taxation and commercial

Estate Planning – the practicalities of effective structuring

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These materials represent the law as it stood on 2 June 2009.

1 Estate planning vehicles

1.1 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 1997* (Cth) ('**the 1997 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 1997 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 1997 Act).

1.2 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.

1.3 Testamentary trusts

A 'testamentary trust' is an 'express trust'[1], created under the terms of a will, or a codicil[2] 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.

1.4 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 *Income Tax Assessment Act 1936* (Cth) ('**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

[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 succeed 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 provides 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.

of tax to be applicable, the trust must be 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.

1.5 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 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.

1.6 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.

1.7 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 302-65 of the 1997 Act). Further, the income earned on the assets funding such a pension is exempt in the hands of the trustee.

2 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].

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

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.

2.1 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.

2.2 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.
>
> (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.

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

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 subsection63(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 disponee. 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 *Wenthworth 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 domicil, 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 *Kavalle 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 Fearne 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.'

3 What is a testamentary trust?

A 'testamentary trust' is an 'express trust'[6], created under the terms of a will, or a codicil[7] 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 beneficiary[8] 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]

- ***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;

[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 succeed 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 provides 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*.

- ***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.

4 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).

Macdonald[11] 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
- 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).

[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.

Further, and as noted by Macdonald[12], 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.

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:

[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.

- 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.

4.1 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 'dutiable 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).

5 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 from 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
- 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:

[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.

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.

6 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.

6.1 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.

6.2 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 owned 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.

7 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.

8 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.

9 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).

10 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).

11 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 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.

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[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.

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).

12 Trustee' Duties

Testamentary trusts are typically established within a family group. It is usually a member of a testators 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.

12.1 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.

12.2 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).

12.3 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).

12.4 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 trustees 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 …*'.

13 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 beneficiaries 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).

13.1 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).

13.2 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).

13.3 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).

14 Other taxation implications

14.1 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 Advantages of discretionary will trusts

15.1 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

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.

15.2 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.

15.3 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.

15.4 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.