



Specific Issues in Taxation and Estate Planning

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1 Overview of the taxation of deceased estates

Commissioner of Stamp Duties (Qld) v Livingstone (1960) 107 CLR 411 (High Court) and [1965] AC 694 (Privy Council) stands for the proposition that upon the death of a taxpayer, the legal title to any property which the taxpayer owned as at the date of their death vests absolutely in the legal personal representative of the deceased (i.e. the executor or the administrator). The ownership by the legal personal representative is subject to that person's duty to:

- Collect the deceased's assets;
- Pay off the deceased's death; and then
- Distributing the deceased's remaining assets in accordance with their will, or according to the applicable rules of intestacy.

As a matter of general law, the LPR does not hold the assets as trustee for the beneficiaries of the deceased's estate. The beneficiaries only have the right to compel proper administration of the deceased's estate.

Rather, at general law, a trust for the beneficiaries only comes into existence if:

- administration is complete, and if the executor continues to hold assets post-administration; or if
- the legal personal representatives appropriate particular assets to beneficiaries pursuant to the terms of the will (before administration is complete).

However, subsection 6(1) of the 1936 Act defines the term 'trustee' as including '... an executor or administrator ...'. That is, according to the 1936 Act, a trust estate comes into existence upon death. Notwithstanding that, the Courts have held that before administration is complete, no beneficiary can be 'presently entitled' to the income derived within the (trust) estate, with the result that the income is subject to tax in the hands of the trustee pursuant to either section 99 or 99A of the 1936 Act.

After administration is complete, Division 6 of Part III of the 1936 Act applies with respect to net income of the (trust) estate with respect to assets which continue to be held by the executor / a trustee.

1.1 Income accrued before or as at the date of death, but received after death

Section 101A of the 1936 Act applies to amounts received after the death of a taxpayer (but which accrued before the date of death), and which would have been assessable to the taxpayer, had the taxpayer been alive at the time of receipt. Such amounts are assessable in the hands of the executor.

Without section 101A of the 1936 Act, amounts accrued before the date of death, but which are paid after the date of death would be capital of the deceased estate.

Subsection 101A(1) of the 1936 Act provides that:

Where in the year of income, the trustee of the estate of a deceased person receives any amount which would have been assessable income in the hands of the deceased person if it had been received by him during his lifetime, that amount shall be included in the assessable income of that year of the trust estate and shall be deemed to be income to which not beneficiary is presently entitled

That is, section 101A of the 1936 Act subjects the executor to tax on receipts which accrued prior to death of the deceased, but which are only received after death of the deceased.

Section 101A of the 1936 Act was introduced as a result of the decision in *C of T (NSW) v Lawford* (1937) 56 CLR 774. The deceased was in a partnership (of solicitors), which operated on a cash basis. At the date of death, the partnership had rendered accounts for fees with respect to professional services rendered.

After the deceased's death, the outstanding legal fees owing as at the date of death were received. The deceased's share of those fees were paid to the executor of the deceased's estate.

The High Court held that the fees received by the executor were not assessable, but formed part of the corpus of the deceased's estate, as each payment was '*... a mere debt forming part of the assets which devolve ...*' upon the executor.

The High Court held in *Single v FC of T* (1964) 110 CLR 177 that section 101A of the 1936 Act applies to receipts with respect to fees for services which was incomplete (i.e. such that no account had been rendered) as at the date of death.

Section 101A of the 1936 Act does not apply to all amounts which are received after death. It was held in *Case 6* (1969) 15 CTBR (NS) 24, that amounts received by a legal personal representative was not subject to tax on a payment with respect to a life insurance policy pursuant to section 101A of the 1936 Act as:

... it is difficult to apply ... [section 101A of the 1936 Act] ... to an amount which could not, under any conceivable circumstances, have been receivable by a deceased person in his lifetime because it only became payable in consequence of his death.

Further, section 101A of the 1936 Act does not apply to lump sum payments for unused annual leave (section 26AC of the 1936 Act) or long service leave (section 26AD of the 1936 Act), which would have been assessable in received by the deceased (before the deceased's death) (see subsection 101A(2) of the 1936 Act).

The amounts are not assessable pursuant to either section 26AC or 26AD of the 1936 Act, and on the basis that the amounts are treated as capital receipts by the executor, and because there is no disposal (or deemed disposal) of a capital asset with the result that no capital gain arises, such amounts are not assessable.

Subsection 101A(3) of the 1936 Act provides that eligible termination payments received by a trustee (i.e. a legal personal representative) is assessable to the trustee (pursuant to either section 99 or 99A of the 1936 Act).

1.2 Income accrued and derived after the date of death

Income which accrues, and is derived after the date of death of the deceased is subject to Division 6 of Part III of the 1936 Act (as modified).

That is, until the estate is completely administered, then the trust estate is subject to section 99 or 99A of the 1936 Act – as it is income to which no beneficiary is 'presently entitled' to.

Upon administration being complete, and if the assets of the deceased are passed to the beneficiaries, then Division 6 of the 1936 Act has no continuing application. However, if the executor becomes a trustee of a (e.g. testamentary) trust, then the income derived is subject to section 97, 98, 99 or 99A of the 1936 Act.

2 Estate planning vehicles

2.1 Joint Tenants

A joint tenancy relationship is characterised by survivorship, that is, upon the death of a joint tenant, that person's interest will pass to the survivor(s) in the joint tenancy subject to any alteration made before death, or any court order.

This means that the interest a joint tenant has in a joint asset prior to death would not form part of his/her estate; rather, it will become the property of the survivor.

The CGT implication of a joint tenancy under the *Income Tax Assessment Act 1936* (Cth) ('the 1936 Act') is that the joint tenants are treated as if they each owned a separate CGT asset constituted by an equal interest in the asset as a tenant in common (section 108-7 of the 1936 Act). Moreover, a surviving joint tenant is taken to have acquired the deceased's interest in the asset on the date of death (section 128-50 of the 1936 Act).

2.2 Inter vivos trusts

An inter vivos trust is a trust made during the life of the settler; a common example is as a family discretionary trust.

Trusts are usually subject to the rule against perpetuities; in New South Wales, the applicable perpetuity period under section 7 of the *Perpetuities Act 1984* (NSW) is 80 years from the date of establishment of the trust.

2.3 Testamentary trusts

A 'testamentary trust' is an 'express trust'¹, created under the terms of a will, or a codicil² of a will (i.e. a 'testamentary instrument'). That is, testamentary trusts are not created inter vivos,³ as such trusts come into existence when the testator / testatrix (whose property is settled on to the testamentary trust) dies.

As with *inter vivos* trusts, it is the beneficial owner of the property (i.e. the testator / testatrix) that declares that particular property is to be subject to the testamentary trust (*Tierney v Wood* (1854) 52 ER 377 at 379).

This paper will focus on testamentary trusts as an effective estate planning vehicle.

2.4 Post mortem trusts

A post mortem trust is relevant when a testator wish to provide for minor children. Such trusts may be established after the death of the testator and the ordinary rates of tax would still be applicable under Division 6AA of the 1936 Act to the unearned income of minor beneficiaries pursuant to section 102AG(2)(d)(ii) of the 1936 Act. However, for the ordinary rate of tax to be applicable, the trust must be

¹ There are three categories of trusts, being express trusts, resulting trusts and constructive trusts. An express trust is a trust created by express intention. A resulting trust is a trust created by implied intention. A constructive trust is a trust that is imposed to prevent person(s) from succeeding in making an unconscionable assertion of ownership over property.

² A codicil is a '... document supplementary to a will made earlier which is executed by a testator with the intention of adding to, altering, revoking, explaining or confirming a will, provision or part of a will. As a subsidiary testamentary instrument, a codicil must be executed with the same formalities as a will and when so executed, becomes part of the will and must be provided with the will ...' (see *Butterworths Concise Australian Legal Dictionary*).

³ 'Inter vivos' - a deed or other instrument executed *inter vivos* is executed between living persons.

established with trust capital that came from the estate of the testator within three years of the date of death of the testator, and the trust must provide for the beneficial acquisition of the trust property by the beneficiaries upon termination of the trust.

2.5 Superannuation proceeds trust

Pursuant to section 102AG(2)(c)(v) of the 1936 Act, a superannuation proceeds trust must be one that is derived by the trustee of the trust estate from the investment of any property transferred from a superannuation fund to the trustee for the benefit of the beneficiary directly as a result of the death of the testator in order for the ordinary rate of tax to apply to minor beneficiaries under Division 6AA of the 1936 Act.

Section 302-10 of the *Income Tax Assessment Act 1997* (Cth) (**'the 1997 Act'**) provides that the trust will be 'look through' to the underlying beneficial ownership of the fund to assess whether the superannuation death benefit tax concessions should apply.

2.6 Life interests

Life interest is a form of property interest for the duration of the beneficiary's lifetime. Life interest can be created by writing, such as a will, over land or personal property. Upon the termination of the life interest, the interest in the property will revert to the remainderman.

However, the creation of a life interest by a will is considered by the ATO to be a new asset created at the death of the testator and not an asset owned by the testator just before dying. On the other hand, the remainderman is considered to have derived his interest from the estate under which the life interest was created.

A life interest may be distinguished with a right to occupy, which is a lesser interest as compared to a life interest.

2.7 Superannuation funds

Superannuation funds can be used as estate planning vehicles by way of payment of a pension from a superannuation fund. This can be particularly useful in the case of self managed superannuation funds. Moreover, section 343 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**'SIS Act'**) provides that the rules against perpetuities do not apply to superannuation trusts.

For superannuation death benefits paid on or after 1 July 2007, the death benefit can be paid to a dependant for tax purposes as a lump sum, an income stream or a combination of both. The income from the pension is tax free if either the deceased or the beneficiary is over the age of 60 (section 302-62 of the 1997 Act). Further, the income earned on the assets funding such a pension is exempt in the hands of the trustee.

3 Family provision legislation

In New South Wales, the provisions contained in *Succession Act 2006* (NSW) (**'the Succession Act'**) regarding family provisions, which replaced the *Family Provision Act 1982* (NSW), seek to limit the freedom of testation to the extent consistent with the purposes of the Act and the Bill. That purpose is to:-

'enable a court to override the terms of a deceased person's will or the distribution of a deceased person's estate on intestacy if it determines it is necessary to do so to ensure that the family and other dependants of a deceased person are adequately provided for'⁴.

The conflict between testamentary freedom (often expressed as 'the freedom to leave my property to anyone I like') and the 'community standards' often referred to by judges in deciding family provision cases leads to situations of emotion and stress. The plaintiff cannot understand why he or she has been left out, and the beneficiaries under the will cannot understand why the plaintiff is not happy with his or her lot. Often, the impact of the will can be minimised before death; rarely can it be totally avoided.⁵

An understanding, even if only a general one, of the impact and reach of the Family Provision legislation is important in considering the position of wills in estate and succession planning. For will drafters, there are considerations of inclusion of relatives, for provision of reasons for exclusion, and the advice which can be given as to possible applications by disappointed family members. For succession planners, considerations need to be given to the effectiveness of strategies to remove property from the estate.

3.1 Overview of family provision

Under Chapter 3 of the Succession Act, the Court may make a family provision order in relation to the estate of a deceased person in favour of an eligible person on application by the eligible person to the court (section 59, Succession Act). However, the Court may only make the order if the eligible person has not been adequately provided for by the testator for the person's maintenance, education or advancement in life (section 59, Succession Act).

An eligible person as defined in section 57 of the Succession Act include the spouse, child, former spouse, a person who was wholly or partly dependent on the deceased who is either a grandchild or was a member of the deceased's household, and a person with whom the deceased person was living in a close personal relationship at the time of the deceased person's death.

Under subsection 58(2) of the Succession Act, any applications made under the Succession Act must be made within 12 months from the date of death of the deceased unless otherwise ordered by the court.

3.2 Family Provision and Trusts

Section 63 of the Succession Act contains a list of property that may be used for family provisions orders, which include:

- (1) A family provision order may be made in relation to the estate of a deceased person.
- (2) If the deceased person died leaving a will, the estate of the deceased person includes property that would, on a grant of probate of the will, vest in the executor of the will, or would on a grant of administration with the will annexed, vest in the legal representative appointed under that grant.
- (3) A family provision order may not be made in relation to property of the estate that has been distributed by the legal representative of the estate in compliance with the requirements of section 93, except as provided by subsection (5).
- (4) Where property of the estate of a deceased person is held by the legal representative of that estate as trustee for a person or for a charitable or other purpose, the property is to be treated, for the purposes of this Chapter, as not having been distributed unless it is vested in interest in that person or for that purpose.

⁴ Explanatory Note, Overview of Bill, Succession Amendment (Family Provision) Bill 2008.

⁵ For an entertaining review of this conflict, see Professor Croucher's *Conflicting Narratives in Succession Law* (2007) 14 APLJ 179.

(5) A family provision order may be made in relation to property that is not part of the estate of a deceased person, or that has been distributed, if it is designated as notional estate of the deceased person by an order under Part 3.3.

As can be seen from subsection 63(4), properties subject to the testamentary trust are properties that may be used for family provisions orders.

Further, Part 3.3 of the Succession Act enables the court to make an order designating property that the deceased disposed of before death as being property that forms part of the deceased's 'notional estate', and the court may make a family provisions order out of this notional estate under subsection 63(5), Succession Act.

The Note to Part 3.3 in the Succession Act summarises the notional estate provision:

Property may be designated as notional estate if it is property held by, or on trust for, a person by whom property became held (whether or not as trustee), or the object of a trust for which property became held on trust:

(a) as a result of a distribution from the estate of a deceased person (see section 79), whether or not the property was the subject of the distribution, or

(b) as a result of a relevant property transaction, whether or not the property was the subject of the transaction (see section 80), or

(c) as a result of a relevant property transaction entered into by a person by whom property became held, or for whom property became held on trust, as a result of a relevant property transaction or a distribution from the estate of a deceased person (see section 81), whether or not the property was the subject of the relevant property transaction.

Property may also be designated as notional estate if it is property:

(a) held by the legal representative of the estate of a person by whom property became held as a result of a relevant property transaction or distribution referred to in paragraphs (a)-(c) above and who has since died (known as the "deceased transferee"), or

(b) held by, or on trust for, a person by whom property became held, or for the object of a trust for which property became held on trust, as a result of a distribution from the estate of a deceased transferee,

whether or not the property was the subject of the relevant property transaction or the distribution from the estate of the deceased person or the deceased transferee (see section 82).

As a result of the provisions in Part 3.3, properties subject to a testamentary trust may become part of the deceased's notional estate.

In *Kavalee v Burbidge* (1998) 43 NSWLR 422, the New South Wales Court of Appeal held that assets transferred by the deceased in a series of transactions during his lifetime to a foundation established under the laws of Liechtenstein were available to be designated as notional estate. The Court found that instructions could be given from time to time by the deceased to the 'Founder' controlling the foundation, who was legally obliged to implement the instructions of the deceased.

Mason P (with whom Meagher JA agreed) said at 446-7:

'... I do not see s 22(1)(a) [Now s75(1) of the Succession Act] as confined to acts or omissions that are the operative cause of property becoming held by the deceased's intended donee. To do so would ignore the thrust of this liberal enactment which emphasises its scope with the words "directly or indirectly", "as a result of which" (emphasis added) and "whether or not the property becomes so held immediately"... The legislation is clearly intended to operate in a context of human agents where several may have to act in concert and where there is the possibility that one may not co-operate. To paraphrase Mason J in *Fagan v Crimes Compensation Tribunal* (at 673), "the fact that other unconnected events may also have had some relationship to the occurrence is not material if the act was a cause, even if not the sole cause"...

The respondents dispute that it is correct to approach the issue of causation in this way. They support Windeyer J in his conclusion that the relevant act or omission must be the effective cause. We were reminded that the Act interferes with property rights. But the critical issue is the extent of that potential interference. In my view, the choice of a looser test of causation is open. For the reasons given, s 22(1) suggests, and certainly permits, the looser approach to the factual issue of causation that I have adopted. *Schaeffer* (at 318) citing *Wentworth v Wentworth* (Bryson J, 14 June 1991, unreported) identifies:

“... a purpose of the Legislature that the notional property provisions should extend the powers of the Court to the full range of benefits and advantages controlled by testators. In so far as any question of construction presents a choice, a construction which would promote this purpose is to be preferred: see s 33 of the *Interpretation Act 1987*.”

... In any event, s 22(1)(a) extends to omissions. And since, as I have held, the deceased had the legal power to direct the Founder to do his bidding, the failure to exercise this power before death must surely be seen as an operative cause of the by-law remaining in its final form. That by-law “designate[d] as beneficiaries” of the Foundation those persons referred to in the “bequests” section of the memorandum. By omitting to exercise his entitlement to direct the Founder to revoke the by-law, the deceased omitted to do an act as a result of which the bequests stipulated in the by-law came to be paid by the Foundation, which was obliged to obey its terms.’

Mason P then considered at pages 450-454 whether or not there might be a prescribed transaction due to the deceased’s omission to exercise the power to appoint or to dispose of the property of the foundation and:

‘The appellants submit that, during his lifetime, the deceased could have caused the assets of the Gartner Foundation to be dealt with as he pleased. They rely upon the trial judge’s finding that the deceased had control of Mr Defago who in turn had control of the Foundation through the capacity to compel the exercise of the full gamut of Founder’s rights that were vested in DFC at the time of the deceased’s death. I have already indicated that I accept that such control existed.

Windeyer J held that s 22(4)(a) [Now s76(2)(a) of the Succession Act] did not apply because:

- (a) the deceased had no power to appoint or dispose of the property of the Foundation; and
- (b) the property of the Foundation did not become held by another person as a result of the deceased’s omission to exercise the power before his death (in the terms of s 22(4)(a)(i)).

The respondents support these propositions. The appellants dispute them and also invoke s 22(4)(a)(ii)..

(a) Did the deceased have the power to appoint or dispose of the property of the Foundation during his lifetime?

Windeyer J answered “no”. He did not find it necessary to consider (as I have) whether the deceased had legal rights to compel Mr Defago, and through him the Founder, to do his bidding. And he distinguished between the power of the deceased over the Founder on the one hand, and the power of the Founder over the Foundation on the other...

...

In my opinion, the distinction drawn by the learned trial judge (between a power to or dispose of property that was directly exercisable, and one which depended upon compelling Mr Defago to execute various documents) finds no support in this legislative scheme. What I have described as the deceased’s legal power to compel Mr Defago, through DFC, to cause the Foundation to deal with its assets as the deceased might stipulate was in effect an entitlement to exercise a power to dispose of the property in the Gartner Foundation. That power existed (albeit indirectly) through the agency of Mr Defago and his firms, SCF and DFC. A “power to ¼ dispose of property” is not a technical term of law. In context it must mean something more than a traditional power of appointment, assuming that the latter concept were limited in any presently relevant way.

...

Returning, as I must, to construing s 22(4)(a) in context, and faithful to the purpose of Pt 2, Div 2 of the Act as expounded in *Schaeffer* (at 318-319). I am satisfied that the deceased had until his death an entitlement to exercise a power to dispose of property which was not in his estate, being the property vested in the Foundation.

I accept that there is a vital distinction between de facto control and legal entitlement: see *Re Sutton Coldfield Grammar School* (1881) 7 App Cas 91; *National Companies & Securities Commission v Brierley Investments Ltd* (at 287). Section

22(4)(a) requires entitlement. However, entitlement and immediate enjoyment are different. Here the powers of DFC as Founder were at the deceased's disposal as a matter of right, through the rights which the deceased had over Mr Defago. And, if he chose, the deceased was, as a matter of right, able to have the Founder replaced by a Founder that would do the deceased's bidding. Indeed, the deceased could have required DFC to appoint the deceased himself as the Founder. All steps to effect an appointment or disposal of assets as the deceased chose were really administrative once the deceased determined to act.

I have no difficulty in conceding that the power to appoint or dispose of the assets of Gartner (through art 6) was vested in the Founder for the time being. Absent a contrary direction from the deceased, the Founder immediately before and after the deceased's death (DFC) was entitled to exercise that power of disposition. But more than one person may have concurrent powers to deal with or dispose of the same item of property...

(b) Did the omission to exercise the power before death cause either of the events in s 22(4)(a)(i) or (ii)?

I agree generally with Windeyer J on s 22(4)(a)(i). The property of the Foundation remained vested in it before and after the deceased's death. It did not "become held by another person" as a result of the omission to exercise the relevant power and the deceased's death.

However, s 22(4)(a)(ii) must also be considered. The death of the deceased F either led to the transmission of the deceased's rights over the Founder according to the law of the deceased's domicile, or it terminated those rights ... If the former, there was obviously "another person" (cf s 22(4)(a)(ii)) who became entitled to exercise the deceased's power of disposition, and this occurred as a result of the deceased's omission to do so and his death.

If the latter, the expiry of the deceased's rights left the Founder's powers G intact. Can it be said that as a result of the deceased's omission to exercise his power and of his death, the Founder "continue[d] to be, entitled to exercise the power" (to which it was previously entitled) to dispose of the assets of the Foundation?

The respondents are correct in their submission that "the power" referred to in subpar (ii) must be the same power as that which was enjoyed by a deceased before he or she ceased to be entitled to exercise it. But the very fact that the subparagraph contemplates that "another person" may continue to be entitled to exercise the power shows that the provision embraces the situation of two or more persons having a concurrent power to dispose of property with one of those persons (being the deceased) ceasing to exercise it as a result of the prior omission to exercise it and death. ... The Founder's entitlement to exercise the power preceded the deceased's death and continued after it. This satisfied subpar (ii) if it were the case that the deceased's entitlement was non-transmissible.

This alone is not sufficient to satisfy s 22(4)(a)(ii). It must also be shown that the continuation of the Founder's power came about "as a result of" the deceased's omission to exercise his concurrent power and of his death. The respondents submit that it is at this point that the appellant's argument breaks down. They submit that there is no link or connection between the continuation of the Founder's powers under the articles of the Foundation and the deceased's omission to dispose of the Foundation's assets (as he could have, through his power over the Founder that I have found to exist) before his death. And the respondents emphasise (correctly) that the same "power" is involved wherever it is mentioned in the paragraph.

... I would reject the respondents' argument for the following reasons. If the deceased had exercised the power which he held yet omitted to exercise, then the assets of the Foundation would have been effectively disposed of. For example, the deceased could have directed the Founder to make a by-law whereby the corpus of the Founder's assets (after payment of the "bequests") were paid to one or more of the appellants. That by-law could have been made irrevocable ... The deceased did not procure this during his lifetime. It can therefore be said that his omission to do so before his death was a cause of the assets remaining in the Foundation. The Founder's concurrent powers of disposition (through making by-laws) remained as it stood under the articles. It continued after the deceased's death. The provision does not require that the concurrent powers of disposition should be exercisable in identical ways. That continuation was causally linked to the deceased's omission in that the omission contributed to the continuation of the Founder's power of disposition under the (unamended) articles, and left the Founder with assets at its disposition in the Foundation.

The decision of *Kavalee* was considered by the New South Wales Supreme Court in *Flinn v Fearne* [1999] NSWSC 1041. In *Flinn*, Master McLaughlin distinguished *Kavalee* and said:

'23 It must, however, be recognised that the decision in *Kavalee v Burbidge* was essentially a decision upon its own facts, dealing with the legal rights of a testator in the context of the law of Liechtenstein, and the specific legal powers vested in

the testator in that case (see the judgment of Mason P at 451E), which are to be distinguished from the powers vested in the deceased in the instant case. Whereas, in *Kavalle v Burbidge* there was a legal duty imposed upon Mr Defago, the trustee, to act in accordance with the directions of the testator, in the instant case there was no such legal duty imposed upon the trustee to act in accordance with the directions of the deceased.

24 There is no doubt, in the instant case, that the deceased during his lifetime, in his capacity as the Nominator, had the power, to remove the trustee named in the deed and to appoint another trustee of the G & A Fearn Family Trust. It seems to me, however, that that power is very different from the power of *de facto* control of the trust asserted by the plaintiffs to have reposed in the deceased. Indeed, the entire basis of that assertion of *de facto* control appears to depend upon assumptions, firstly, that the deceased would be able to find another potential trustee who would be amenable to the dictates of the deceased, and, secondly, that any such entity or person, when appointed trustee, would disregard his duties as a trustee (see *Jacobs' Law of Trusts in Australia*, 6 ed (1997), 51, paragraph 265; 409, paragraphs 1609ff).

25 It was submitted on behalf of the defendant that the deceased held his power in a fiduciary capacity and that he could exercise it only in such a fiduciary capacity. Whether or not that was so, it is abundantly clear that the deceased could not have properly given, and the trustee could not have properly received, a direction that the trustee dispose of the trust property. The most that the deceased could have done was to remove the nominated trustee and to appoint as a new trustee a person or entity whom the deceased might have expected would act in accordance with his direction. (It was suggested on behalf of the plaintiffs that the deceased could even have appointed as such new trustee a company controlled by the plaintiff.)

26 Nevertheless, there could be no certainty that either the original trustee or any replacement thereof appointed by the deceased would necessarily have acted in accordance with such a direction by the deceased, since the conduct of the trustee, were he merely to have acted as directed by the deceased, without independently carrying out his duties and exercising his discretion (in the manner described in the foregoing passages from *Jacobs*), would have constituted on the part of the trustee a clear breach of trust. (If the deceased had appointed as a replacement trustee a company which he himself controlled, it is possible that any disposition of trust property to the deceased by such a trustee would have been in contravention of clause 18(a)(ii) of the deed.)

27 It seems to me that a clear distinction must be drawn between, on the one hand, the conduct of the deceased in failing to exercise his powers as the Nominator, and, on the other hand, the conduct of the trustee. It is all very well for the plaintiffs to say that the deceased could have dismissed the trustee and could have appointed a fresh trustee who would be malleable and would act in accordance with the wishes of the deceased. Nevertheless, the essential question is whether the deceased himself entered into a prescribed transaction, not whether the trustee, by his failure to do anything, allowed the property to remain subject to a trust.'

4 What is a testamentary trust?

A 'testamentary trust' is an 'express trust'⁶, created under the terms of a will, or a codicil⁷ of a will (i.e. a

Testamentary trusts have the same attributes as other trusts. That is, they are a relationship as between a trustee and beneficiary⁸ with respect to trust property. Further, and for the purposes of both trusts created inter vivos and those created under testamentary instruments, the following elements must be present in order for a trust estate to subsist:⁹

⁶ There are three categories of trusts, being express trusts, resulting trusts and constructive trusts. An express trust is a trust created by express intention. A resulting trust is a trust created by implied intention. A constructive trust is a trust that is imposed to prevent person(s) from succeeding in making an unconscionable assertion of ownership over property.

⁷ A codicil is a '... document supplementary to a will made earlier which is executed by a testator with the intention of adding to, altering, revoking, explaining or confirming a will, provision or part of a will. As a subsidiary testamentary instrument, a codicil must be executed with the same formalities as a will and when so executed, becomes part of the will and must be provided with the will ...' (see *Butterworths Concise Australian Legal Dictionary*).

⁸ Charitable trusts do not vest beneficial estates or interests in any persons, as they are established to promote a purpose, or purposes, and not for the direct benefit of persons as individuals or members of a class of individuals (see *Attorney-General for New South Wales v Perpetual Trustee Company (Limited)* (1940) 63 CLR 209 at 222-223).

⁹ See paragraph 104 and following of *Jacobs' Law of Trusts in Australia*.

- **firstly** – there needs to be at least one trustee, who holds a legal (or equitable) interest in the trust property. The trustee has an obligation to deal with the trust property in terms of the trust;
- **secondly** – there must be property capable to be held on trust (*Port of Brisbane Corporation v ANZ Securities Ltd* [2003] 2 Qd R 661). Further, there must be certainty as to the property held subject to a trust (*Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271);
- **thirdly** – there must be a beneficiary for whom the trust assets are held; and
- **fourthly** – the trustee must be under a personal obligation to deal with the trust property for the benefit of the beneficiaries.

Testamentary trusts are also known as ‘executory trusts’. Gummow J in *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271 observed at 280 that the term ‘executory trust’:

... is used usually to describe situations where there is (a) an agreement or covenant for the subsequent execution of a trust instrument or (b) a direction or declaration (usually in a will) giving instructions or short leads from which the trustee is to prepare a formal written statement ...

Lord Cairns in *Mortimer Sackville-West v Viscount Holmesdale* (1870) LR 4 HL 543:

[T]he second codicil to the will of the testatrix ... creates what is commonly described as an ‘executory trust’, that is to say, not a trust which remains to be executed, for in this sense all trusts are ‘executory’ at their creation, but a trust which is to be executed by the preparation of a complete and formal settlement, carrying into effect, through the operation of an apt and detailed legal phraseology, the general intention compendiously indicated by the testatrix. The codicil is, in fact, equivalent to directions or instructions for a settlement.

Broadly speaking, a testamentary trust displays the following characteristics:

- **firstly** - testamentary trusts are established under a testamentary instrument;
- **secondly** – testamentary trusts are funded by either:
 - the assets of a deceased estate; or
 - payments to the estate in consequence of death, such as superannuation death benefits or insurance proceeds paid to a deceased estate, rather than being paid to nominated beneficiaries under a will; and
- **thirdly** – testamentary trusts are typically administered by the executor of the estate, or another person appointed as the trustee under the terms of the will. The testamentary trust is subject to the terms of the will.

5 Why establish testamentary trusts?

The main taxation benefit of a testamentary trust is the income tax concessions for minors, who are taxed as adults with the benefit of the tax free threshold under Division 6AA of the 1936 Act. Section 102AG of the 1936 Act provides for ‘excepted trust income’, being a category of income derived by minors.

‘Excepted assessable income’ includes Income derived by a minor from property of a deceased estate or which is transferred to a minor from a deceased estate (see paragraph 102AE(2)(c) of the 1936 Act).

‘Excepted trust income’ includes:

- **paragraph 102AE(2)(c) of the 1936 Act** – ‘... assessable income of a trust estate that resulted from ... a will, codicil or an order of a court that varied or modified the provisions of a will or codicil ...’; and
- **paragraph 102AE(2)(d) of the 1936 Act** - ‘... is derived by the trustee of the trust estate from the investment of any property ... that devolved for the benefit of the beneficiary from the estate of a deceased person ...’

That is, the essential requirement for minors to be eligible for the concessionally taxed income is that the income is ‘... assessable income of a trust estate that resulted from ... a will...’. That is, it is essential to ensure that the trust under which the minor benefits is established under the testamentary instruments, and not subsequently declared or settled without the appropriate intentions / actions of the testator.

Further, it should be noted that a distribution to minor beneficiaries under the terms of a testamentary trust creates a legal entitlement in favour of the minor beneficiary. As a result, the distribution must either be physically paid to the minor beneficiary, or a loan account in favour of the minor beneficiary will be created, which will ultimately be payable to the minor either at demand, or when the testamentary trust vests.

As a result, and in the event that the testator wishes for the residuary estate be divided (ultimately) equally, and ‘equalisation clause’ may be required in the will. Such clauses allow for an allocation of ‘non-will benefits’ (e.g. insurance or superannuation proceeds) to be allocated to the other (non-minor) beneficiaries.

The purpose of the establishment of the testamentary trust will dictate whether it is ‘discretionary’ or ‘fixed’ in nature (or a combination of both), and as a result, the associated benefits which attach to the structure. A testamentary trust may be drafted so as to be (for example) on one hand:¹⁰

- **a restricted trust** – being established to protect particular vulnerable beneficiaries; and on the other
- **a discretionary testamentary trust** - under which there may be a wide range of potential beneficiaries under the terms of the trust.

Another example of a testamentary trust is a trust established with respect to certain property whereby (for example) a beneficiary has a life interest (i.e. an income beneficiary), with the remainder going to other beneficiaries (i.e. capital beneficiaries).

Macdonald¹¹ provides for the following reasons for establishing a testamentary trust:

- tax benefits on distributing income to minor children, grandchildren (see above);
- tax benefits on distributing income to lower taxed beneficiaries (see below);
- protection of assets from ex-spouses;
- protection of assets from creditors;
- protection of assets from being wasted by spendthrift beneficiaries;
- protection of assets from being wasted by addicted beneficiaries; and

¹⁰ Perkins M and Monahan. Estate Planning – A Practice Guide for Estate and Financial Service Professionals. LexisNexis – Butterworths, Sydney, 2005 p 111.

¹¹ Arlene Macdonald. *Testamentary Trusts: Not Just ‘Another’ Trust?*. 14th National Intensive Retreat, 17-19 August 2006.

- a combination of all of the above.

Further, the terms of a testamentary trust may allow for the streaming of particular distributions to particular beneficiaries (e.g. franking credits, the 50% CGT discount, etc).

Further, and as noted by Macdonald¹², as a testamentary trust does not come in effect until the death of the testator, the terms of a testamentary trust may be varied at any time before the testator's death. Further, the property to be dealt with under the terms of the testamentary trust may change from time to time by the testator, until the testator's death.

The use and advantages of discretionary trusts in both tax planning and asset protection contexts have been well documented. In the usual form of discretionary trust, the trustee is given a 'discretion' to choose the share or amount of income which any one or more particular beneficiary (typically chosen from a specified class) of the trust is to receive. For example a trust deed may provide that '*... the trustee may distribute the trust income to the children of the Testator, and any members of the Testator's family according to the trustee's unfettered discretion*'.

It may be appropriate to vest a 'discretion' in the trustee when, for example, the needs of the beneficiaries may vary from time to time. From a tax planning prospective, such flexibility may enable the trustee to distribute the trust income in such a way (ie. to those beneficiaries and in those amounts) so as to minimise the overall tax liability on the total trust income or on the total income of the family group for an income year.

Furthermore, as the beneficiaries of a discretionary trust are 'mere objects', then they have no rights to the assets held subject to the trust. As a result, the creditors of a beneficiary cannot prima facie attack the assets held subject to a discretionary trust.

Discretionary trusts are favoured because of the advantages attaching to their use. These include:

- when the trust property is held by the trustee, the assets are protected from claims by creditors of the beneficiaries and the beneficiaries are protected from claims by creditors of the trust. By comparison, in the case of a 'fixed trust' the (for example) unit holders have an item of property which may be attacked by the unit holder's creditors – being the unit in the unit trust;
- trust income and capital can be distributed to beneficiaries in a tax effective way, the trustee having the discretion to accumulate trust income in the trust or to distribute it to beneficiaries; and
- the ability to transfer the use, enjoyment and benefit of (for example) the trust's assets free of transaction costs.

The tax disadvantages with the discretionary trust structure include that:

- losses are trapped within them (i.e. cannot be distributed);
- beneficiaries of a discretionary trust cannot claim a tax deduction for interest referable to borrowings which they might use to 'invest' in a discretionary trust.¹³ This is because, as a result of a trustee's discretion to allocate income – a beneficiary in a discretionary trust has no expectation of receiving distributions of income. Rather, a beneficiary only has a right to be considered. If the Testamentary Trust is to be geared, then it would be necessary to do this in the trust – i.e. the trustee borrows and not the beneficiaries.

¹² *ibid*

¹³ A vexed issue (and not in the scope of this paper) is whether further settlements can be made on a testamentary trust after it has come into effect.

An issue to consider in the testamentary trust concept is how both the advantage, and the assets held subject to a testamentary trust remain with, and pass to the testator's family group. This may be achieved by:

- Ensuring that only those who are in the testator's family may benefit under the terms of the testamentary trust. In particular, it should be ensured that the capital default beneficiaries are those in the testator's family;
- Ensuring that the control (e.g. a position of 'appointor') passes to the testator's family groups. As the position of appointor is personal, it may need to be ensured that the position passes under the will of those that will take the position is consistent with the testator's will; and
- Have an open beneficiary clause.

5.1 Stamp duty concession

An issue that often arises is that real property has been purchased, and held by an individual, but after any borrowings referable to the property have been discharged, the individual wants to retain the property for the benefit of the individual's whole family group.

Whilst transferring the property from the individual to a trust will be a 'dutiabale transfer', and subject to ad velorum duty, if the property is transferred to a testamentary trust upon the individual's death, then only nominal duty is paid upon that transfer. Section 63 of the *Duties Act 1997* (NSW) ('**the Duties Act**') provides that:

(1) Duty of \$50 is chargeable in respect of:

(a) a transfer of dutiable property by the legal personal representative of a deceased person to a beneficiary, being:

(i) a transfer made under and in conformity with the trusts contained in the will of the deceased person or arising on an intestacy, or

(ii) a transfer of property the subject of a trust for sale contained in the will of the deceased person, or

(iii) an appropriation of the property of the deceased person (as referred to in section 46 of the *Trustee Act 1925*) in or towards satisfaction of the beneficiary's entitlement under the trusts contained in the will of the deceased person or arising on intestacy, and

(b) a consent by a legal personal representative of a deceased person to a transmission application by a beneficiary, and

(c) a transmission application to a devisee who is also the sole legal personal representative.

(2) If a transfer of dutiable property is made by a legal personal representative of a deceased person to a beneficiary under an agreement (whether or not in writing) between the beneficiary and one or more other beneficiaries to vary the trusts contained in a will of the deceased person or arising on intestacy, the dutiable value of the dutiable property is to be reduced by the portion of the dutiable value that is referable to the dutiable property to which the beneficiary had an entitlement arising under the trusts contained in the will or arising on intestacy.

(3) Section 25 does not apply to a dutiable transaction to which subsection (2) applies.

That is, in order to obtain the nominal stamp duty concession, the transfer from the testator to the trust needs to be provided for in the will of the individual (registered proprietor).

6 Formalities for establishing a testamentary trust

As testamentary trusts are created under the terms of testamentary instrument(s), the formal requirements for establishing a trust under a will are the same as the requirements for the creation of a valid will, or codicil. As a result, the section 6 of the *Succession Act 2008* (NSW) ('**the Succession Act**'), which contains those requirements need to be satisfied. Section 6 of the Succession Act provides that:

(1) A will is not valid unless:

(a) it is in writing and signed by the testator or by some other person in the presence of and at the direction of the testator, and

(b) the signature is made or acknowledged by the testator in the presence of 2 or more witnesses present at the same time, and

(c) at least 2 of those witnesses attest and sign the will in the presence of the testator (but not necessarily in the presence of each other).

(2) The signature of the testator or of the other person signing in the presence and at the direction of the testator must be made with the intention of executing the will, but it is not essential that the signature be at the foot of the will.

(3) It is not essential for a will to have an attestation clause.

(4) If a testator purports to make an appointment by his or her will in the exercise of a power of appointment by will, the appointment is not valid unless the will is executed in accordance with this section.

(5) If a power is conferred on a person to make an appointment by a will that is to be executed in some particular way or with some particular solemnity, the person may exercise the power by a will that is executed in accordance with this section, but is not executed in the particular way or with the particular solemnity.

(6) This section does not apply to a will made by an order under section 18 (Court may authorise a will to be made, altered or revoked for a person without testamentary capacity).

That is, in order for a testamentary instrument (and therefore a testamentary trust under a testamentary instrument) to be valid:

- the testamentary instrument must be in writing;
- the testamentary instrument should be signed by the testator or by some other person in the presence of and at the direction of the testator;
- the testator's signature is made (or acknowledged) in front of at least two (2) witnesses; and
- at least two of the witnesses attest and sign the will in front of the testator.

Section 6 of the Succession Act, like section 23C of the *Conveyancing Act 1919* (NSW)¹⁴ is intended to prevent fraud.

As with other express trusts, in order to validly create a testamentary trust, there must be certainty with respect to:

- the intention to create the trust;
- the subject matter of the trust (i.e. the trust property); and

¹⁴ Section 23C of the *Conveyancing Act 1919* (NSW), which is modelled on the Statute of Frauds 1677 (Eng) has the objective of preventing hidden oral transactions in certain type of property, which defrauded those truly entitled to them (see *Vandervell v Inland Revenue Commissioners* [1967] 2 AC 291 at 311). This objective was accomplished by requiring the relevant transactions to be executed in writing or at least evidenced in writing.

- the object(s) (i.e. the beneficiaries) of the trust.

Whilst all three of the certainties are often subject to dispute, the two most disputed aspects of testamentary trusts (and indeed testamentary instruments) include the capacity of a testator to make a will, and whether the testator was under undue influence when creating the trust instrument. It should be noted that as long as a testator has testamentary capacity, the testator (subject to illegality) may have a 'capricious' will - Young J in *Gregory v Hudson* (1974) 41 NSWLR 573:

There is nothing to stop a person making the most capricious will. A person could make a will which said that he gave all his property to X to be held on trust, the terms of which were that X was to arrange for a 0055 telephone number and was to pay the whole of the testator's estate to the hundredth person who rang that number, or for the first born child at a certain hospital in 1998. There is nothing to stop the testator directing that his executor convert the whole of the money into bank notes and proceeding to the corner of George and King Streets at 8 o'clock on a designated night and throwing the money away.

Further, there may be situations where the testamentary instruments show intention by the testator to establish a testamentary trust, but the precise terms of the trust are not provided. If the testamentary instrument provides that a trust is to be established, then a person taking a gift must hold the gift upon the trusts provided for, or upon trust for whom the law provides. It was observed in *Morice v Bishop of Durham* (1805) 32 ER 974 at 953 that:

If he ... [the testator] ... says, he gives in trust, and stops there, meaning to make a codicil, or an addition to his Will, or, where he gives upon trusts, which fail, or are ineffectually expressed, in all those cases the Court has said, if upon the face of the Will there is declaration plain, that the person, to whom the property is given, is to take it in trust; and, though the trust is not declared, or is ineffectually declared, or becomes incapable of taking effect, the party shall be trustee; if not for those who were to take by the Will, for those, who take under the disposition of the law.

Similarly, in *Briggs v Penny* (1851) 42 ER 371 at 375, Lord Truro LC observed that:

It is not necessary to exclude the legatee from a beneficial interest that there should be a valid or effectual; trust; it is only necessary that it should clearly appear that a trust was intended ... Once establish that a trust was intended, and the legatee cannot take beneficially. If a testator gives upon trust, though he never adds a syllable to denote the objects of that trust, or though he declares a trust in such a way as not to exhaust the property, or though he declares it imperfectly, or though the trusts are illegal, still in all these cases, as is well known, the legatee is excluded, and the next-of-kin take.

For completeness, it should be noted that the rule against delegation of will-making power has been brought into line with the rule in equity regarding certainty of objects via section 44 of the Succession Act, which provides that:

A power or trust to dispose of property, created by will, is not void on the ground that it is a delegation of the testator's power to make a will, if the same person or trust would be valid if made by the testator by instrument during his or her lifetime.

7 Differentiating as between an 'executor' and a 'trustee'

Although both executors and trustees are in a fiduciary relation (in particular, the duty to due administration) with respect to a beneficiary, the duties of an executor differ from the duties of a trustee of a trust created under a will. An executor is appointed by a deceased to execute, manage, administer, direct and dispose of a deceased's will. An executor is required to get in the assets of the deceased, pay expense, and distribute the residuary estate in accordance with the will (or intestacy or order of the court) (see *Re Chirnside* [1956] VLR 295).

An executor only has a power to act in relation to a deceased's property after a grant of probate is obtained (*The Daily Pty Ltd v White* (1964) 63 WN (NSW) 262). That is, an executor's duties and powers

are based on the principle that an executor is required to wind-up the deceased's estate. In contrast, a trustee has an on-going role, dependent on the term and duration in the trust deed.

With respect to a residuary estate, a change in character from a personal representative (or executor) to a trustee occurs when an estate has been fully administered – that is, when all of the debts and liabilities have been discharged and the residuary is ascertained. Further, an executor (if property is retained after executorial duties are performed – see below) can become a trustee with respect to different assets of the estate at different times – acting in both the capacity of trustee and executor (see *Porteous v Rinehart* (1998) 19 WAR 495 at 503).

The duties of an executor is more circumscribed than those of other trustees. *Hansen v Young* [2004] 1 NZLR 37 is authority for the proposition that the primary responsibilities of executors are those that relate to:

- the collection of the testator's debts;
- the identification of assets of the deceased;
- the payment of funeral and testamentary expenses; and
- the discharge of legacies provided under the will.

Lindley LJ in *Re Chapman* [1895] All ER 1104 observed that the role of an executor is:

[S]imply to call to the testator's unsecured debts and to convert into money so much of his personal estate as was necessary to enable him to then pay his funeral and testamentary expenses and his debts and pecuniary legacies and to handover to trustees whatever personal estate was not wanted for those purposes.

Isaacs J in *Union Bank of Australia v Harrison, Jones & Devlin Ltd* (1910) 11 CLR 492 at 515-516 observed that:

'Death, while removing the individual, leaves the property, debts, and claims of the deceased still remaining. His nomination of an executor is a request to represent him for certain purposes including the payment of debts, and do what he can no longer do for himself. Wentworth ... says that the office of executors is 'to execute the mind, will, and intent of their testator' ... And for this reason that 'the main and principal part of an executor's office, and that which concerns the soul of a testator ... is the payment of his debts: now who knows not that the very making of an executor is the continuing of such a person who is to pay all debts'.

Isaacs J at 515 further observed that an executor is '*... the minister and dispenser and distributor of the testator's property ...*'.

In contrast, the essential duties of a trustee of a trust which is created under a will is to obtain control of the trust property. It was observed in *Hansen v Young* [2004] 1 NZLR 37 that the responsibility of trustees of trusts that are created under a will include:

- gather in funds due to the trust estate;
- preserve trust property, secure it from risk and loss; and
- conform to, and carry out the terms of the trust.

7.1 Similarities as between executors and trustees

There are some similarities as between executors and trustees. Specifically:

- both executors and trustees owe a fiduciary duty of due administration to the beneficiaries (see *Johnson v Trotter* [2006] NSWSC 67);

- in the event of misapplication of trust property, then the equitable entitlement to trace subsists (see *Foskett v McKeown* [2001] 1 AC 102);
- trustee legislation include 'legal personal representative' within the definition of 'trustee' (see for example section 5 of the *Trustee Act 1925* (NSW)). As a result, the courts have a statutory (and inherent) power to remove trustees and executors (see for example *Gibbs v Gibbs* [2004] WASC 132). However, it should be noted that except in Victoria, the respective trustee provisions do not allow a court to appoint a new executor (see for example subsection 6(12) of the *Trustee Act 1925* (NSW)).
- In most jurisdictions probate and administration legislation allows commissions to personal legal representatives and trustees of testamentary trusts (see section 86 of *Probate and Administration Act 1898* (NSW)). Although not specifically provided for in NSW, commissions may be provided to NSW trustees under the 'expediency' jurisdiction.

7.2 Distinctions as between executors and trustees

The powers and duties of executors and trustees differ (see *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 324-325). Specifically:

- An executor is obliged to wind-up a deceased's estate, whereas a trustee has an on-going role. As a result, executors have a broader power of sale than trustees (see for example section 153 of the *Conveyancing Act 1919* (NSW)). However, a trustee has a broader power to carry on a business than an executor has.
- Both the legal and equitable interests in the estate is held by the executor. In contrast, only the legal interest vests in a trustee.

However, an executor still has fiduciary duties. Whilst both legal and beneficial interests are held by executors, the full beneficial ownership is not held by the executor, and executors are still bound by fiduciary duties owed to beneficiaries of the estate (*Hosken v Danahar* [1911] VLR 214). Whilst beneficiaries of unadministered estates do not have an equitable interest in the estate, they have no right to caveat any property held subject to the estate (*Meynert v Leafdale Pty Ltd* [2005] WASC 102 at [32] – [39]). However, beneficiaries do have a right to secure proper administration of the estate (*Commissioner of Stamp Duties (QLD) v Livingstone* [1965] AC 694 and *Official Receiver in Bankruptcy v Schultz* (1990) 170 CLR 306).

Further, an executor who retains property after its executorial duties are performed will become a trustee with respect to the property (*McCaughey v Commissioner of Stamp Duties* (1946) 46 SR (NSW) 192). At that time, the equitable interest of the beneficiaries become vested, quantifiable and identifiable (*Probert v Commissioner of State Taxation* (1998) 72 SASR 48).

- In disposing trust property, trustees are required to act unanimously. However, individual executors can bind an estate, and can do so without concurrence of any other executors (see *Johnson v Trotter* [2006] NSWSC 67 at [21], *Attenborough v Solomon* [1913] AC 76 and *Exception Holdings Pty Ltd (in liq) v Albarran* (2005) 223 ALR 487 at [20] – [26]).
- During administration, executors cannot retire or appoint successor trustees. In contrast, appointment and removal of trustees is provided for in statute. However, an executor who holds an estate upon trust (i.e. after administration) may use the statutory powers (*Re Cockburn's Will Trusts* [1957] 1 Ch 438 and *Estate of Graham* [1910] VLR 466).

Further, in some jurisdictions, there are distinctions with respect to limitation of actions as between executors and trustees.

8 Importance of the terms of the testamentary trust

As well as establishing a testamentary trust, the testamentary instruments will also provide for the terms of the testamentary trust. As with trusts established inter vivos, the powers, duties, trusts and discretions that a trustee of a testamentary trust has is contained in the trust instrument – being the testamentary instruments. Indeed, Lord Westbury LC in *Wilkins v Hogg* (1861) 31 LJ Ch 41 at 43 observed that:

The testatrix was at liberty to say ‘Your duty shall require no more of you than this’. The Court could not extend the office, or invest it with greater obligation.

As a result, both the rights and obligations of trustees of testamentary trusts, as well as beneficiaries will be provided for (primarily) in the testamentary instruments.

As a result, the usual tensions arise with respect to whether the powers and trusts under the trust are wide, and the potential resulting tensions that arise as between trustees (who control the trust estate) and beneficiaries. This may be an issue (for example) if there is property held subject to a testamentary trust by a sole trustee, for the benefit of more than one (adult) beneficiary.

Further, the flexibility of the use of the trust fund (for example, power of investment, amalgamation of trust fund etc) may be drafted narrowly for the purposes of protecting the trust fund, but may become an issue when dealing with the trust fund some time after the establishment of the testamentary trust.

9 More than one testamentary trust?

A common issue that arises in the context of succession planning, particularly in the context of establishing testamentary trust(s) by a testator with a number of (adult) children, is whether one or more testamentary trusts should be established under a will.

For example, should one child be the trustee and appointor to hold the trust fund for the benefit of all of the children, should a testamentary trust be established for each of the testator(s) children, or a mixture of both?

This will depend on the individual circumstances of the family group, and will depend on circumstances outlined above.

10 The position of appointor

As with other trusts (e.g. inter vivos discretionary trusts), a method of ensuring control of a trust is maintained is by providing for an ‘appointor’, who may have rights with respect to (for example) the appointment and removal of trustees (i.e. overall control of a trust).

The considerations with respect to appointors of testamentary trusts are the same as those for inter vivos trusts.

It should be noted that the position of Appointor is a personal position, and is not an item of ‘property’. In *Re Burton; Wily v Burton* - BC9405738, Davies J in the context of bankruptcy law, observed that ‘... *the power which Mr Burton holds as Appointor is not ‘property’ which vests in his trustee in bankruptcy nor a power ‘as might have been exercised by the bankrupt for his own benefit’*. As a result, the position of Appointor, because it is not an item of property but rather is a personal appointment, it was held that the position does not pass to a trustee in bankruptcy.

Similarly, in the context of succession laws, the position of appointor passes to a deceased's personal legal representative, and does not enter into a deceased Appointor's estate. For example, section 40 of the *Probate and Administration Act 1898* (NSW) provides that the existence of 'property'¹⁵ within the jurisdiction (i.e. NSW) is essential to grant probate and letters of administration: '*The Court shall have jurisdiction to grant probate of the will or administration of the estate of any deceased person leaving property, whether real or personal, in New South Wales.*' The only exception to this rule is a grant of administration to permit an application to be made under the *Family Provision Act 1982* (see section 41A of the *Wills, Probate and Administration Act 1898* (NSW)).

As a result, a position of appointor created under a testamentary trust, unless otherwise provided for, will pass to the appointor's personal legal representative and not the appointor's estate. The position of appointor will not be dealt with by (and for example) the *Probate and Administration Act 1898* (NSW).

11 Secret Trusts

'Secret trusts' are a type of trust that may arise under a will. Secret trusts have been described as follows:

Secret trusts arise where a testator leaves property to X after communicating with X that X is to hold the property on trust. ... Since a will is open for public inspection on the testator's death, a secret trust allows a testator to provide for an object he or she wishes to be kept secret.¹⁶

However, it should be noted that 'secret trusts' may arise in wills under the terms of wills. In addition to the requirements required to establish an 'express trust',¹⁷ secret trusts require the following three elements (see *Blackwell v Blackwell* [1929] AC 318):

- the testator's intention that the property is to be used according to its specifications;
- communication of intention to the intended trustee(s); and
- acquiescence on behalf of the trustee(s).

It should be noted that secret trusts arise in a will, but do not operate because of a will. Secret trusts arise outside of a will, and the beneficiary obtains its interest because of the trust and not the will (*Ledgerwood v Perpetual Trustee Co Ltd* (1997) 41 NSWLR 532).

12 Varying the terms of a testamentary trust

An issue is whether the terms of a testamentary trust may be changed.

Whether a testamentary trust may be changed to appoint new beneficiaries has been a vexed point. The issue is whether such an amendment causes a resettlement to occur, or indeed if there is a

¹⁵ It should be noted that the term 'property' is not defined in the *Wills, Probate and Administration Act 1898* (NSW). Rather, the terms 'real estate' and 'personal property' are defined in section 3 of the *Wills, Probate and Administration Act 1898* (NSW) as follows:

Real estate extends to messuages, lands, rents, and hereditaments, of freehold or any other tenure, and whether corporeal, incorporeal or personal, and to any undivided share thereof, and to any estate, right, or interest (other than a chattel interest) therein, and in part 2 includes lands held under building leases or any lease for twenty-one years and upwards.

Personal estate, except in part 2 as hereinbefore mentioned, extends to leasehold estates and other chattels real, and also to moneys, shares of government and other funds, securities for money (not being real estates), debts, choses in action, rights, credits, goods, and all other property whatsoever, which, prior to the coming into operation of the *Real Estates of Intestates Distribution Act of 1862*, commonly known as "Dr. Lang's Act," by law devolved upon the executor or administrator, and to any share or interest therein.

¹⁶ G. E. Dal Pont and DRC Chalmers. *Equity and Trusts in Australia*. Law Book Co, Sydney, 2007 para18.45.

¹⁷ That is, the 'three certainties' – being the certainty of intention to create a trust; certainty with respect to trust property; and certainty of objects / beneficiaries.

delegation of trust power. It seems that the better view is that varying the terms of a testamentary trust to include a new 'class' of beneficiary will cause a resettlement to occur.

As with inter vivos trust estates, the first issue to determine when seeking to vary the terms of a testamentary trust is determining whether the trust instrument has a variation clause.

If the will does not contain a power of variation, then either the inherent jurisdiction of the court must be sought, or the terms of the *Trustee Act 1925* (NSW) must be relied upon.

In *Chapman v Chapman* [1954] AC 429, Lord Simmons explained four instances in which the court may exercise its inherent jurisdiction, which include:

- to change the nature of an infants' property holdings from personalty or realty, and vice-versa;
- to pay maintenance out of income where there is a direction to accumulate income;
- to effect a compromise on behalf of some infant beneficiaries; and
- to direct that, in the event of an emergency, a transaction unauthorized by the trust instrument should be carried out by way of salvage of the trust property.

Further, regard should be given to the court's statutory power to amend the terms of a trust. Relevantly, section 81 of the *Trustee Act 1925* (NSW) provides that:

(1) Where in the management or administration of any property vested in trustees, any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure, or transaction, is in the opinion of the Court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the instrument, if any, creating the trust, or by law, the Court:

(a) may by order confer upon the trustees, either generally or in any particular instance, the necessary power for the purpose, on such terms, and subject to such provisions and conditions, including adjustment of the respective rights of the beneficiaries, as the Court may think fit, and

(b) may direct in what manner any money authorised to be expended, and the costs of any transaction, are to be paid or borne as between capital and income.

(2) The provisions of subsection (1) shall be deemed to empower the Court, where it is satisfied that an alteration whether by extension or otherwise of the trusts or powers conferred on the trustees by the trust instrument, if any, creating the trust, or by law is expedient, to authorise the trustees to do or abstain from doing any act or thing which if done or omitted by them without the authorisation of the Court or the consent of the beneficiaries would be a breach of trust, and in particular the Court may authorise the trustees:

(a) to sell trust property, notwithstanding that the terms or consideration for the sale may not be within any statutory powers of the trustees, or within the terms of the instrument, if any, creating the trust, or may be forbidden by that instrument,

(b) to postpone the sale of trust property,

(c) to carry on any business forming part of the trust property during any period for which a sale may be postponed,

(d) to employ capital money subject to the trust in any business which the trustees are authorised by the instrument, if any, creating the trust or by law to carry on.

(3) The Court may from time to time rescind or vary any order made under this section, or may make any new or further order.

(4) The powers of the Court under this section shall be in addition to the powers of the Court under its general administrative jurisdiction and under this or any other Act.

(5) This section applies to trusts created either before or after the commencement of this Act.

It should be noted that the power to vary trusts is narrower in New South Wales than in Queensland, Victoria, South Australia, Tasmania and Western Australia. The other States have provisions which specifically empower the courts to vary trusts.

Further, the New South Wales provisions only allow a court to vary if to do so, would be advantageous to the beneficiaries of the trust as a whole (*Riddle v Riddle* (1952) 85 CLR 202 at 220).

13 Trustee' Duties

Testamentary trusts are typically established within a family group. It is usually a member of a testator's family that is a trustee of the testamentary trust, with the whole of the testator's family able to benefit (including the trustee) under the terms of the testamentary trust.

However, notwithstanding that testamentary trusts are established within a family group, the rights and obligations of the parties to a testamentary trust relationship are the same as those which apply to other forms of trusts.

As advisors, it is important that those involved in the trust estate understand their rights and obligations. In particular, when determining who in a family group will hold the position of trustee of a testamentary trust, regard should be given to the fiduciary nature of the position. For example, the principle of fiduciary duty provides that the fiduciary interest should not be placed in conflict with its own (personal) interest. That is, a fiduciary should not use its position as a fiduciary for the purpose of acquiring a personal advantage. A fiduciary is not permitted to retain any advantage acquired unless the person(s) to whom the duty is owed freely and with full knowledge consent to the acquisition and retention of the advantage (see for example *Bray v Ford* [1896] AC 44 at 51-2 and *Gluckstein v Barnes* [1900] AC 240 at 255). This tension is illustrated in the scenario where a trustee of a testamentary trust is also a beneficiary under the terms of that trust.

The High Court in *Maguire v Makaronis* (1997) 188 CLR 499 at 473 outlined a trustee's fiduciary duties and the remedies which may apply if there is a breach:

Whilst the trustee is the archetype of a fiduciary, the trust has distinct characteristics. In particular, where a trust is created by will or settlement in traditional form, the trustee holds title to property on behalf of beneficiaries or for charitable purposes. If the trust be still subsisting, the objective of an action to recover loss upon breach of trust is the restoration of the trust fund. The right of the beneficiaries is to have the trust fund reconstituted and duly administered, rather than to recover a specific sum for the sole use and benefit of any beneficiary. Indeed, no one particular beneficiary may have sustained a present and individual loss. This may be so if the trustee is a discretionary trust or no interest vests, either in interest or possession before the termination of a prior interest. Further, the particular breach of which complained is made may be consequent upon failure in observance of one or other of the duties which attend trust administration, such as those to make only authorised investments, and to use due diligence and care in the administration of the trust.

The court in *Reading v A-G* [1951] AC 507 observed the scenario in which a fiduciary relationship subsists:

... a fiduciary relationship exists (a) whenever the plaintiff entrusts to the defendant property ... and relies on the defendant to deal with such property for the benefit of the plaintiff or purposes authorized by him, and not otherwise, and (b) whenever the plaintiff entrusts to the defendant a job to be performed ... and relies on the defendant to procure for the plaintiff the best terms available ...

There are a wide range of duties which a trustee (including trustees of testamentary trusts) have. As a result, only a number are dealt with in this paper, including a trustees:

- Duty to carry out the terms of the trust;
- Duty of care in the management of trust affairs;
- Duty to administer trust affairs impartially;
- Duty to perform trusts honestly and in good faith for the benefit of the beneficiaries.

13.1 Duty to carry out terms of the trust

Trustees are subject to a duty to carry out, and act within the terms of a trust. This is on the basis that a trustee is expected to give effect to a settler / testator's intention as provided in a trust / testamentary instrument. However, it has been held that a trustee is not bound to fulfil the terms of a trust instrument if:

- All beneficiaries (of full legal capacity) direct the trustee to act outside the scope of a trust instrument (*Wharton v Masterman* [1895] AC 186);
- Fulfilling the terms is illegal;
- Statute or a court order provides that the trust instrument cannot be satisfied; or
- A court (either in its inherent jurisdiction or via statute) allows a deviation.

13.2 Duty of care in the management of the trust affairs

Equity has developed a standard of care which applies to trustees in the management of trust affairs on behalf of beneficiaries. It was observed by Gummow J in *Breen v Williams* (1996) 186 CLR 71 at 137 that the characteristic that gives rise to this duty of care:

... is the holding of the legal title to property with duties to deal with it for the benefit of charitable purposes or for one or more persons, at least one of whom is not the sole trustee...

In such a situation, it was held by Gummow J that:

... where an express trust has been effectively constituted and under its terms the trustee is obliged to manage a trust business, the trustee is required both to observe the terms of the trust, and in doing so, to exercise the same care as an ordinary, prudent person of business would conduct in the conduct of that business were it his or her own...

There is case law which stands for the proposition that a trustee's overarching principal is to protect the financial interests of the beneficiaries. This is because trusts are usually established to financially benefit the beneficiaries. As a result, the trustee's duty of care requires it to secure the best financial returns for the trust. In *Cowan v Scargill* [1985] 1 Ch 270, it was held that:

When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment ... the power must be exercised so as to yield the best return for the beneficiaries, and the prospects for the yield of income and capital appreciation both have to be considered in judging the return from the investment.

Therefore, when a testamentary trust (for example) deals with trust property with respect to a beneficiary (e.g. making a loan to a beneficiary), an issue to determine is whether the trustee is considering the best financial interests of the beneficiaries of the testamentary trust.

A trustee is not compelled to take every conceivable precaution against financial loss. Rather, the trustee is only required to exhibit due care with respect to the trust fund. In *re Speight* (1883) 22 Ch D 727 it was observed that:

It seems to me that upon general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt, or conduct the business in any other way. If it were, no one would be a trustee at all.

The standard was expressed as a higher level in *In re Whiteley* (1886) 33 Ch D 347 at 355 – being a prudent person dealing with property which, in equity, is owned by others:

The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty rather is to take such care as an ordinary prudent man would take if he were needed to make an investment for the benefit of other people for whom he felt morally bound to provide. This is the kind of business the ordinary prudent man is supposed to be engaged in; and unless this is borne in mind the standard of a trustee's duty will be fixed too low.

As mentioned above, it is usual in the context of a testamentary trust that the beneficiaries also control the testamentary trust (e.g. as trustee). As an example of the stringency of the trustee's duty of care, if a trustee – who is also one of a number of beneficiaries of a trust – overpays the other beneficiaries, then the trustee / beneficiary is not entitled to claim an adjustment. This is notwithstanding that an underpaid beneficiary is entitled to such an adjustment (see *In re Horne* [1905] 1 Ch 76).

13.3 Duty to act impartially

Whilst administering the affairs of a trust, trustees have a duty to administer the affairs of a trust impartially.¹⁸ The duty prohibits a trustee to (for example) favour one class of beneficiary as compared to another beneficiary (*Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285).

An example of a situation where the duty comes into play include where there are successive beneficial interests – for example in the life interest / remainderman context.

It should be noted that the duty to act impartially is not fettered in the event that a trustee exercises a discretionary power to benefit one beneficiary over another, provided that the discretion is not exercised irresponsibly, capriciously or wantonly (*Edge v Pensions Ombudsman* [1998] Ch 512). Indeed, it was observed in *Edge v Pensions Ombudsman* that the duty of impartiality is '*... inapposite where what is in point is a discretionary power to choose between different beneficiaries ...*'. However, it was observed in *Rowds v Bibb* [1900] 2 Ch 107 that '*... a general discretionary power conferred by the trust deed does not override the trustee's duty to be fair and impartial between all the beneficiaries ...*'.

Trustees who breach the duty of impartially are brought to account (see *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118 at 136). It was observed in *Cowan v Scargill* [1984] 2 All ER 750 at 760 that the duty of the trustee is:

... to exercise their powers in the best interests of the present and future beneficiaries holding the scales impartially between different classes of beneficiaries.

As an example, it was observed in *Re Pauling's Settlement Trusts; Younghusband v Coutts & Co* [1963] 3 All ER 1 at 8 that before a trustee exercises a power of advancement, a trustee must '*... weigh on one side the benefit of the proposed advance and on the other hand the rights of those who are or may hereafter become interested under the terms of the settlement*'.

¹⁸ It should be noted that the duty to act impartially is not a fiduciary duty, but rather only a trustee duty (see *Re Stewart* [2003] 1 NZLR 809 at 816).

13.4 Duty to perform trusts honestly and in good faith for the benefit of beneficiaries

Both trustees and executors have a duty to perform the trusts honestly, in good faith, and for the benefit of the beneficiaries (see *Reid v Hubbard* [2003] VSC 387). That is, trustees (and executors) need to act without regard to self-interest, and only consider the best interest of the beneficiaries.

The need to act without regard to self-interest may cause a conflict of interest in the event that a trustee is also a beneficiary.

An example of a trustee's duty to perform in the best interest of the beneficiaries was provided in *Partridge v Equity Trustees Executors and Agency Co Ltd* (1947) 75 CLR 149. It was held in *Partridge* that a power in a will to postpone the recovery of a debt was inserted for the benefit of the relevant trust estate, and not for the debtor. It was the duty of the trustee to collect the debt. Further, the trustees had the power to consider the financial position of the debtor and grant further time in which the debt could be paid only '... if it was satisfied that the ... [debtor] ... reasonably required such time to pay the debt and that it ... [i.e. further time] ... could be granted without detriment to the estate ...'.

14 Rights of aggrieved beneficiaries of a testamentary trust

Like beneficiaries of trusts created inter vivos, aggrieved beneficiaries may have standing to sue, and obtain appropriate remedies. This scenario may arise if:

- there has been a 'breach of trust', which has been defined in *Re Spedding (deceased)* [1966] NZLR 447 at 463-464 as '... nothing more nor less than an act by the trustee in contravention of the duties imposed on him by the trust or in excess of his powers ...'; or
- even if acting within its power, a trustee failed to exercise its powers reasonably, in good faith and for the purposes for which they were conferred (see *Walker v Stones* [2001] QB 902 at 916).

The first issue to determine is whether a beneficiary has standing to bring proceedings. A trustee of a trust may be sued with respect to breaches of trust by a beneficiary (including a representative of a beneficiary's estate), a co-trustee or a successor trustee (see *Occidental Life Insurance Co of Australia Ltd v Bank of Melbourne* (1991) 7 ANZ Ins Cases).

14.1 Compensation

If there is a breach of trust, then the trustee is liable to restore the trust estate in the position it would have been had the breach not occurred. As observed in *Vyse v Foster* (1872) LR 8 Ch App 309, the court compels:

... restitution of property unconscientiously withheld; it gives full compensation for any loss or damage through failure of some equitable duty; but it has no power of punishing any one ...

The relevant date for the purposes of determining the loss is usually the date of judgement (*Re Dawson (deceased)* [1966] 2 NSWLR 211). If the breach is an improper disposal of an asset, and the asset could have been disposed of properly at a later date, the loss may be assessed at the later date (*Re Bell's Indenture* [1980] 1 WLR 1217). If the trust is vested, then the date of assessment may be the date of final distribution of the trust property (*Elders Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426).

The courts may grant compensation to beneficiaries for gains that would have been made, had the trustee acted with reasonable due diligence. Although the courts have been reluctant to make trustees liable for loss of returns, the courts have done so when there is a blatant breach of trust, and there is a link as between the breach and a quantifiable loss.

Some examples where the courts have awarded compensation for gains that have not been made include where:

- a trustee effects an unauthorized sale, and the asset subsequently rises in value (*Re Bell's Indenture* [1980] 1 WLR 1217);
- a trustee exercises a power of sale, but does not obtain the best price (*Clay v Clay* (1999) 20 WAR 427);
- if a trustee fails to purchase an asset that it was required to purchase, and that asset goes up in value (*Elders Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426); and
- if a trustee retains an asset that should have been sold, and the asset subsequently falls in value (*Hicks v Trustees, Executors and Agency Co Ltd* (1901) 27 VLR 389).

14.2 Account of profits

A trustee must account to beneficiaries for profits made by the trustee from the trust fund, whether as a result of a breach of trust or in the ordinary course of management of a trust.

Compensation and accounts of profit are (typically) alternative remedies. For example, if there is a single breach of trust, then the beneficiary must choose as between an account of profits or compensation. However, if there have been discrete changes in the use of funds, or distinct breaches of trust, then both compensation and account of profits may be available for the distinct components or breaches (see *Heathcote v Hulme* (1891) 37 ER 322).

14.3 Interest

The reasoning behind an award of interest is to strip a trustee of profits, rather than compensating a beneficiary (see *Edmunds v Pickering (No 4)* (2000) 77 SASR 381).

As a result, interest usually attaches to compensation. However, a court may also order interest to attach to an account of profits (e.g. if profits payable under a contract are paid at a later date due to dispute) (see *Nixon v Furphy* (1926) 26 SR (NSW) 409).

15 Estate planning and superannuation

15.1 Overview - Tax on Super Death Benefits

The payment of superannuation benefits after the death of a member is governed by the SIS Act and the rules of the superannuation fund.

Subsection 55A(1) of the SIS Act provides that '*the governing rules of a regulated superannuation fund must not permit a fund member's benefits to be cashed after the member's death otherwise than in accordance with standards prescribed for the purposes of section 31.*'

The standards prescribed by section 31 of the SIS Act relating to the cashing of super benefits after a member's death are contained in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ('**the SIS Regulations**'). Super death benefit can be paid either as a lump sum, an income stream or combination of both pursuant to regulation 6.21 of the SIS Regulations. However if the death benefit is paid on or after 1 July 2007 to a person who is not a dependant of the deceased member for tax purposes, the death benefit must be paid as a lump sum under regulation 6.21(2A) of the SIS Regulations.

The taxation of superannuation death benefits depends on whether the person receiving the benefit is a death benefit dependant. A death benefit dependant is defined in section 302-195 of the 1997 Act to include:

- a spouse or former spouse;
- a child under the age of 18;
- any other person with whom the deceased member had an interdependency relationship just before the member's death;
- any other person who was a dependant just before the member's death.

Two persons have an interdependency relationship under section 302-200 of the 1997 Act if:

- they have a close personal relationship; and
- they live together; and
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.

A lump sum payment to a death benefit dependant is tax free regardless of the amount of the payment, whereas payment of benefits as an income stream to a beneficiary will be subject to different tax treatment depending on the age of the deceased member at the time of death and the age of the beneficiary (section 302-60, 1997 Act).

Payment as an income stream will be tax free if the deceased member was aged 60 or above, or if the income stream is paid to a beneficiary aged 60 or above (section 302-65, 1997 Act). However, if both the deceased member and the beneficiary are under the age of 60, then the tax-free component of the income stream will be tax free, while the taxable component will be taxed at the beneficiary's marginal tax rate, although the beneficiary will receive a 15% tax offset (sections 302-70 and 302-75, 1997 Act). Once the beneficiary reaches the age of 60, the income stream will be tax free.

In contrast, a non-death benefit dependent will receive the tax free component of their lump sum payment free of tax, while the taxable component will be taxed at 16.5% (including Medicare levy) for the taxed element and 31.5% (including Medicare levy) for untaxed element.

A binding death nomination can be used by a member to bind the trustee to pay superannuation benefits to a nominated death benefits dependant at the death benefits. However, the nominated person must be a death benefits dependant or the legal personal representative(s) or executor(s) of the deceased member, who will in turn distribute the superannuation benefits in accordance with the terms of the will. However, a binding death nomination will cease to have binding effects at the expiration of 3 years (regulation 6.17A of the SIS Regulations).

15.2 Estate planning and superannuation

A member's interest in a superannuation fund does not automatically form part of their estate. However, in the context of estate planning and superannuation, there are a number of considerations, including:

- when benefits must be paid;
- who can receive the benefits;
- in what form should those benefits be taken; and
- the taxation implications for the beneficiaries.

15.3 What is a 'death benefit'?

Regulation 6.21 of the SIS Regulations provides that a trustee of a regulated superannuation fund is required to cash a member's benefit as soon as practicable after a member's death. Except if there is an effective death benefit nomination, the superannuation fund's trustee has a discretion as to which dependants it should distribute a deceased's benefits.

The term 'superannuation death benefit' is defined in section 307-5 of the 1997 Act. Amongst other things, item 1 of column 3 in that section defines a 'superannuation death benefit as *'A payment to you from a superannuation fund, after another person's death, because the other person was a fund member.'*

Section 307-10 of the 1997 Act sets out the payments which are not considered 'superannuation death benefits'.

15.4 Payment of death benefits

A payment from a superannuation fund in consequence of the death of a member can be paid either:

1. directly to a beneficiary; or
2. to the executor of the deceased's estate or a trustee of a testamentary trust, with the amounts then paid to a beneficiary as a distribution from the estate or the trust.

Broadly speaking, upon death a member's superannuation interest is transferred from the member's fund, being a 'death benefit'. Subject to the terms of the particular trust deed of the superannuation fund, the transfer may be effected by either a lump sum payment, an income stream, or both.

Regulation 6.21(2) of the SIS Regulations provides that a lump sum must not be paid in more than two instalments.

Further, there are limitations with respect to the payment of income streams.

15.5 Timing of payment of death benefits

Regulation 6.21(1) of the SIS Regulations provides that *'... a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the member dies.'* That is, there is no

prescribed time in which a death benefit must be paid. All that is required is that the payment must be made as soon as practicable after death.

15.6 Lump sum payments

Section 302-60 of the 1997 Act provides that lump sum payments received by a dependant of the deceased is tax free. The amount is treated as non-assessable non-exempt income.

However, if a lump sum is paid to a non-dependant, then the tax free component will not be subject to tax (see section 302-140 of the 1997 Act), but the taxable component of the lump sum is included in the recipient's assessable income and subject to tax at marginal rates. Section 302-145 of the 1997 Act provides for a tax offset mechanism, that ensures that the rate of tax on the tax free component does not exceed 30% (plus Medicare levy), whereas the rate of tax on the tax free component does not exceed 15% (plus Medicare levy).

Superannuation lump sum death benefit	Dependent	Non-dependent	
		Taxed element	Untaxed element
Tax free component	Tax free	Tax free	Tax free
Taxable component	Tax free	15%	30%

The possible methods of transfer of a member's interest upon death depend on the character of the recipient, with the possibilities being:

Recipient	Permitted benefit
Spouse	Either or both a lump sum and/or income stream
Dependent children under the age of 18	Either or both a lump sum and/or income stream. However, income stream must cease at 25.
Non-dependent children over the age of 18	Lump sum
Dependent children between 18 and 25	Either or both a lump sum and/or income stream. However, income stream must cease at 25.
Dependent child over the age of 25	Lump sum
Dependent grandchildren	Either or both a lump sum and/or income stream
Non-dependent grandchildren	Lump sum (made via estate)
Non-dependent (i.e. not child or spouse)	Lump sum (made via the estate)
Estate	Lump sum

15.7 Income streams

Section 302-65 of the 1997 Act provides that a superannuation income stream is tax free if either the deceased or the dependant is aged at least 60 as at the time of death.

If a superannuation income stream is paid to a dependant upon death, and neither the deceased or the dependant are aged at least 60 at the time of death, then:

- that part of the income stream which is the **tax free component** is tax free;
- that part of the income stream which is paid from a **taxed component** is assessable income for the dependent. The dependent is entitled to a tax offset which is equal to 15% of the element taxed in the fund. The income stream becomes tax free when the recipient turns 60 years of age;
- that part of the income stream which is paid from an **untaxed component** is assessable income for the dependent. The dependent will receive a tax offset of only 10%, but only when they attain the age of 60.

A non-dependant is unable to receive a superannuation income stream. Such income streams must be commuted, and paid to the non-dependant as a lump sum.

15.8 Who is a dependent?

The term 'dependent' for taxation purposes is defined in section 302-195 of the 1997 Act. Subsection 302-195 of the 1997 Act provides that:

- (1) A **death benefits dependant**, of a person who has died, is:
- (a) the deceased person's spouse or former spouse; or
 - (b) the deceased person's child, aged less than 18; or
 - (c) any other person with whom the deceased person had an interdependency relationship under section 302-200 just before he or she died; or
 - (d) any other person who was a dependant of the deceased person just before he or she died.

That is, a 'death benefit dependant' with respect to a deceased includes:

- the deceased's spouse;
- the deceased's former spouse;
- the deceased's child, provided that at the time of death the child is under the age of 18;
- a person with whom the deceased had an 'interdependency relationship' just before the deceased died;

- any other person who was a 'dependant' of the deceased just before the death of the deceased; and
- under section 302-195 of the 1997 Act, a death benefits dependant also includes a person who receives a superannuation pension or annuity if the annuity or pension commenced before 1 July 2007 as a result of the death of another person.

15.9 Interdependency relationship

The term 'interdependency relationship' for the purposes of paragraph 302-195(1)(c) of the 1997 Act is provided for in section 302-200 of the 1997 Act:

'What is an interdependency relationship?'

- (1) *Two persons (whether or not related by family) have an **interdependency relationship** under this section if:

 - (a) *they have a close personal relationship; and*
 - (b) *they live together; and*
 - (c) *one or each of them provides the other with financial support; and*
 - (d) *one or each of them provides the other with domestic support and personal care.**
- (2) *In addition, 2 persons (whether or not related by family) also have an **interdependency relationship** under this section if:

 - (a) *they have a close personal relationship; and*
 - (b) *they do not satisfy one or more of the requirements of an interdependency relationship mentioned in paragraphs (1)(b), (c) and (d); and*
 - (c) *the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.**
- (3) *The regulations may specify:

 - (a) *matters that are, or are not, to be taken into account in determining under subsection (1) or (2) whether 2 persons have an **interdependency relationship** under this section; and*
 - (b) *circumstances in which 2 persons have, or do not have, an **interdependency relationship** under this section.'**

That is, two individuals have an interdependency relationship if they satisfy **all** of the following conditions (see section 302-200 of the 1997 Act):

- they have a close personal relationship;
- they live together;
- one or each of them provides the other with financial support; and

- one or each of them provides the other with domestic support and personal care.

15.10 Life insurance and superannuation funds

An important part of a financial plan is life insurance. Generally speaking, a life insurance payout can:

1. form part of the deceased's estate;
2. be directed to a specific beneficiary; or
3. be paid to the policy owner.

The purpose of life insurance is to provide a lump sum benefit upon death of the life insurer. Life insurance which is 'term insurance' is guaranteed to be renewable (i.e. the policy cannot be changed) whilst the premiums continue to be paid. Such a policy can be held within a superannuation fund, with the result that upon death of the individual insured, the proceeds are paid to the fund. This has the result of increasing the death benefit payable.

Upon death, the proceeds of life insurance policies held by the superannuation fund are paid directly to the fund (as the policy owner). The proceeds are allocated to the member's fund as a taxable component.

The death benefit is paid tax free as a lump sum to a death benefit dependent. However, such a payment made to a non-financial dependant will be taxable (with no low rate threshold for the taxable component).

The taxable component paid from insurance proceeds may be either a taxed component or an untaxed component. A higher rate of tax is payable on an untaxed component received by a non-death benefit dependent. If:

- the superannuation fund **has not** claimed a tax deduction for the premiums paid for the insurance policy, then the **taxable component** is a **taxed component**; and
- the superannuation fund **has** claimed a tax deduction for the premiums paid for the insurance policy, then the **taxable component** is an **untaxed component**.

Further, in the year that a death benefit is made, the trustee can choose to claim a deduction for the future service period of that member instead of claiming a tax deduction for the premium paid on the insurance policy. This strategy will only be beneficial if the fund is in accumulation (i.e. tax paying) phase, and not income phase.

15.11 Binding nominations in the context of self-managed superannuation fund

Section 59 of the SIS Act provides that:

- (1) Subject to subsection (1A), the governing rules of a superannuation entity other than a self managed superannuation fund must not permit a discretion under those rules that is exercisable by a person other than a trustee of the entity to be exercised unless:*
- (a) those rules require the consent of the trustee, or the trustees, of the entity to the exercise of that discretion; or*

- (b) *if the entity is an employer-sponsored fund:*
 - (i) *the exercise of the discretion relates to the contributions that an employer-sponsor will, after the discretion is exercised, be required or permitted to pay to the fund; or*
 - (ii) *the exercise of the discretion relates solely to a decision to terminate the fund; or*
 - (iii) *the circumstances in which the discretion was exercised are covered by regulations made for the purposes of this subparagraph.*
- (1A) *Despite subsection (1), the governing rules of a superannuation entity may, subject to a trustee of the entity complying with any conditions contained in the regulations, permit a member of the entity, by notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person or persons mentioned in the notice, being the legal personal representative or a dependant or dependants of the member.*
- (2) *If the governing rules of a superannuation entity are inconsistent with subsection (1), that subsection prevails, and the governing rules are, to the extent of the inconsistency, invalid.'*

Further, section 31 of the SIS Act provides that regulations may be made so as to provide operating standards for superannuation fund. Relevantly, Regulation 6.17A of the *Superannuation Industry (Supervision) Regulations 1993* (Cth) provides that:

**‘6.17A Payment of benefit on or after death of member
(Act, s 59 (1A))**

- (1) *For subsections 31(1) and 32(1) of the Act, the standard set out in subregulation (4) is applicable to the operation of regulated superannuation funds and approved deposit funds.*
- (2) *For subsection 59(1A) of the Act, the governing rules of a fund may permit a member of the fund to require the trustee to provide any benefits in respect of the member, on or after the death of the member, to the legal personal representative or a dependant of the member if the trustee gives to the member information under subregulation (3).*
- (3) *The trustee must give to the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to provide the benefits.*
- (4) *Subject to subregulation (4A), and regulations 6.17B, 7A.17 and 7A.18, if the governing rules of a fund permit a member of the fund to require the trustee to provide any benefits in accordance with subregulation (2), the trustee must pay a benefit in respect of the member, on or after the death of the member, to the person or persons mentioned in a notice given to the trustee by the member if:*
 - (a) *the person, or each of the persons, mentioned in the notice is the legal personal representative or a dependant of the member; and*
 - (b) *the proportion of the benefit that will be paid to that person, or to each of those persons, is certain or readily ascertainable from the notice; and*
 - (c) *the notice is in accordance with subregulation (6); and*

- (d) *the notice is in effect.*
- (4A) *The trustee is not required to comply with subregulation (4) if the trustee:*
 - (a) *is subject to a court order that has the effect of restraining or prohibiting the trustee from paying a benefit in respect of the member in accordance with a notice of the kind described in that subregulation; or*
 - (b) *is aware that the member of the fund is subject to a court order that:*
 - (i) *requires the member to amend or revoke a notice of that kind that the member has given the trustee; or*
 - (ii) *has the effect of restraining or prohibiting the member from giving a notice of that kind.*
- (5) *A member who gives notice under subregulation (4) may:*
 - (a) *confirm the notice by giving to the trustee a written notice, signed, and dated, by the member, to that effect; or*
 - (b) *amend, or revoke, the notice by giving to the trustee notice, in accordance with subregulation (6), of the amendment or revocation.*
- (6) *For paragraphs (4) (c) and (5) (b), the notice:*
 - (a) *must be in writing; and*
 - (b) *must be signed, and dated, by the member in the presence of 2 witnesses, being persons:*
 - (i) *each of whom has turned 18; and*
 - (ii) *neither of whom is a person mentioned in the notice; and*
 - (c) *must contain a declaration signed, and dated, by the witnesses stating that the notice was signed by the member in their presence.*
- (7) *Unless sooner revoked by the member, a notice under subregulation (4) ceases to have effect:*
 - (a) *at the end of the period of 3 years after the day it was first signed, or last confirmed or amended, by the member; or*
 - (b) *if the governing rules of the fund fix a shorter period — at the end of that period.'*

However, in Self Managed Superannuation Funds SMSFD 2008/3, entitled *Self Managed Superannuation Funds: is there any restriction in the Superannuation Industry (Supervision) legislation on a self managed superannuation fund trustee accepting from a member a binding nomination of the recipients of any benefits payable in the event of the member's death?*, the Commissioner of Taxation observed that:

'Section 59 of the Superannuation Industry (Supervision) Act 1993 (SISA) and regulation 6.17A of the Superannuation Industry (Supervision) Regulations 1994 (SISR) do not apply to self managed superannuation funds (SMSFs). This means that the governing rules of an SMSF may permit members

to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A of the SISR.

2. However, a death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards in the SISR. The relevant operating standards are mentioned in Appendix 1 of this Determination.'

As a result, before a death benefit nomination is made, regard should be given to the particular constituent documents for the fund so as to determine what (if any) death benefit nominations can be made. In the event that the constituent documents are silent on the matter, then no nomination can be made.

Further, if the constituent documents provide that binding death benefit nominations may be made under the SIS Act, and because the relevant binding death benefit rules in the SIS Act do not apply to self-managed superannuation funds, such a provision will not allow a member to make such nominations.

It should be noted that the jurisdiction of the Superannuation Complaints Tribunal does not extend to decisions made by trustees of self-managed superannuation funds or certain public sector superannuation schemes. As a result, self-managed superannuation funds are a valuable mechanism to ensure that a death benefit is paid as directed by the deceased member.

Further, because death benefits are not dealt with under a will, legal challenges can be greatly reduced by directing payments from a self-managed superannuation fund upon death directly to a person specified by the deceased, as opposed to having such payments directed to the estate of the deceased.

However, it should also be noted that if the decision as to who will receive the death benefit is made by the remaining trustee(s) of the self-managed superannuation fund, the death benefit may be paid in a way which is contrary to the deceased member's wishes. Consideration should be given to the decision in *Katz v Grossman* [2005] NSWSC 934, which according to the first sentence of the judgement was: '*...a contest between a brother and a sister over the control of a superannuation trust fund established at the behest of their late father Ervin Katz. The assets of the fund exceed \$1 million.*'

Katz v Grossman is authority for the proposition that in the event that binding directions are not provided to the trustee of a self-managed superannuation fund, then the trustee of a fund has complete discretion with respect to dealings with superannuation benefits. Such discretion includes the trustee providing the benefits to themselves, notwithstanding that they are not dependants of the deceased.

Ervin Katz was a member of the E. Katz Employees Trust Fund, which was a self-managed superannuation fund. Both Mr Katz and his daughter, Linda Ann Grossman were trustees of the self-managed superannuation fund. Mr Katz had made a non-binding nomination, in which he expressed the desire for his death benefit to be divided equally amongst his daughter (the co-trustee) and his son.

However, following the death of Mr Katz, Mrs Grossman appointed her husband as a co-trustee. The trustees then resolved to pay the whole of Mr Katz's death benefit to Mrs Grossman.

Mr Katz's son took action in the New South Wales Supreme Court arguing that:

- Mr Katz had not validly appointed Mrs Grossman as a trustee; and that
- Mrs Grossman was not validly appointed as a member.

With respect to the first issue, after reviewing the terms of the superannuation fund's deed, the relevant documentation and consideration of the *Trustee Act 1925 (NSW)*, Smart AJ held that Ms Grossman had been validly appointed. As a result, Mrs Grossman's decisions were held to be valid, which included the payment of the death benefit referable to Mr Katz's interest in the fund to herself.

With respect to the issue of whether Mrs Grossman was validly appointed as a member of the fund, Smart AJ considered that because the fund's deed required an appointment as a member to be effective the trustee had to consent to it, as there was no documentary evidence which showed that the trustee had consented to Mrs Grossman becoming a member, it was held that Mrs Grossman was not a member of the fund.

As a result, in order to ensure that the wishes of a member with respect to the payment of their interest in a self-managed superannuation fund occurs, either a binding death benefit nomination should be executed, or there should be a trust deed direction which provides for such wishes.

15.12 Superannuation proceeds trusts

Division 6AA of the 1936 Act discourages 'income splitting' by means of diversion of income to children to take advantage of the tax-free threshold and progressive tax rates. Broadly speaking, the provisions apply a 45% tax rate on unearned income of minors. Such income includes certain distributions from trusts.

However, Division 6AA of the 1936 Act does not apply to certain 'excepted trust income'. Such trust income includes that from a 'superannuation proceeds trust'. That is, superannuation proceeds trusts may be established by the transfer of property from a superannuation fund, as a result of the death of a person, to a trustee of a trust which will hold the property for the benefit of a child.

Paragraph 102AG(2)(c)(v) of the 1936 Act provides that:

'(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:

...

(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:

...

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

The terms of the trust must provide for the beneficial acquisition of trust property by the beneficiary upon the termination of the trust.

Although death benefits do not generally form part of an estate, generally speaking, superannuation proceeds trusts are established under the terms of a will. Such a transfer may be ensured via a binding death benefit nomination.

The Commissioner in ATO ID 2001/751 accepts even where a superannuation death benefit is paid to a trustee, apart from the estate (e.g. so as to satisfy the superannuation cashing rules, to an adult child of

the deceased), in order to assess whether the superannuation death benefit tax concessions apply, one should look through the trust to the underlying beneficial ownership of the trust.

This would be the situation if the beneficiaries of such a trust were minor children of the deceased.

15.13 Corporate reconstruction exemption

The Duties Act imposes duty on a transfer of dutiable property, which includes a business asset in New South Wales that is goodwill, intellectual property or a statutory licence or permission. However, the Duties Act provides an exemption for certain transactions between the members of a group of corporations.

Specifically, section 281 of the Duties Act provides that duty is not chargeable on a corporate reconstruction transaction approved by the Chief Commissioner in accordance with guidelines approved by the Treasurer. A 'corporate reconstruction transaction' includes, amongst other things, a transfer or agreement for the sale or transfer, of dutiable property between corporations that are members of the same group.

In Revenue Ruling DUT 26, the Chief Commissioner sets out the applicable guidelines for granting exemptions to corporate reconstruction transactions effected on or after 1 January 2004. In order for the guidelines to apply, there must be eligible transactions as specified in the guidelines. Relevantly, a transfer of dutiable property between members of a corporate group is an eligible transaction to which the guidelines apply. A corporate group is defined in the guidelines to mean a parent corporation and its subsidiary where the parent corporation directly owns (other than as trustee) at least 90% of issued shares and voting power. Further, the transaction must not be an ineligible transaction, that is:

- the property the subject of the transaction must not be trust property immediately before or immediately after the transaction;
- the relevant members of the corporate group in the transaction must be members of that group for at least 12 months before the transaction, unless the dutiable property was acquired by the transferor after it became a member of the corporate group;
- the transaction must not be made under an arrangement under which:
 - part or all of the consideration for the transaction has been or will be provided or received, directly or indirectly, by a person other than a member of the corporate group; or
 - a member of the corporate group is to be enabled to provide any of the consideration by another person, other than:
 - by a financial institution by way of loan on ordinary commercial terms, or
 - by another member of the corporate group, or
 - under an offer and sale or issue of shares or units to the public in the circumstances mentioned in paragraph (11)(b) in the guidelines (which relates to the offer, sale or issue of shares for the purposes of listing a company on the Australian Stock Exchange).

The exemption is available to a transaction to which the guidelines apply so that duty is not chargeable on the transaction if the Chief Commissioner is satisfied that:

- the transaction is, or is one of a series of transactions, undertaken for the purpose of changing a corporate structure to make internal adjustments to corporate arrangements, or changing the holding of assets within the corporate group, or both, and
- the transaction or each transaction is necessary to give effect to that purpose, and is not undertaken for a purpose of avoiding any Commonwealth, State or Territory taxation, and
- the transaction is not part of an arrangement under which any corporation involved with any of the transactions ceases to belong to the same corporate group other than in certain limited circumstances outlined below.

A written application for the exemption is to be made to the Chief Commissioner and must contain a written undertaking to notify the Chief Commissioner if any parties to the relevant transaction cease to remain a member of the corporate group except in the circumstances outlined below. The application may be made at any time prior to the relevant transaction or within 5 years of the date of assessment of the transaction.

Approval by the Chief Commissioner of the corporate reconstruction exemption is conditional on every party to the transaction remaining a member of the corporate group for 12 months after the transaction, subject to the following exceptions:

- a corporation ceases to be a member of the corporate group because it ceases to exist, other than under an arrangement, a significant purpose of which was to avoid the condition imposed on the exemption; or
- the transaction is part of an arrangement under which shares or units of the corporation, or shares or units of a parent corporation, are offered and sold or issued to the public for the purpose of listing the corporation on the Australian Stock Exchange, and the shares or units are quoted within 12 months after the offer to the public.

Failure to satisfy the condition for the exemption would cause the Chief Commissioner to reassess the stamp duty on the transaction.

15.14 Superannuation and Stamp Duties

Consideration should also be given to the stamp duty exemption in relation to superannuation funds under the Duties Act in relation to business real property.

15.14.1 Transfer as a result of change in superannuation membership

Section 61 of the Duties Act provides for an exemption in respect of transfers of property in connection with persons changing superannuation fund. On application of the exemption, the duty chargeable on a relevant transfer is ad valorem duty or \$500, whichever is the lesser (see subsection 61(2)).

Relevantly, subsection 61(1) of the Duties Act provides:

(1) This section applies to a relevant transfer that occurs in connection with a person:

- (a) *ceasing to be a member of, or otherwise ceasing to be entitled to benefits in respect of, a superannuation fund that is a complying superannuation fund or was a complying superannuation fund within the period of 12 months before the transfer was made, and*
- (b) *becoming a member of, or otherwise becoming entitled to benefits in respect of, another superannuation fund that is also a complying superannuation fund or will, in the opinion of the trustees of both funds concerned, be a complying superannuation fund within 12 months after the transfer is made.'*

A 'relevant transfer' is set out in subsection 62(1A) to be:

- '(a) a transfer of, or an agreement to transfer, dutiable property from a trustee of a superannuation fund, or a custodian of the trustee, to the trustee of another superannuation fund, or to a custodian of the trustee of another superannuation fund,*
- (b) a transfer of, or an agreement to transfer, dutiable property from a trustee of a superannuation fund to a custodian of the trustee, or from a custodian of the trustee of a superannuation fund to the trustee,*
- (c) a transfer of, or an agreement to transfer, marketable securities from a trustee of a pooled superannuation trust, made in exchange for a redemption of units in the trust, to the trustee of a superannuation fund, or a custodian of the trustee of a superannuation fund,*
- (c1) a transfer of, or an agreement to transfer, marketable securities from the trustee of a superannuation fund, or a custodian of the trustee of a superannuation fund, made in exchange for the issue of units in a pooled superannuation trust, to a trustee of the pooled superannuation trust,*
- (d) a transfer of, or an agreement to transfer, marketable securities from a life company or custodian for a life company to the trustee of a superannuation fund or a custodian of the trustee of a superannuation fund if the transfer is made in consideration of the surrender or termination, by the trustee of the superannuation fund of which the person has ceased to be a member, of a policy of life insurance issued by the life company.'*

It is noted that the exemption in section 61 is available to complying superannuation funds whilst the exemption in section 62A is only available to self managed superannuation funds.

15.14.2 Transfer to a self managed superannuation fund

Section 62A of the Duties Act provides for nominal duty to be paid on a transfer to the trustee or the custodian of the trustee of a self-managed superannuation fund ('SMSF'):

'62A Transfers to self managed superannuation funds

- (1) Duty of \$50 is chargeable on a transfer of, or an agreement to transfer, dutiable property from a person (the transferor) to the trustee of a self managed superannuation fund but only if:*
 - (a) the transferor is the only member of the superannuation fund or the property is to be held by the trustee solely for the benefit of the transferor, and*
 - (b) the property is to be used solely for the purpose of providing a retirement benefit to the transferor.*

- (2) *Property held by the trustee of a superannuation fund is held solely for the benefit of the transferor if:*
- (a) *the property is held specifically for the benefit of the transferor, as a member of the superannuation fund, and*
 - (b) *the property (or proceeds of sale of the property) cannot be pooled with property held for another member of the superannuation fund, and*
 - (c) *no other member of the superannuation fund can obtain an interest in the property (or the proceeds of sale of the property).*
- (3) *Duty of \$500 is chargeable on a transfer of, or an agreement to transfer, dutiable property from a person (the **transferor**) to the custodian of the trustee of a self managed superannuation fund but only if:*
- (a) *the transferor is the only member of the superannuation fund, or*
 - (b) *the property is to be used solely for the purpose of providing a retirement benefit to the transferor.*
- (4) *This section does not apply in respect of a transfer of, or an agreement to transfer, dutiable property if, as a result of the transfer, the superannuation fund will cease to be a complying superannuation fund.'*

In particular, subsection 62A(3) was inserted by the *State Revenue Legislation Further Amendment Act 2010 (NSW)* which had effect from 1 January 2011.

The insertion of subsection 62A(3) means that a person may transfer NSW dutiable property to the custodian of a SMSF if the transferor is the only member of the fund, or the property is to be used solely for the purpose of providing a retirement benefit to the transferor (see also subsection 62A(2)).

The property could then be held on a gearing arrangement pursuant to section 67A of the SIS Act. Section 67A of the SIS Act requires that the legal title of the property is to be held on trust so that the trustee of the SMSF acquires a beneficial interest in the property. As a result, and pursuant to both section 67A of the SIS Act and the security trust, the registered proprietor of the property (and therefore the 'transferee' disclosed on the transfer) will be the bare trustee / custodian.

The security trust deed will be subject to nominal (\$50) duty pursuant to subsection 55(1) of the Duties Act, which provides that:

'Duty of \$50 is chargeable in respect of:

- (a) *a declaration of trust made by an apparent purchaser in respect of identified dutiable property:*
 - (i) *vested in the apparent purchaser upon trust for the real purchaser who provided the money for the purchase of the dutiable property, or*
 - (ii) *to be vested in the apparent purchaser upon trust for the real purchaser, if the Chief Commissioner is satisfied that the money for the purchase of the dutiable property has or will be provided by the real purchaser ...'*

Paragraph 55(1A) of the Duties Act further provides that:

'For the purposes of subsection (1), money provided by a person other than the real purchaser is taken to have been provided by the real purchaser if the Chief Commissioner is satisfied that the money was provided as a loan and has or will be repaid by the real purchaser.'

That is, under the gearing arrangement, the mere registered proprietor / bare trustee / custodian (i.e., the 'apparent purchaser' pursuant to section 55 of the Duties Act) of the property will hold the property for the 'real purchaser', being the SMSF trustee.

15.14.3 Transfer of property to trustees or custodians of superannuation funds

Section 62 of the Duties Act provides an exemption for a transfer or an agreement to transfer dutiable property between trustees and custodians of superannuation funds or pooled superannuation trusts where there is no change in the beneficial ownership of the property.

On application of the exemption, the duty chargeable on a dutiable transaction is ad valorem duty or \$500, whichever is the lesser (see subsection 62(3)), or if the transfer relates to marketable securities, the duty of \$10.

16 Advantages of discretionary will trusts

16.1 Potential for CGT savings for beneficiaries

Under the acquisition rules contained in section 109-55 of the 1997 Act, when a CGT asset passes to a beneficiary in the estate of the deceased, the beneficiary is taken to have acquired the asset when the individual died. However, the special rules in section 115-30 on the time of acquisition means that a post-CGT asset of the deceased acquired by the beneficiary or the legal personal representative of the deceased is taken to have acquired the asset when the deceased acquired the asset. A pre-CGT asset acquired by the beneficiary or legal personal representative of the deceased is still taken to be acquired at the time of the deceased's death under section 115-30 of the 1997 Act.

Division 128 of the 1997 contains provisions which disregard any capital gain or loss that resulted from death.

The capital gain from this CGT event happening is not disregarded under Division 128 of the ITAA 1997 as this interest in the dwelling did not pass to the beneficiary under the deceased's will in the ways set out in section 128-20 of the ITAA 1997

In PS LA 2003/12, the Commissioner stated at paragraph 2 that:

'...the Commissioner will not depart from the Tax Office's long-standing administrative practice of treating the trustee of a testamentary trust in the same way that a legal personal representative is treated for the purposes of Division 128 of the ITAA 1997, in particular subsection 128-15(3).'

Further, it was stated in paragraph 8 that:

'There is a widespread understanding in the tax community of the Tax Office's practice not to recognise any taxing point in respect of assets owned by a deceased person until they cease to be owned by the beneficiaries named in the will (unless there is an earlier disposal by the legal personal representative or testamentary trustee to a third party or CGT event K3 applies). To adopt a different approach now would result in a general unsettling of the community and an increase in compliance costs.'

This means that any capital gain or loss that arises when an asset of the deceased person passes to the trustee of a testamentary trust created under their Will is disregarded (as with the treatment of legal

personal representative in Division 128). Further, by using a testamentary trust, capital gains can be distributed amongst potential discretionary beneficiaries, and the beneficiaries estate are also able to access the 50% CGT discount on distributed capital gains.

16.2 Potential to preserve CGT main residence CGT exemption

The use of a testamentary trust may preserve the main residence CGT exemption under Subdivision 118-B of the 1997 Act. For a pre-CGT property, the main residence CGT exemption is available under section 118-195 of the 1997 Act if:

- the beneficiary dispose of the dwelling within two years of the deceased's date of death; or
- from the deceased's death to the date of disposal, the dwelling was the main residence of one or more of:
 - the spouse of the deceased;
 - a person who had the right to occupy the dwelling under the deceased's will; or
 - if the CGT event was brought about by the individual to whom the ownership interest passed as a beneficiary – that individual;

For the CGT exemption in section 118-195 of the 1997 Act to apply, a post-CGT dwelling must be the deceased's main residence just before the deceased's death and was not then being used for the purpose of producing assessable income, and must be:

- disposed by the beneficiary within two years of the deceased's date of death; or
- from the deceased's death to the date of disposal, the dwelling was the main residence of one or more of:
 - the spouse of the deceased;
 - a person who had the right to occupy the dwelling under the deceased's will; or
 - if the CGT event was brought about by the individual to whom the ownership interest passed as a beneficiary – that individual;

The ATO has confirmed in ATO ID 2003/109 that the terms of the deceased's will must provide for a right for a person to occupy the dwelling in order to satisfy the requirements in 118-195.

A partial exemption is provided under section 118-200 of the 1997 Act, which provides for a partial exemption for the portion of time that the dwelling was the main residence of the deceased before his death, or the deceased's spouse or a person with the right to occupy the dwelling under the deceased's will after the death, to the total number of days that the dwelling has been held.

There are special rules in section 118-205 of the 1997 Act dealing with when a dwelling is acquired from a deceased individual who himself/herself inherited the dwelling from a deceased estate.

16.3 potential to preserve land tax principal place of residence exemption

Section 10(1)(r) of the *Land Tax Management Act 1956* (NSW) ('**LTM Act**') provides that land is exempt from tax under the LTM Act if it is land that is exempt under the principal place of residence exemption ('**the PPR Exemption**') provided for by Schedule 1A.

Clause 2 in Schedule 1A provide that a parcel of residential land used and occupied as the principal place of residence of the owner of the land and for no other purpose (except as allowed in clauses 2(4) and 2(5)).

Clause 9 in Schedule 1A of the LTM Act provides that upon the death of an owner of residential land used and occupied as a principal place of residence, the PPR Exemption will continue to apply until the earlier of:

- the period of 12 months starting from the date of death; or
- When the land is transferred to any person other than the deceased's personal representative, or a beneficiary of the deceased's estate.

Further, clause 10 in Schedule 1A provides:

For the purposes of the principal place of residence exemption, if the owner of land dies and the land is used and occupied as the principal place of residence of:

- (a) a person using and occupying the land under a right of occupancy created by the will of that owner, or
- (b) a person (other than a tenant) who resided with that owner immediately before his or her death and who continues to use and occupy the land with the permission of the deceased person's personal representative, or of any other person, granted under a power or right conferred by the will of that owner or with the permission of any other person to whom the land is transferred following that death,

then the person who so uses and occupies the land is taken to be the owner of the land, but only while that use and occupation continues.

As a result of the provisions in clause 10, the PPR Exemption would be available to a person who has a right of occupancy under the terms of the testamentary trust.

16.4 beneficiary's inheritance can be protected from bankruptcy

When a testamentary trust is established under a will, the assets of the deceased estate pass directly into the testamentary trust without becoming the asset of the beneficiary under the trust. Further, a beneficiary under a discretionary testamentary trust does not have any entitlement to the trust assets; they only have the right to be considered by the trustee for a trust distribution.

This means that the creditors of beneficiaries who are at risk of bankruptcy would not be able to access the assets held in the testamentary trust. Moreover, as the assets never formed part of the beneficiary's estate, there can be no clawback against the beneficiary and the property vested in the testamentary trust.

The will under which the testamentary trust is established could also exclude a bankrupt person from becoming or remaining as a trustee or appointor of the trust, thus further protecting the trust assets.

17 Effect of a family provision order CGT and stamp duty

17.1 Capital gains tax implications of a family provision order

Paragraph 128-20(1)(a) of the 1997 Act provides that '*A CGT asset passes to a beneficiary in your estate if the beneficiary becomes the owner of the asset ... under your will, or that will as varied by a court order...'*

Because section 72 of the Succession Act (and see also section 14 of the Family Provision Act with respect to deaths that occurred before 1 March 2009) provides that a family provision order has the effect of varying the will of the deceased, paragraph 128-10(1)(a) of the 1997 Act has the effect of

having assets which pass pursuant to a family provision order to be a transfer pursuant to the deceased's will.

17.2 Stamp duty implications of a family provision order

Deaths that occur before 1 March 2009, the *Family Provision Act 1982* (NSW) ('**the Family Provision Act**') applies. Chapter 3 of the *Succession Act 2006* (NSW) ('**the Succession Act**') applies with respect to deaths after 1 March 2009 (see clause 11(2) of Schedule 1 of the Succession Act).

Effect of a family provision order

Section 14 of the Family Provision Act, and section 72 of the Succession Act provides that the effect of a family provision order is that the order is a codicil to the deceased's will. As a result, if a family provision order is made with respect to a deceased's estate (i.e. with respect to assets beneficially owned by the deceased as at the time of death and which pass to the LPR – see *Easterbrook v Young* (1977) 136 CLR 308 – and not out of the deceased's 'notional estate') is made, then as the order is deemed to be a codicil to the deceased's will, section 63 of the Duties Act will prima facie apply to subject any transfer of NSW dutiable property no nominal duty.

Effect of a notional estate order

However, if an order is made from the 'notional estate' of a deceased person pursuant to section 15 of the Family Provision Act, or section 66 (and 69) of the Succession Act, specific exemptions in the respective Acts apply.

With respect to an order pursuant to section 15 of the Family Provision Act, section 34 of the Family Provision Act provides that an '... instrument executed pursuant to an order made under section 15, being an instrument relating to property in the notional estate of a deceased person, is not liable to duty under the Duties Act 1997'.

Similarly, subsection 66(3) of the Succession Act provides that with respect to 'notional estate' orders made pursuant to the Succession Act provides that:

The execution of an instrument relating to property in the notional estate of a deceased person pursuant to an order under this section is not liable to duty under the Duties Act 1997.

Regard should also be given to the Chief Commissioner's comments in Revenue Ruling No SD 032, entitled *Family Provision Act 1982 – Duty Concessions*,¹⁹ which dealt with the interaction between the Family provision Act and the (repealed) *Stamp Duties Act 1920* (NSW). In that ruling, the Chief Commissioner observed that:

¹⁹ Paragraph 17 of Revenue Ruling No. DUT 1 entitled *Commencement of the Duties Act 1997* acknowledges that the former SD rulings (i.e. those that relate to the (repealed) *Stamp Duties Act 1920* (NSW)) '... may continue to be of guidance in interpreting the provisions of the Duties Act'.

The approach from an assessment point of view does not, however, need any detail to be supplied due to the terms of Section 34. That Section specifically states that an instrument executed pursuant to an order under Section 15, insofar as the instrument relates to property in the "notional estate" of a deceased person, is not liable to stamp duty under the Stamp Duties Act, 1920.

17.3 Deeds of arrangement to vary the terms of a will

Section 128-20 of the 1997 Act:

*(1) A CGT asset **passes** to a beneficiary in your estate if the beneficiary becomes the owner of the asset:*

(a) under your will, or that will as varied by a court order; or

(b) by operation of an intestacy law, or such a law as varied by a court order; or

(c) because it is appropriated to the beneficiary by your legal personal representative in satisfaction of a pecuniary legacy or some other interest or share in your estate; or

(d) under a deed of arrangement if:

(i) the beneficiary entered into the deed to settle a claim to participate in the distribution of your estate; and

(ii) any consideration given by the beneficiary for the asset consisted only of the variation or waiver of a claim to one or more other CGT assets that formed part of your estate.

(It does not matter whether the asset is transmitted directly to the beneficiary or is transferred to the beneficiary by your legal personal representative.)

*(2) A CGT asset does not **pass** to a beneficiary in your estate if the beneficiary becomes the owner of the asset because your legal personal representative transfers it under a power of sale.*

The Commissioner in Taxation Ruling TR 2006/14, entitled *Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests* observed with respect to paragraph 128-20(1)(d) of the 1997 Act that:

34. Assets may pass to them as a beneficiary in the estate under paragraph 128-20(1)(d). If this occurs, there will be no consequences for the life and remainder interests as the intended owners of those interests are treated as if they had not been bequeathed them.

35. A deed of arrangement will be effective for the purposes of paragraph 128-20(1)(d) provided that it is entered into:

- to settle a claim to participate in the estate; and*

- *any consideration given by the beneficiary consisted only of the variation or waiver of a claim to an asset or assets that formed part of the estate.*

36. For the purposes of paragraph 128-20(1)(d) a deed of arrangement must be entered into prior to the administration of the estate being completed unless the beneficiary can demonstrate that a court would, at the time the deed was entered into, have entertained their application for family provision, or an extension of time in which to make such an application. (Paragraphs 209 to 223 of this Ruling further explain this requirement. Importantly, determining whether a Court would entertain applications such as these depends on the succession laws in each State.)

37. A taxpayer is not required to commence legal proceedings in order to establish, for the purposes of paragraph 128-20(1)(d), that they have a claim to participate in the distribution of the assets of the estate. A claim may be established by a potential beneficiary communicating to the trustee their dissatisfaction with the will.