneficiary.

(6) Where:

(a) any assessable income is derived by a trustee of a trust estate from the investment of any property transferred to the trustee for the benefit of a beneficiary of the trust estate by way of, or in satisfaction of a claim for, damages in respect of:

(i) loss by the beneficiary of parental support; or

(ii) personal injury to the beneficiary, any disease suffered by the beneficiary or any impairment of the beneficiary's physical or mental condition; and

(b) that property was transferred to the trustee otherwise than in pursuance of an order of a court;

paragraph (2)(c) applies only to so much (if any) of that assessable income as the Commissioner considers fair and reasonable.

(7) Where:

(a) any assessable income is derived by a trustee of a trust estate from the investment of any property transferred to the trustee for the benefit of a beneficiary of the trust estate by another person out of property that devolved upon that other person from the estate of a

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deceased person and was so transferred to the trustee within 3 years after the date of death of the deceased person; and

(b) the amount referred to in paragraph (a) or, if the assessable income of that beneficiary of the year of income includes any amount that:

(i) was derived by the beneficiary from property that was transferred to the beneficiary by another person out of property that devolved upon that other person from the estate of that deceased person and was so transferred within 3 years after the date of death of that deceased person;

(ii) was derived by the beneficiary from property that devolved upon the beneficiary from the estate of that deceased person; or

(iii) is included in that assessable income under section 97 or 100 in respect of the share of that beneficiary of the net income of another trust estate, being a trust estate that resulted from a will or codicil of that deceased person, an order of a court that varied or modified the provisions of a will or codicil of that deceased person, a partial intestacy of that deceased person or an order of a court that varied or modified the application, in relation to the estate of that deceased person, of the provisions of the law relating to the distribution of estates of persons who die intestate;

the sum of the amount referred to in paragraph (a) and the amount or amounts applicable by virtue of subparagraphs (i), (ii) and (iii) of this paragraph, exceeds the amount that, in the opinion of the Commissioner, would have been included in the assessable income of the beneficiary of the year of income in respect of an amount or amounts derived by the beneficiary from property that, in the opinion of the Commissioner, would have devolved directly upon that beneficiary if that deceased person had died intestate;

the amount of the assessable income of the trust estate that would, apart from this subsection, have been excepted trust income in relation to that beneficiary by virtue of subparagraph (2)(d)(ii) shall be reduced by the amount of that excess.

(8) For the purposes of this section, where:

(a) any property is transferred to the trustee of a trust estate; and

(b) the trustee has a discretion to pay or apply the income derived from that property to or for the benefit of specified beneficiaries or beneficiaries included in a specified class of beneficiaries;

that property shall be taken to have been transferred to the trustee for the benefit of each of those specified beneficiaries or for each of the beneficiaries in that specified class of beneficiaries, as the case may be.

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