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Succession Planning - Superannuation and Trusts

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Succession planning and trusts

A paper presented by Michael Bennett and Denis Barlin at the NSW Young Lawyers CLE

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All references in this paper are to:

- the *Income Tax Assessment Act 1936* (Cth) (**'the 1936 Act'**);
- the *Income Tax Assessment Act 1997* (Cth) (**'the 1997 Act'**);
- the *Bankruptcy Act 1966* (Cth) ('**the Bankruptcy Act**');
- the *Corporations Act 2001* (Cth) ('**the Corporations Act**');
- the *Succession Act 2006* (NSW) ('**the Succession Act**');
- the *Superannuation Industry (Supervision) Act 1993* (Cth) (**'the SIS Act'**);
- the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**'the SIS Regulations'**); and
- the *A New Tax System (Goods and Services Tax) Act* 1999 (Cth) ('**the GST Act**').

About the Presenters

Michael and Denis are barristers at Seven Wentworth Chambers and Thirteen WentworthSelborne Chambers respectively.

They both have a broad practice that includes but is not limited to the legal and tax matters.

This paper has been prepared for the purposes of general training and information only. It should not be taken to be specific advice purposes or be used in decision-making. All readers are advised to undertake their own research or to seek professional advice to keep abreast of any reforms and developments in the law. Michael Bennett and Denis Barlin exclude all liability relating to relying on the information and ideas contained within.

These materials represent the law as it stood on 1 June 2011.

PT 1 – SUCCESSION: SUPERANNUATION

1 Introduction

Superannuation, being the concessionally taxed vehicle through which investments can be made, is an opportunity to all of our clients. But the benefits are not limited to the commonly understood concessional tax treatment. There are, for instance, asset protection advantages for investing in superannuation.

It is these benefits, combined with the Government's policy of retirement savings arising from forced contributions, that has made superannuation most peoples second most significant asset outside their house. For some their superannuation is by far the most valuable asset.

This makes a person's superannuation important for succession planning. Though it is a common mistake to assume that a person's superannuation forms part of their estate. It does not.

This paper will discuss a number of discreet issues or areas that impact on the use of superannuation as a wealth accumulation vehicle and how it ties in with succession planning.

2 Overview – the Old System vs the "Simplified System"

First, it pays to highlight how a recent change to the superannuation environment has made superannuation more beneficial to its members though, at the same time, harder to build up a superannuation balance.

The taxation of superannuation was significantly reformed with a package of 11 Bills that were introduced into Parliament in December 2006 and February 2007. They generally took effect from 1 July 2007. There are commonly referred to as the "simpler super" or "simplified super" reforms.

With the introduction of the simpler super reforms the focus of the regulations changed from "back end" to "front end" restrictions. This makes sense from a policy perspective – the concessional environment of superannuation previously permitted the accumulation of great wealth, beyond that needed to stay off the Government pension, to be concessionally taxed.

Previously, the whole emphasis was one that let members go along whatever pace suited them throughout their contribution period (including contributing millions of dollars at a single time) – the member's excessive accumulation of wealth was penalised through increased tax rates upon and after retirement. The new "simplified" system does not seek to penalise excessive wealth upon and after retirement; rather it restricts the contributions that can be made to superannuation.

From 1 July 2007, contributions for which a deduction is allowed are referred to as a 'concessional contributions'. Concessional contributions, whether made by the member or an employer, are included in the assessable income of the superannuation fund. Undeducted contributions are referred to as 'non-concessional contributions'.

Generally speaking, concessional contributions are either employer contributions or deductible personal superannuation contributions that are included in the assessable income in the recipient's superannuation fund.

Self-employed or substantially self-employed persons may be entitled to a deduction for contributions into a complying superannuation fund or an RSA. Generally speaking, being substantially self-employed means that the individual earns less than 10% of their income in a year from employment-related activities. If the individual satisfies the deduction conditions, then there is no limit on the amount of deductible contributions that may be made. However, excess contributions tax may be imposed if the contributions that exceed the contributions cap for the year.

That is, despite the full deductibility of 'concessional contributions' to the contributor, there are limits on the amount of concessional contributions that can benefit from concessional treatment when paid to the fund (i.e. subject to 15% tax when contributed into the fund and potentially 0% when paid from the fund as a superannuation benefit). Concessional contributions which exceed the cap are subject to excess concessional contributions tax of 31.5%.

Similarly, excess contributions tax at 46% is imposed on non-concessional (i.e. undeducted) contributions where those contributions exceed the relevant cap amount for the year. It should be noted that non-concessional contributions are subject to no tax when contributed into a superannuation fund, and may be subject to no tax when paid out as a superannuation benefit. It is also important to get these contributions correct as excess contribution can potentially be subject to an effective tax rate of 93% if done incorrectly.

Contribution caps for the financial year 2009/2010:

Type of contribution	Age requirement	Cap amounts	Tax on contributions over the caps
Concessional	Less than 50 years old	$25,000	31.5% (plus 15% which is already paid by the fund) AND Amounts over the concessional cap count towards the non-concessional contribution cap
	50 years old or more	$50,000	As above
Non-concessional	65 years old or more (to contribute you must satisfy certain criteria)	$150,000	46.5%
	Less than 65 years old	$450,000 over a	46.5%

	3-year period	

From 1 July 2007 new limits on how much can be contributed to superannuation apply.

Contribution type	Age requirement	Annual dollar limit 2009 - 2010
Concessional	Less than 50 years old	$25,000 (indexed)
	50 years old or more (ends 30 June 2012 then see above)	$50,000 (non-indexed)
Non-concessional	Less than 65 years old	$150,000 (indexed) or $450,000 (non-indexed) over a 3-year period
	65 years old or more	$150,000 (indexed)

The change in the concessional contribution cap amount (i.e. from $50,000 to $25,000), coupled with the tax effectiveness and asset protection advantages of superannuation, have caused gearing in superannuation to become a popular method of increasing superannuation balances. This attractiveness has been further heightened given the volatility with respect to equities and the preference of many towards real estate investments.

With the 50% reduction in the concessional contributions from 1 July 2009 an appropriate strategy to contribute to super and maximise the balance is more important than ever.

There can be seen from this change that there is one group who have done very well from the simplified super reform. Anyone who had contributed excessive amounts to superannuation before the change, which took effect on 1 July 2007, is ahead of the curve because they have wealth in a concessional environment that is no longer assessed at increased (if any) rates of tax upon and after retirement.

3 What interest does a beneficiary of a superannuation fund have in the assets held by the superannuation fund?

Given the increase in the value held in superannuation funds in this country it is becoming more important, though it was never unimportant, to know exactly what interest a member of a superannuation fund has.

Justice Gzell referred to (amongst others) the decision of *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53 in *CSR v The Chief Commissioner of State Revenue* [2006] NSWSC 1380 in finding that no members of a superannuation fund '*... had any beneficial ownership of any of the underlying investments ...*' held within the superannuation fund. Gzell J observed that:

> *The trust deed was amended on a number of occasions in the period from 30 June 2002 to 30 June 2004. Key provisions, however, remained constant. The assets of the Fund were held by the trustee upon trust to be applied in accordance with provisions of the*

> *deed pursuant to cl 4.2. Clause 6.3 provided that no person should have any claim, right, or interest to or in respect of the fund, or any contributions thereto, or any interest therein, or any claim upon or against the trustee or an employer, except under and in accordance with the provisions of the deed. Members had to elect between a pension and a lump sum. The pension was calculated as a percentage of the final three years' average salary, the percentage increasing with the number of years of service. Likewise, the lump sum was calculated as a multiple of the final three years' average salary, the multiple increasing with the number of years of service. Upon termination of the Fund, cl 13, and later cl 13A, provided that any surplus should be applied by the trustee in any manner reasonably consistent with any of the objects of the Fund. Clause 7.4 provided that if the trustee should determinate at any time, on the advice of the actuary, that the value of the assets of the Fund exceeded 120% of the amount required to meet actuarial liabilities, the trustee might agree with CSR to apply all or part of the excess to CSR, to augment benefits payable to members, or as they might otherwise agree.*
>
> *Clause 13 and cl 13A of the deed vary the usual situation in which an ultimate surplus in a superannuation fund is prima facie held on a resulting trust for those who contributed to it (*Air Jamaica Ltd v Charlton *[1999] UKPC 20; [1999] 1 WLR 1399 at 1411*, Wrightson Ltd v Fletcher Challenge Nominees Ltd *[2002] 2 NZLR 1 at [23]).*
>
> *None of the members of the Fund had any beneficial ownership of any of the underlying investments including, in particular, the top-up contributions (*CPT Custodian Pty Ltd v Commissioner of State Revenue *[2005] HCA 53; (2005) 79 ALJR 1724 at [25],* Halloran v Minister Administering National Parks and Wildlife Act 1974 *[2006] HCA 3; (2006) 80 ALJR 519 at [75]).*
>
> *Until the happening of a prescribed event that crystallizes a member's right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of any amount that stands to the credit of the member's account from time to time (*Re Coram; Ex parte Official Trustee in Bankruptcy v Inglis *(1992) 36 FCR 250 at 253,* Wrightson *at [28]).*

Similarly, Heerey J in *Re John Sloane Kirkland; Ex Parte: Official Trustee in Bankruptcy* [1997] FCA 684 held that the rule in 'Saunders v Vautier' does not apply in the context of a superannuation fund. The Court observed that:

> *The Official Trustee in Bankruptcy, as trustee of the bankrupt estate of John Sloane Kirkland (the bankrupt), seeks payment of a benefit to which the bankrupt is entitled under the TNT Group Retirement Fund (the Fund). In essence the Official Trustee contends that the amount in question, although payable at a future date, has unconditionally vested in the bankrupt and that he can call for immediate payment under the Rule in* Saunders v Vautier *(1841) Cr & Ph 240, 49 ER 282.*

Justice Heerey found that:

> *I conclude that at the date of the bankrupt's resignation, the date of sequestration, and the present time, the bankrupt was and is not entitled to payment of the Preserved Withdrawal Benefit. The rule in Saunders v Vautier does not apply. Because superannuation funds in Australia enjoy substantial tax benefits there is a complex*

> *statutory regime which restricts the access members may have to benefits. Speaking very generally, the object of superannuation is to make provision for death, disablement or retirement at normal retiring age, or earlier if there are exceptional circumstances. It would conflict with that objective if members of funds could treat their entitlements as though they were funds on deposit, available at call.*
>
> *The bankrupt could not on resignation or at the date of sequestration, and cannot at the present time, obtain payment of those benefits. The applicant can be in no better position than the bankrupt.*

That is, a member of a superannuation fund does not have an interest in the assets held subject to a superannuation fund. Rather, the member's interest is the interest in the superannuation fund.

4 Estate planning and superannuation

As stated above a member's interest in a superannuation fund does not automatically form part of their estate. This fact is often misunderstood in practice. However, in the context of estate planning and superannuation, there are a number of considerations, including:

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

4.1 What is a 'death benefit'?

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

The term 'superannuation death benefit' is defined in section 307-5 of the 1997 Act. Amongst other things, item 1 of column 3 in that section defines a 'superannuation death benefit as '*A payment to you from a superannuation fund, after another person's death, because the other person was a fund member.*' Section 307-10 of the 1997 Act sets out the payments which are not considered 'superannuation death benefits'.

4.2 Payment of death benefits

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

1. directly to a beneficiary; or

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

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

Subregulation 6.21(2) of the SIS Regulations provides that a lump sum must not be paid in more than two instalments. Further, there are limitations with respect to the payment of income streams.

4.3 Timing of payment of death benefits

Subregulation 6.21(1) of the SIS Regulations provides that '*… a member's benefits in a regulated superannuation fund must be cashed as soon as practicable after the member dies.*' That is, there is no prescribed time in which a death benefit must be paid. All that is required is that the payment must be made as soon as practicable after death.

4.4 Lump sum payments

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

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

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

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

Recipient	Permitted benefit
Spouse	Either or both a lump sum and/or income

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

4.5 Income streams

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

If a superannuation income stream is paid to a dependent upon death, and neither the deceased nor the dependant is aged at least 60 at the time of death, then:

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

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

4.6 Who is a dependent?

The term 'dependent' for taxation purposes is defined in section 302-195 of the 1997 Act. Subsection 302-195(1) of the 1997 Act provides that:

'(1) A ***death benefits dependant****, of a person who has died, is:*

(a) the deceased person's spouse or former spouse; or

(b) the deceased person's child, aged less than 18; or

(c) any other person with whom the deceased person had an interdependency relationship under section 302-200 just before he or she died; or

(d) any other person who was a dependant of the deceased person just before he or she died. '

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

- the deceased's spouse;
- the deceased's former spouse;
- the deceased's child, provided that at the time of death the child is under the age of 18;
- a person with whom the deceased had an 'interdependency relationship' just before the deceased died;
- any other person who was a 'dependant' of the deceased just before the death of the deceased; and
- under section 302-195 of the 1997 Act, a death benefits dependant also includes a person who receives a superannuation pension or annuity if the annuity or pension commenced before 1 July 2007 as a result of the death of another person.

4.7 Interdependency relationship

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

'What is an interdependency relationship?

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

(a) they have a close personal relationship; and

(b) they live together; and

(c) one or each of them provides the other with financial support; and

(d) one or each of them provides the other with domestic support and personal care.

(2) In addition, 2 persons (whether or not related by family) also have an **interdependency relationship** under this section if:

(a) they have a close personal relationship; and

(b) they do not satisfy one or more of the requirements of an interdependency relationship mentioned in paragraphs (1)(b), (c) and (d); and

(c) the reason they do not satisfy those requirements is that either or both of them suffer from a physical, intellectual or psychiatric disability.

(3) The regulations may specify:

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

(b) circumstances in which 2 persons have, or do not have, an **interdependency relationship** under this section.'

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

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

4.8 Life insurance and superannuation funds

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

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

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

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

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

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

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

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

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

Section 59 of the SIS Act provides that:

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

(a) those rules require the consent of the trustee, or the trustees, of the entity to the exercise of that discretion; or

(b) if the entity is an employer-sponsored fund:

(i) the exercise of the discretion relates to the contributions that an employer-sponsor will, after the discretion is exercised, be required or permitted to pay to the fund; or

(ii) the exercise of the discretion relates solely to a decision to terminate the fund; or

(iii) the circumstances in which the discretion was exercised are covered by regulations made for the purposes of this subparagraph.

(1A) Despite subsection (1), the governing rules of a superannuation entity may, subject to a trustee of the entity complying with any conditions contained in the regulations, permit a member of the entity, by notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person or persons mentioned in the notice, being the legal personal representative or a dependant or dependants of the member.

(2) If the governing rules of a superannuation entity are inconsistent with subsection (1), that subsection prevails, and the governing rules are, to the extent of the inconsistency, invalid.’

Further, section 31 of the SIS Act provides that regulations may be made so as to provide operating standards for superannuation fund. Relevantly, regulation 6.17A of the SIS Regulations provides that:

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

(1) For subsections 31(1) and 32(1) of the Act, the standard set out in subregulation (4) is applicable to the operation of regulated superannuation funds and approved deposit funds.

(2) For subsection 59(1A) of the Act, the governing rules of a fund may permit a member of the fund to require the trustee to provide any benefits in respect of the member, on or after the death of the member, to the legal personal representative or a dependant of the member if the trustee gives to the member information under subregulation (3).

(3) The trustee must give to the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to provide the benefits.

(4) Subject to subregulation (4A), and regulations 6.17B, 7A.17 and 7A.18, if the governing rules of a fund permit a member of the fund to require the trustee to provide any benefits in accordance with subregulation (2), the trustee must pay a benefit in respect of the member, on or after the death of the member, to the person or persons mentioned in a notice given to the trustee by the member if:

(a) the person, or each of the persons, mentioned in the notice is the legal personal representative or a dependant of the member; and

(b) the proportion of the benefit that will be paid to that person, or to each of those persons, is certain or readily ascertainable from the notice; and

(c) the notice is in accordance with subregulation (6); and

(d) the notice is in effect.

(4A) The trustee is not required to comply with subregulation (4) if the trustee:

(a) is subject to a court order that has the effect of restraining or prohibiting the trustee from paying a benefit in respect of the member in accordance with a notice of the kind described in that subregulation; or

(b) is aware that the member of the fund is subject to a court order that:

(i) requires the member to amend or revoke a notice of that kind that the member has given the trustee; or

(ii) has the effect of restraining or prohibiting the member from giving a notice of that kind.

(5) A member who gives notice under subregulation (4) may:

(a) confirm the notice by giving to the trustee a written notice, signed, and dated, by the member, to that effect; or

(b) amend, or revoke, the notice by giving to the trustee notice, in accordance with subregulation (6), of the amendment or revocation.

(6) For paragraphs (4) (c) and (5) (b), the notice:

(a) must be in writing; and

(b) must be signed, and dated, by the member in the presence of 2 witnesses, being persons:

(i) each of whom has turned 18; and

(ii) neither of whom is a person mentioned in the notice; and

(c) must contain a declaration signed, and dated, by the witnesses stating that the notice was signed by the member in their presence.

(7) Unless sooner revoked by the member, a notice under subregulation (4) ceases to have effect:

(a) at the end of the period of 3 years after the day it was first signed, or last confirmed or amended, by the member; or

(b) if the governing rules of the fund fix a shorter period — at the end of that period.'

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

> 'Section 59 of the Superannuation Industry (Supervision) Act 1993 (SISA) and regulation 6.17A of the Superannuation Industry (Supervision) Regulations 1994 (SISR) do not apply to self managed superannuation funds (SMSFs). This means that the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A of the SISR.
>
> 2. However, a death benefit nomination is not binding on the trustee to the extent that it nominates a person who cannot receive a benefit in accordance with the operating standards in the SISR. The relevant operating standards are mentioned in Appendix 1 of this Determination.'

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

The recent unreported decision of *Donovan v Donovan* [2009] QSC 26 from the Supreme Court of Queensland highlights the importance of the form a superannuation trust deed and the implications of whether a death benefit nomination is binding on the trustee of a super fund.

In this case, Mr Donovan established a superannuation fund with a corporate trustee, of which Mr Donovan was a member at all material times. Mr and Mrs Donovan (his wife by a second marriage) were also the respective director and secretary of this corporate trustee. The revised trust deed of Mr Donovan's super fund required a corporate trustee to be bound by a binding death benefit nomination, where such binding death benefit nomination satisfies the "Statutory Requirements".

Mr Donovan signed a letter addressed to the corporate trustee, advising that, upon his death, he wished to have his superannuation entitlements distributed to his legal personal representative for inclusion in his estate assets. On Mr Donovan's death, his daughter by his first marriage, Lynda (who was the beneficiary under his will), brought an application to seek the court's determination that Mr Donovan's nomination was binding on the corporate trustee, which Mrs Donovan had control of.

The Court found that the intent of the particular trust deed was to require Mr Donovan's letter to be in the form described in subregulation 6.17A(6) of the SIS Regulations, and so further held that Mr Donovan's letter was not binding on the trustee. As Mr Donovan's letter was a non-binding death benefit nomination, the corporate trustee was not obliged to distribute his superannuation entitlements to his legal personal representative for inclusion in his estate assets.

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

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

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

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

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

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

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

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

- Mr Katz had not validly appointed Mrs Grossman as a trustee; and

- Mrs Grossman was not validly appointed as a member.

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

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

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

4.10 Superannuation proceeds trusts

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

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

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

> '(2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:
>
> …
>
> (c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary:
>
> …
>
> (v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;'

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

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

The Commissioner in ATO ID 2001/751 accepts that even where a superannuation death benefit is paid to a trustee, apart from the estate (e.g. so as to satisfy the superannuation cashing rules, to an adult child of the deceased), in order to assess whether the superannuation death benefit tax concessions apply, one should look through the trust to the underlying beneficial ownership of the trust.

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

5 What Restrictions are there on a Trustee's discretionary powers?

In the author's experience entirely too little attention is given to the equitable obligations a trustee of a superannuation has when exercising a discretion provided by the superannuation fund documents. This is an area that requires attention and will, it is predicted, become more and more relevant as challenges to superannuation trustees decisions are made; these challenges are inevitable given the increasing degree to which intergenerational wealth is now held in super.

In the most general terms, a trustee is someone who has title to property, subject to obligations to deal with it faithfully or the benefit of a person or purpose other than the trustee. But to aim for more specifics, and say what a trustee must do, and what a particular trustee is free to do if he, she or it so chooses, you need to look to the facts about the particular superannuation fund concerned and the particular circumstances of the case that the trustee is determining. It has even been held that the identity of the trustee can be relevant to the construction of the trust instrument and how a trustee's discretion is to be exercised.[1]

Despite this requirement to always go back to the trust documents, a paper of this nature can only deal with more generalities. The discussion that follows is therefore of cases and issues that have arisen and would, in practice, need to be localised to the circumstances of a particular superannuation fund.

5.1 What is "discretion"?

The concept of "discretion" involves making a choice from a number of available alternatives, amongst which the decision-maker is free to choose. Some decisions of superannuation trustees are clearly discretionary in this sense – such as if the trustee has power to pay a death benefit to such one or more of the dependants of a deceased members as the trustee chooses, or such as a decision about whether to invest in one authorised investment instead of another.

There are other discretions that trustees of superannuation funds are sometimes called on to make that a are not discretionary in the sense described in the previous paragraph. They are

[1] In *Dundee General Hospital Board of Management v Walker* [1952] 1 All ER 896 the House of Lords took into account, in construing a gift dependent upon the trustees forming a certain opinion, that the trustees were people well known to the settler and were well placed to have personal knowledge about the subject matter – this must also be the case where the members of the fund are also the trustees or directors of the corporate trustee.

decisions where entitlement to a benefit depend upon the trustee forming an opinion concerning a matter of fact. Analogy can be drawn here to situations where the power of a decision-maker to make a decision is dependent upon the decision-makers opinion about the existence of a jurisdictional fact (a reference to administrative law principles).

An obvious discretion the exercise of which is likely to be later scrutinised by the persons affected is the discretion trustees have to choose which of the dependants of the member will receive the benefit, and the definition of "dependant" is along the lines of "any child of the member and any other person who, *in the opinion of the trustees*, was at the relevant date wholly or partially depend upon him".[2] The formation of the trustee's opinion about whether a particular person was wholly or partially dependent upon the member at the relevant date is a precursor to the discretionary decision about which of hte dependants will get the benefit.

5.2 Can the trustee's decision be reviewed?

The often quoted passage of McGarviie J in *Karger v Paul* [1984] VR 161 at 163-164 has resulted, in practice, in many trustees, especially of what are called "family discretionary trusts" not giving reasons for many decisions. His Honour there said:

> *The discretionary power given to the trustees by cl 3, was a power, upon the request of Mr Smith, in their absolute and unfettered discretion to pay or transfer the whole or part of the capital of the estate to him. In my opinion the effect of the authorities is that, with one exception, the exercise of a discretion in these terms will not be examined or reviewed by the courts so long as the essential component parts of the exercise of the particular discretion are present. Those essential component parts are present if the discretion is exercised by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. The exception is that the validity of the trustees' reasons will be examined and reviewed if the trustees choose to state their reasons for their exercise of discretion.*

There are two points to note about this passage. First, it relates to a discretion "in these terms" – that is, it is dealing with a particular trust instrument. A peculiarity of the terms of the relevant clause was that the trustees had power to transfer to one of them; at least in relation to that one any fiduciary duty not to derive a personal advantage from exercise of the power must have been impliedly negatived by the terms of the gift. Further, the power was described in these terms "absolute and unfettered discretion". Secondly, the allegation in the case was that the breaches consisted of not acting in good faith and not acting upon a fair and proper consideration. Thus, any statements of McGarvie J that, some different allegation that was not actually made in the case would be *obiter dictum*.

These points of note, themselves, show the broadness (if taken out of context) of the above statement may not be appropriate. There are also other decisions that establish a trustee's exercise of discretion is in no way immune to review of alteration.

In *Parkes Management Ltd v Perpetual Trustee Co Ltd* (1977) 3 ACLR 303 at 311 Hope JA (with whom Moffit P agreed) held:

[2] Emphasis added. See generally *Attorney-General (Cth) v Breckler* (1999) 197 CLR 83 at [5]; *McFadden v Public Trustee (Vic)* [1981] 1 NSWLR 15 at 24; *HEST Australia Ltd v Skyley* (2005) 147 FCR 248 at [13].

> *In equity, where a trustee has a discretionary power, that power "must be exercised with an absence of indirect motive, with honesty of intention and with a fair consideration of the issues":* Jacobs Law of Trusts, *4th ed p 301. In* Lewin on Trusts *15th ed p 32, the requirement is expressed to be that the trustee's conduct be bona fide and the determination not influenced by improper motives. There is ample authority for these propositions.*

Chief Justice Barwick, in *Lutheran Church of Australia South Australian District Inc v Farmers' Co-operative Executor & Trustees Ltd* (1970) 121 CLR 628 at 639, said of a mere power conferred on a trustee:

> *... whilst the power is not in the nature of a trust so that the trustee must exercise it, equity would ensure that the trustee bona fide considers whether or not the power should be exercised, and that in doing so, proper considerations are in mind, and improper considerations excluded. The discretionary nature of the power does not mean that the discretion is absolute, in the sense that it can be exercised irresponsibly, capriciously or wantonly.*

Another formulation of when an exercise of a discretionary power can be held ineffective is if the trustees act for reasons that are "irrational, perverse, or irrelevant to any sensible expectation of the settlor.": *Re Manisty's Settlement* [1974] Ch 17 at 26. Other cases have also highlighted what constitutes a valid exercise of a discretionary power – for instance, there being a duty for the donee of the power to exercise it in person and not under the dictation of someone else, and a duty not to fetter the exercise of a discretion.

In the context of a superannuation fund, Heerey J, in the Full Court of the Federal Court, in *Wilkinson v clerical Administrative & Related Employees Superannuation Pty Ltd* (1998) 79 FCR 469 at 480 quoted a statement of Northrop J in the court below concerning the grounds on which an exercise of a trustee's power could be challenged in a court:[3]

> *Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelevantly to any sensible expectation of the settler, or without giving a real or genuine consideration to the exercise of the discretion. The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable or unwise. Where a discretion is expressed to be absolute it may be that bad faith needs to be shown. The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness.*

The joint decision of Gleeson CJ, McHugh, Gummow, Hayne and Callinan JJ in *Attorney-General (Cth) v Breckler* (1999) 197 CLR 83 suggests their Honours approved of the above quote.

These cases show that the exercise of a trustee will be subject of review and how they will be reviewed.

[3] Citations in the quote itself are removed.

5.3 Test to apply to a superannuation trustee

Even though the formation by a trustee can be one of two kinds, the exercise of a discretion proper or the forming of an opinion on a matter of fact, the courts have held the same tests will apply in certain circumstances. In relation to the specific topic of a superannuation trustee forming an opinion on a matter of fact that is a precondition for payment of a benefit, McLelland J (as his Honour then was) in *Rapa v Patience* (unreported, Supreme Court, NSW, McLelland J, 4 April 1985) held that the principles of *Karger* apply to such decisions. That aspect of *Rapa v Patience* has been frequently followed.[4]

It seems that the basis for applying the same test for the exercise of a discretionary power to the formation of an opinion by the trustee is that forming the opinion in question is a task that has been conferred upon the trustee, and equity requires a trustee to carry out his or her task faithfully. Precisely the same sorts of circumstances as would lead to the exercise of a discretionary power not being carried out faithfully can also lead to a task of forming an opinion on a matter of fact not being carried out faithfully.

5.4 The *Karger v Paul* Test

The first task or a the court in deciding whether a trustee has exercised a discretion or formed an opinion appropriately is to turn to the trust documents, in this case the superannuation fund documents. Careful attention must be paid to the exact discretion that is under review. If the trustee has not considered the correct question, the decision is not the type of decision that the trust deed empowers the trustee to make, and so it is not an effective exercise of power. If the correct question(s) was asked by the trustee the court then reviews the way the trustee answered the question.

The court can be assisted in deciding whether a trustee has complied with the *Karger v Paul* requirements for the exercise of a discretion or formation of opinion by examining the material on the basis of which the trustees have made their decision. If on that material trustees acting honestly and reasonably could not have come the conclusion to which the trustee actually came, the decision is invalid. Justice Bryson said it thus in *Sayseng v Kellogg Superannuation Pty Ltd* [2003] NSWSC 945 at [63]:

> *... if the Trustee came to a conclusion which no reasonable person could have come to one of the first three grounds of challenge referred to in* Rapa v Patience *must be available; an unreasonable conclusion cannot be reached without either a failure to exercise power in good faith, or a failure to exercise the power upon real and genuine consideration, or a failure to exercise the power in accordance with the purposes for which it was conferred.*

In finding that the decision is invalid the court need not identify precisely which of the first three grounds of challenge has been breached; it is sufficient to decide that one or other of them must have been breached. Such a process of reasoning is one that had been used by the

[4] See for example *Vidovic v Email superannuation Pty Ltd* (unreported, Supreme Court, NSW, Bryson J, 3 March 1995) at 15; *Baker v Local Government Superannuation Scheme Pty Ltd* [2007] NSWSC 1173 at [2]-[3] (McDougall J); and implicitly approved in *Hannover Life Re of Australasia Ltd v Sayseng* [2005] NSWCA 214 at [32] (Santow JA; with whom Spigelman CJ and Tobias JA agreed).

High Court. In *Elders Trustee & Executor Co Ltd v Higgins* (1965) 113 CLR 426 at 451-452 Dixon CJ, McTiernan and Windeyer JJ said:

> *the appellant has asked us to infer that, since mala fides or neglect is not to be imputed to a trustee from his silence alone, the various possibilities must have all been considered and a decision made to reject them. If that were so, the decision would seem to have been one that a prudent man, duly considering the relevant facts, could not reasonably reach.*

The message to take from these cases would appear to be a trustee's exercise of a discretion is not immune to challenge – the usual principles of a fiduciary nature will impose restricting constraints and require the trustee to properly conduct the superannuation fund.

6 Amending Superannuation Trust Deeds

Amending trust deeds, including superannuation fund trust deeds, is a more common occurrence that it has been in the past. In 1992 Young J (as his Honour then was) said in *Re Cosaf Pty Ltd* (unreported, NSWSC Young J, 18 December 1992) at 3 '*amendments to trust deeds are nowadays more readily accepted as an aspect of fiduciary life than they were in the past.'*

We are, of course, dealing with a special kind of trust when we consider superannuation funds. Courts often refer to the status of superannuation fund members as other than volunteers – to be contrasted with the bounty aspect of the traditional private trust – as a significant factor justifying special legal treatment.[5] That modern trusts are used for investment and operating business purposes may reduce the effect of this difference, however, there are two other features of superannuation funds that complicate the legal principles of trust law generally. First is the potentially complex interaction of trust and contract law arising out of the role of the employer in an employer sponsored fund. The second is the regulatory framework imposed by the SIS Act and the SIS Regulations. That these tensions exist should be kept in mind during the discussion that follows.

6.1 Amending Trusts

It is common that a trust deed would provide the trust cannot be amended without certain consensus – this does not necessarily require all beneficiaries and objects of the trust, but is usually focused on the trustee, possibly the settlor or the appointor/protector and, where there are units in the trust, a certain percentage of the unitholders. In the superannuation context, however, the consent of the trustee is necessary. Paragraph 60(1)(a) of the SIS Act provides that the governing rules of a superannuation entity (other than a self managed superannuation fund) must not permit those rules to be amended unless the trustee, or the trustees, of the entity have consented to the amendment.

It is, in all likelihood, going to be the trust instruments of the superannuation fund that will provide for how the terms of the superannuation fund can be amended. This is important as a court has no inherent power to vary the terms of a trust, even where such a variation may be agreed to by the current trustee and the beneficiaries: *Tickle v Tickle* (1987) 10 NSWLR 581.

[5] See for example *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 2 All ER 597 at 605 per Browne-Wilkinson VC.

The court does, however, have inherent power to sanction deviations from the trust in circumstances of emergency (see *Re New* [1901] Ch 534), but that is not a power that can be invoked, for instance, to improve the tax position of the trust or superannuation fund. This restrictive position at common law led the enactment of legislation in the various States that gives the courts power to authorise variations to trusts. In New South Wales, for instance, '*adjustment of the respective rights of the beneficiaries*' as the court may think fit, in cases in which it is 'expedient' can be made under section 81 of the *Trustee Act* 1925 (NSW).[6] To amend a superannuation fund trust deed under section 81 is, however, a very expensive way to go about amending a trust deed.

The need to include a power of amendment in the trust deed is even more important in a superannuation fund than a trust of a different kind. This is because of the frequency of changes to the SIS Act and the SIS Regulations, and the provisions of the 1997 Act that taxes superannuation funds. The following cases show the importance of getting the amendment clause correct, and drafted with sufficient flexibility, because express powers of variation do not necessarily confer an absolute discretion on the trustees to amend a superannuation fund trust deed.

In *Wilson v MGM* (1980) 18 NSWLR 730, Kearney J considered a superannuation fund deed containing a clause empowering the trustees of the fund and the employer company to alter or amend the deed '*in any respect which would in the opinion of the company not prejudice any benefit secured by contributions made on behalf of any member.'* In his Honour's view, that power to vary did not confer an absolute discretion. The deed also provided that any surplus in the hands of the trustees was to be applied *'for the provision of such (further) benefits to such members as the Company may direct.'* Justice Kearney held that the reference to 'benefits' in the amendment clause included these possible further benefits. Accordingly, he was of the view that an amendment to the trust deed whereby, on the winding up of the trust, any surplus moneys in excess of the amount payable to members for benefits secured by their contributions would be paid to the company was not in conformity with the power of amendment. Any amendment that prevented the surplus being applied for the provision of 'such (further) benefits' was prejudicial to benefits secured by contributions made on behalf of members. Justice also considered that the fiduciary obligations imposed on the company prevented it from using its power of amendment to benefit itself.

Presumably that issue would not arise where the power of amendment was vested in the trustee and the trustee was separate from the principal employer. This would be the case in most superannuation funds.

In *UEB Industries Ltd v Brabant* [1992] 1 NZLR 294 there was a purported amendment to a superannuation fund trust deed which would have enabled the company to take the surplus moneys in the fund over and above the amount required to pay benefits to members. The deed stipulated that no amendment could be made which would adversely affect a member's interest without the member's consent. The deed provided for distribution of any surplus on winding up among the members. It also stated that contributions made by the company ceased to be its property. The court held that the proposed amendment was clearly adverse to the interests of members.

[6] See also section 95 of the *Trusts Act* 1973 (Qld); section 59C of the *Trustee Act* 1936 (SA); section 63A of the *Trustee Act* 1958 (Vic); and section 90 of the *Trustees Act* 1962 (WA).

In Australia, however, a different result was reached by Waddell CJ in Eq in *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593, although one not inconsistent actually inconsistent in principle with the decisions in *Wilson v MGM* and *UEB Industries Ltd v Brabant*. In *Lock v Westpac Banking Corporation* a member of the Westpac Staff Superannuation Scheme challenged a resolution of the board of the bank amending the superannuation trust deed to allow repayment to the bank of the surplus in the fund over the amount required to meet the fund's liabilities, including benefits secured to members. The scheme was a defined benefit scheme. The rules specified the amount of benefits payable to members, the circumstances in which those benefits would be payable, and the contributions payable by members and by the bank to the fund. The variation clause gave the board of the bank, with the consent of the trustees of the fund, power to alter or replace the provisions of the deed and rules, provided that the value of the rights of members and their dependants accrued at the date of alteration were not thereby reduced without the written consent of at least 75% of the members. The extent of the members' rights was certified by an actuary. The amount of the surplus available cam to $300 million.

Chief Judge in Equity Waddell noted that courts take a different approach to the interpretation of pension and superannuation trusts to that applied to traditional trusts. Pension plans, being based on a contract between employer and employees, pursuant to which both contribute to the fund for the purpose of providing defined benefits in defined circumstances to employees, are to be interpreted in a more practical way than traditional trusts. In this case, his Honour held that the bank was not precluded from exercising the power of amendment in the manner proposed. Even if, as was submitted, the deed provided that on dissolution of the fund the surplus should be distributed among the members, his Honour did not think that meant that the surplus should be held on an irrevocable trust to provide defined benefits and to await the possibility of a dissolution of the fund. Chief Judge in Equity Waddell also rejected a submission that in a defined benefit scheme, once the defined benefits had been provided for, the company was precluded by some fiduciary obligation from acting in its own interests with respect to the surplus in the fund. His Honour said that in exercising powers with respect to a superannuation fund, a company is under a duty to act in good faith, as it is in its other dealings with its employees, but is not subject to any fiduciary obligation beyond securing the benefits defined by the scheme. It was further held that the trustees had not acted in breach of duty by consenting to the amendment. They were entitled to consider whether the amendment was in the interests of the members and the bank as a whole.

This case, though instructive, is limited as it may apply in circumstances of other defined benefit schemes but it would have a limited, if any, application to an accumulation fund. That is, the trustee's fiduciary obligation in an accumulation fund is not limited to a particular quantum of benefits.

As these cases demonstrate, though with the qualification, it is important to consider the provisions of the superannuation fund trust deed when assessing the validity of a proposed amendment. In doing so, however, the approach should be '*practical and purposive, rather than detached and literal'* per Warner J in *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 at 1610.

6.2 When amendments fail

A trustee who effects an invalid amendment, wether due to an excess of the amendment power or in the illegitimate process leading to its exercise, commits a breach of trust. This is the case whether the trustee is vested with the power to amend or the power to consent to another's amendment. The illegitimacy of an amendment dictates that the trustee lacks authority to act upon the amended provision; this, too, would amount to acting in breach of the trust.[7]

Where such a breach of trust occurs a cause of action could then vest in the affected members for compensation against the trustee, although the presence of an indemnity within the trust instrument for non-fraudulent breaches may render this remedy nugatory. There is also the possibility that members benefited from an invalid amendment could raise an estoppel that could bind the trustees personally or against other members.[8]

The issue, however, is more frequently phrased in terms of whether the amendment is void. If so the amendment has no legal effect, and the superannuation fund trust deed is interpreted as maintaining the entitlements that preceded the invalid amendment.

6.3 Resettlements

Whenever a trust is being amended the issue of a resettlement of the trust needs to be considered. If the amendments are significant enough to amount to a resettlement there will be capital gains tax and stamp duty implications.

Interestingly, however, the case most often relied on by taxpayers to suggest there has not been a resettlement, and the case most strenuously sought to be confined to its particular facts by the Commissioner of Taxation, is a superannuation case. In *Federal Commissioner of Taxation v Commercial Nominees of Australia Ltd* [2001] ATC 4336, a test case in which the Commissioner funded the taxpayer's costs, the High Court[9] held:

> *The nature of an eligible entity is such that in the incidents of the trust relationship established at its creation are not only possible, but in some respects probably. In the case of an infinitely continuing superannuation fund, operating under the regulatory scheme of the SIS Act, the trustee might change from time to time. The trust property would almost certainly be in a constant state of change, as contributions were received and employee benefits were paid. The identity of the persons entitled to benefit under the trust would be likely to change over time, as new members came into the scheme and others left. The nature of the benefits provided by the scheme might alter over the years, in response to industrial or market pressures, or regulatory requirements. In the case of a public offer superannuation fund, there would be likely to be substantial changes of membership over time, as new participating employers brought their employees in.*

Their Honours were accepting that a superannuation fund can be changed quite substantially without there being a resettlement.

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[7] *BHLSPF Pty Ltd v Brashs Pty Ltd* (2001) 8 VR 602 at [44] per Warren J (as her Honour then was)
[8] Compare *Briffa v Hay* (1997) 75 FCR 428 at 445
[9] A joint judgment of Gleeson CJ, Gaudron, McHugh, Kirby and Callinan JJ.

The Commissioner of Taxation sought to restrict the application of *Commercial Nominees* by taking the view it is limited to superannuation funds – that is, it does not apply to other trusts. Some have, correctly in the author's view, cast doubt on this approach. Mr Slater QC in his paper to the Society of Trust Estates and Practitioners said:[10]

> *The distinctions sought to be advanced by the Commissioner in the "Principles" statement as a basis for disregarding the decisions of the Federal and High Courts – that the High Court 'confined its reasons for judgment to superannuation entities' and the Federal Court judgement is 'of limited, if any, precedential value' – are with respect spurious. The 'superannuation entity' was a trust estate.*

What is clear, whether or not the Commissioner's desperate attempts to limit *Commercial Nominees* to superannuation funds, is that significant amendments can be made to superannuation funds before the issue of a resettlement will arise.

6.4 Changing Trustees

Although not actually a change to the terms of the superannuation fund, a change in trustee is significant and requires thought to ensure unwanted stamp duty issues do not arise. The discussion considers the issues involved in changing a trustee of a self managed superannuation fund or, if a company is the trustee of the fund, changing the directors of a corporate trustee of a self managed superannuation fund.

6.4.1 Read the Deed!

As a self managed superannuation fund, like other superannuation funds, is a trust the starting point is always to read the trust deed. This applies to changing the trustee itself – it is rare (though not impossible) for a trust deed to regulate how directors of a company that is the trustee may come and go.

The superannuation fund trust deed will set out the procedure by which there can be a change of trustee. The ways in which a change can be effected can be as varied as the imagination of the person drafting the deed. What is **critical** is that the process by which a change of trustee occurs complies with the procedure laid down in the deed. If a change of trustee does not comply with the terms of the trust deed the change of trustee is, and all actions of the trustee are, invalid.

6.4.2 Changing Trustees

If there is an actual change of trustee (changing directors of a corporate trustee would not be a change of trustee for these purposes), it is best to effect the change by way of a deed of change of trustee. This ensures the change of trustee, which should also comply with the requirements of the superannuation fund deed (discussed above), will satisfy requirements of the *Trustee Act* 1925 (NSW).

There are also concessions in the *Duties Act* 1997 (NSW) so that the transfers by which the property held by the outgoing trustee is transferred to the incoming trustee of the

[10] Slater QC *Amendment of Trust Instruments*, Paper delivered to the Society of Trust Estate Practitioners, Sydney, 29 September 2009 at page 21

superannuation fund will not be subject to full stamp duty. Advice should be sought to ensure the change of trustee documentation falls within these concessions.

6.4.3 Remember what does the law requires

Section 17A of the SIS Act imposes certain requirements on who can be, and who must be, trustees or directors of a self managed superannuation fund. These requirements relate to who has to be a trustee or director – they are independent of the trust deed requirements discussed above. Section 17A requires that:

- every member of the fund is a trustee or a director of the corporate trustee;
- every trustee or director of the corporate trustee is a member of the fund; and
- the members/trustees or directors must be fewer than 5 individuals.

However, if the self managed superannuation fund is a single member fund. In that case the sole member fund can have:

- a corporate trustee with the member as the sole director, or two directors with the member being one and the other not being an employee of the member (unless the employee is a family member of the fund member); or
- two individuals as trustees with the member being one and the other not being an employee of the member (unless the employee is a family member of the fund member).

Complying with these requirements is important because a superannuation fund that fails to comply with the requirements will cease to be a self managed superannuation fund. This will have significant tax and regulatory consequences for the fund.

7 Strategies to maximise the benefit of superannuation

There are a number of strategies available to maximise the benefits of superannuation. The way to do this is to maximise the account balances of a client, for any given level of resources that they have, and in light of the restrictions imposed by the simpler super amendments.

The most significant strategy in this regard is to gear within the superannuation environment.

7.1 Background to Instalment Warrants

On 3 November 2006, the Minister for Revenue and Assistant Treasurer, the Hon. Peter Dutton, M.P. in Press Release No. 078 ('**the Press Release**') announced that instalment warrants contain an element of borrowing, and are therefore a prohibited investment for superannuation funds. This is notwithstanding longstanding practice and that '*Over a number of years instalment warrants have been marketed to superannuation funds — particularly to self managed superannuation funds (SMSFs)*.'[11]

[11] See also paragraph 3.6 of the Explanatory Memorandum.

Further, both the Australian Prudential Regulation Authority and the Australian Taxation Office (collectively '**the Regulator**'), both being the regulators of the superannuation industry, had previously formed the view that instalment warrants did not involve a 'borrowing'.

Indeed, the Regulator had issued guidelines as to what constitutes a borrowing for the purposes of section 67 of the SIS Act. The Regulator, in Superannuation Circular No II.D.4 entitled *Borrowing by superannuation entities* ('**the Borrowings Circular**'), considered that not all liabilities incurred by a superannuation fund would be a 'borrowing'. As an example, the Regulator at paragraph 16 of the Borrowings Circular distinguished between 'borrowings' and other debts:

> '… in general ... a borrowing involves receiving a payment from someone in the context of a lender/borrower relationship on the basis that it will be repaid. A transaction that gives rise to a debtor/creditor relationship does not necessarily give rise to a lender/borrower relationship and hence does not necessarily represent a borrowing for the purpose of the restriction.'

Further, the Regulator, at paragraph 17 of the Borrowings Circular, provided examples of borrowings, which includes a loan (whether secured or unsecured) and a bank overdraft (in normal circumstances). However, at paragraph 19 of the Borrowings Circular, the Regulator considered that the following would not be a borrowing:

> '… amounts paid on behalf of, or owed by, regulated superannuation funds … [that include] … the purchase by a trustee of property where ownership of the property passes to the trustee before the instalments are finalised. Under this example, an investment in **endowment warrants or instalment receipts** may not be considered borrowing. It is necessary to check the obligations that lie with the purchaser to meet the instalment(s), as these determine whether the investment is a borrowing. Where the **remaining instalment(s) is not "compulsory"** and the **warrant / receipt holder receives the value of the warrant / receipt (less handling or sales costs)** on "default", APRA considers the warrant / receipt does not constitute a borrowing.' [emphasis added]

Further, the Regulator at paragraph 6 of the Borrowings Circular gives examples of endowment warrants and instalment warrants as not involving borrowings by a Fund. The Regulator reiterated the views that it expressed in the Borrowings Circular regarding instalment warrants in the *Guidelines on Instalment Warrants for Superannuation Trustees* ('**Guidelines**'):

> '… prohibition on borrowing was developed before many currently available geared products had been developed … The regulators had previously taken the view that a superannuation fund investment in an instalment warrant **may not** constitute a borrowing under section of the SIS Act.' [emphasis added]

7.2 Prohibition against borrowing in superannuation funds

Notwithstanding the change in the Government's view as announced in the Press Release, the *Tax Laws Amendment (2007 Measures No 4) Bill 2007* (Cth) ('**the Bill'**) amended the SIS Act so as to ensure that investments in instalment warrants do not breach the prohibition against trustees of regulated superannuation funds from borrowing. Subsection 67(1) of the SIS Act expressed the prohibition, by providing that:

> '… a trustee of a regulated superannuation fund must not
>
> (a) borrow money; or
>
> (b) maintain an existing borrowing of money.'

However, there are a number of exceptions to the prohibition contained in subsection 67(1) of the SIS Act, which includes (as a result of the enactment of the Bill), subsection 67(4A) of the SIS Act, which provides that subsection 67(1) of the SIS Act

> '… does not prohibit a trustee (the RSF trustee) of a regulated superannuation fund from borrowing money, or maintaining a borrowing of money under an arrangement under which:
>
> (a) the money is or has been applied for the acquisition of an asset (the original asset) other than one the RSF trustee is prohibited by this Act or any other law from acquiring; and
>
> (b) the original asset, or another asset (the replacement) that:
>
> (i) is an asset replacing the original asset or any other asset that met the conditions in this subparagraph and subparagraph (ii); and
>
> (ii) is not an asset the RSF trustee is prohibited by this Act or any other law from acquiring;
>
> is held on trust so that the RSF trustee acquires a beneficial interest in the original asset or the replacement; and
>
> (c) the RSF trustee has a right to acquire legal ownership of the original asset or the replacement by making one or more payments after acquiring the beneficial interest; and
>
> (d) the rights of the lender against the RSF trustee for default on the borrowing, or on the sum of the borrowing and charges related to the borrowing, are limited to rights relating to the original asset or the replacement; and
>
> (e) if, under the arrangement, the RSF trustee has a right relating to the original asset or the replacement (other than a right described in paragraph (c)) – the rights of the lender against the RSF trustee for the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the original asset or replacement.'

A summary of the key features of subsection 67(4A) of the SIS Act is provided in paragraph 3.12 of the Explanatory Memorandum:

> 'An exception to the prohibition on borrowing in section 67 of the Superannuation Industry (Supervision) Act 1993 will allow a superannuation fund trustee to borrow money in accordance with an arrangement that has the following features:
>
> - the borrowing is used to acquire an asset that is held on trust so that the superannuation fund trustee receives a beneficial interest and a right to acquire the legal ownership of the asset (or any replacement) through the payment of instalments;
> - the lender's recourse against the superannuation fund trustee in the event of default on the borrowing and related fees, or the exercise of rights by the fund trustee, is limited to rights relating to the asset; and
> - the asset (or any replacement) must be one which the superannuation fund trustee is permitted to acquire and hold directly.'

7.3 Further amendments

The instalment warrant exemption was further amended when subsection 67(4A) of the SIS Act was repealed and sections 67A and 67B were inserted. Those sections provide:

> 67A **Limited recourse borrowing arrangements**
>
> Exception

(1) Subsection 67(1) does not prohibit a trustee of a regulated superannuation fund (the ***RSF trustee***) from borrowing money, or maintaining a borrowing of money, under an arrangement under which:

(a) the money is or has been applied for the acquisition of a single acquirable asset, including:

(i) expenses incurred in connection with the borrowing or acquisition, or in maintaining or repairing the acquirable asset (but not expenses incurred in improving the acquirable asset); and

Example: Conveyancing fees, stamp duty, brokerage or loan establishment costs.

(ii) money applied to refinance a borrowing (including any accrued interest on a borrowing) to which this subsection applied (including because of section 67B) in relation to the single acquirable asset (and no other acquirable asset); and

(b) the acquirable asset is held on trust so that the RSF trustee acquires a beneficial interest in the acquirable asset; and

(c) the RSF trustee has a right to acquire legal ownership of the acquirable asset by making one or more payments after acquiring the beneficial interest; and

(d) the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) default on:

(i) the borrowing; or

(ii) the sum of the borrowing and charges related to the borrowing;

are limited to rights relating to the acquirable asset; and

Example: Any right of a person to be indemnified by the RSF trustee because of a personal guarantee given by that person in favour of the lender is limited to rights relating to the acquirable asset.

(e) if, under the arrangement, the RSF trustee has a right relating to the acquirable asset (other than a right described in paragraph (c))--the rights of the lender or any other person against the RSF trustee for, in connection with, or as a result of, (whether directly or indirectly) the RSF trustee's exercise of the RSF trustee's right are limited to rights relating to the acquirable asset; and

(f) the acquirable asset is not subject to any charge (including a mortgage, lien or other encumbrance) except as provided for in paragraph (d) or (e).

Meaning of acquirable asset

(2) An asset is an ***acquirable asset*** if:

(a) the asset is not money (whether Australian currency or currency of another country); and

(b) neither this Act nor any other law prohibits the RSF trustee from acquiring the asset.

(3) This section and section 67B apply to a collection of assets in the same way as they apply to a single asset, if:

(a) the assets in the collection have the same market value as each other; and

(b) the assets in the collection are identical to each other.

Example: A collection of shares of the same class in a single company.

(4) For the purposes of this section and section 67B, the regulations may provide that, in prescribed circumstances, an acquirable asset ceases to be that particular acquirable asset.

RSF trustee

(5) Paragraphs (1)(d) and (e) do not apply to a right of:

(a) a member of the regulated superannuation fund; or

(b) another trustee of the regulated superannuation fund;

to damages against the RSF trustee for a breach by the RSF trustee of any of the RSF trustee's duties as trustee.

(6) A reference in paragraph (1)(d) or (e) (but not in subsection (5)) to a right of any person against the RSF trustee includes a reference to a right of a person who is the RSF trustee, if the person holds the right in another capacity.

67B Limited recourse borrowing arrangements--replacement assets

(1) Subsection (2) applies to:

(a) a reference in paragraph 67A(1)(b), (c), (d), (e) or (f) to an acquirable asset (the ***original asset***); or

(b) a reference in subsection 71(8) to an acquirable asset (the ***original asset***) mentioned in paragraph 67A(1)(b);

(including a reference resulting from a previous application of subsection (2) of this section).

(2) Treat the reference as being a reference to another single acquirable asset (the ***replacement asset***) if:

(a) the replacement asset replaces the original asset; and

(b) subsection (3), (4), (5), (6), (7) or (8) applies.

(3) This subsection applies if:

(a) the original asset consists of:

(i) a share in a company, or a collection of shares in a company; or

(ii) a unit in a unit trust, or a collection of units in a unit trust; and

(b) the replacement asset consists of:

(i) a share in that company, or a collection of shares in that company; or

(ii) a unit in that unit trust, or a collection of units in that unit trust; and

(c) at the time the replacement occurs, the original asset and the replacement asset have the same market value.

(4) This subsection applies if:

(a) the original asset consists of an instalment receipt that confers a beneficial interest in:

(i) a share in a company; or

(ii) a collection of shares in a company; and

(b) the replacement asset consists of that share or collection.

(5) This subsection applies if:

(a) the original asset consists of:

(i) a share in a company, or a collection of shares in a company; or

(ii) a unit in a unit trust, or a collection of units in a unit trust; and

(b) the replacement asset consists of:

(i) a share in another company, or a collection of shares in another company; or

(ii) a unit in another unit trust, or a collection of units in another unit trust; and

(c) the replacement occurs as a result of a takeover, merger, demerger or restructure of the company or unit trust mentioned in paragraph (a).

That this area has been amended so often in its short life suggests further lobbying and amendment will happen. This means that consideration of gearing at any time requires analysis of the provisions then current. The following discussion is broad and should not be considered a substitute for undertaking that analysis at the time.

7.4 The legal relationships required to obtain the borrowing carve-out

It is essential to consider the legal relationships that arise when seeking to avail oneself of the borrowing carve-out in the SIS Act. The provisions require the following conditions to be satisfied:

Condition	Description
One	A trustee of a superannuation fund borrows money (or indeed maintains a borrowing of money).

Two	The asset that has been acquired by the borrowed money.
Three	The asset that has been acquired is held on trust so that the trustee of the superannuation fund has a 'beneficial interest' in the asset.
Four	The trustee of the superannuation fund has an option (i.e. a right to acquire) the 'legal ownership' by making further (instalment) payments.
Five	The right of the lender is limited in recourse – to the asset acquired and held by the trustee.
Six	If, under the arrangement, the trustee of a superannuation fund has a right relating to the asset (other than a right to acquire the underlying asset) – the rights of the lender against the trustee of the superannuation fund are limited to rights relating asset.

That is:

- The trustee of the superannuation fund borrows to acquire the underlying asset (i.e., the '**Investor**');
- The trustee of the superannuation fund needs to have the 'beneficial interest' in the underlying asset;
- The underlying asset is held on trust (indeed – bare trust) for the benefit of the trustee of the superannuation fund (held by a '**Security Trustee**');
- The trustee of the superannuation fund has an option to acquire the underlying asset after paying the loan amount;
- The lender's rights with respect to the borrowing are limited in recourse, to the underlying asset;
- Any rights that the trustee of a superannuation fund has to the underlying asset (except the option to acquire) may be subrogated in the lender, but only to the extent that the rights apply to the underlying asset.

The Security Trustee needs to hold the legal title in the underlying property. The Security Trustee acts as a 'bare trustee' with respect to the underlying property, as the Security Trustee does no more (under the trust relationship) than hold the legal title in the underlying property. It is also essential from a taxation perspective (see discussion below) that the relationship as between the Security Trustee and the Investor with respect to the underlying property is a 'bare trust' - i.e. the Investor is 'absolutely entitled' to the underlying asset and the Security Trustee has no active duty with respect to the underlying asset.

There are a number of contractual relationships that need to be established. A lender / borrower relationship needs to be established as between the lender and the Investor. Under that relationship, the Security Trustee is prohibited from dealing with the underlying asset on behalf of the Investor, unless the Security Trustee is required to do something which involves the discharge of the loan (for example):

- the lender exercises a power of sale with respect to the underlying asset;
- the Investor pays the outstanding amount and the legal title in the underlying asset transferred to the Investor; or
- the Investor wants to dispose of the underlying asset and repay the outstanding loan.

It needs to be ensured that the only right that the lender has (including with respect to the repayment of the loan) is limited to the underlying asset. None of the other assets of the Investor can be at risk. As a result, all of the Investor, the Security Trustee and the lender need to enter into a contractual relationship.

Further, and in some situations, the Security Trustee may be granted a power of attorney by the Investor with respect to the underlying asset, until the borrowing is discharged and the legal title is transferred to the Investor.

The Investor needs to be able to acquire the legal title in the underlying property at any time.

7.5 Superannuation Gearing on Death of a Member

Paragraph 52(2)(c) of the SIS Act requires trustees to act in the best interests of the members of a fund and paragraph 52(2)(f) of the SIS Act requires trustees to formulate and give effect to an overall investment strategy for a fund. A superannuation fund trustee should, therefore, be undertaking an Instalment warrant investment in the most advantageous way having regard to the risk and return from the investment, the fund's diversity and liquidity and the ability of the fund to discharge its existing and prospective liabilities.

These obligations on a superannuation trustee require consideration of how an Instalment warrant investment will be maintained on the death of a member of the fund. A member's benefits must be cashed as soon as practicable after the member dies: see regulation 6.21 of the SIS Regs for SMSF's. The trustee must consider the long term implications of meeting loan repayments (the Instalment payments) when such a cashing is required.

Issues to be considered include:

1. Are death benefits payable? If so how will that payment be funded?
2. Is there a need to sell the asset? What affect does this have on the fund's investment strategy?
3. Can the fund continue to service the Instalment payments without the deceased member's contributions?
4. What impact does the member's death have on the loan documents? For instance, were they a guarantor?

To address the issues in enumerated paragraphs 1 and 2 above a superannuation trustee should consider insurance against death, disability and trauma of the members of the fund. That is, the fund would insure against the death of the member and use the insurance payout to fund the obligation the superannuation trustee has to pay out the deceased member's benefits. This would leave the assets of the fund in place and should avoid the need to sell the asset underlying the Instalment warrant.

The insurance could be held in the superannuation fund, an advantage of which is that the part of the premiums payable for the insurance will be deductible to the superannuation trustee (see generally Subdivision 295-G of the ITAA 1997), or outside of the superannuation fund by the other members. If the insurance is held outside the superannuation fund the other members would then contribute the proceeds to the superannuation fund (as non-concessional contributions, but subject to the contributions caps) in order to assist with paying out the death benefits and continuing to service the loan.

If the fund had anticipated the deceased member's continuing superannuation contributions to fund the Instalment warrant investment (the issue at enumerated paragraph 3 above) there will be a need to source further contributions to the fund. In this regard the remaining members of the fund would need to increase their contributions or an additional member (such as the deceased member's spouse if not already a member) could be added to the fund.

When entering into the Instalment warrant documentation it is important that the bank documents are not drafted so that the death of a member will cause problems (e.g. enumerated paragraph 4 above). This is a planning issue at the commencement of the warrant arrangement. If the deceased member is a guarantor on the documents the remaining members of the fund may need to provide additional security to satisfy the lender's requirements.

The following example illustrates how the death of a member can be a problem:

Ken, Andrew and Polly are members of a SMSF that has entered into an Instalment warrant arrangement that satisfies subsection 67(4A) of the SIS Act. Their superannuation fund acquires a property under the Instalment warrant arrangement. NAB is the bank providing finance.

Two years after settlement of the property, one of the three members dies in a car crash. The following example cash flows show how the death of a member can cause problems for the fund:

Fund cash balance (before Instalment warrant) - *Each member's account balance: $300,000*	*$900,000*
Funds acquired under Instalment warrant (60% LVR)	*$720,000*
Purchase price of property	*($1,260,000)*
Fund cash balance (after Instalment warrant entered)	***$360,000***
First two years super contributions (all three members) - *Each member's annual contribution: $66,666*	*$400,000*

First two year's rent (after tax)	*$120,000*
First two years loan repayments (P&I @ 9% on 5 year loan)	*($360,000)*
Cash balance after first two years	***$520,000***
Death benefits payable for death of member	*$353,333*[12]
Cash balance after first two years and cashing of benefits	***$166,667***

Without appropriate insurance (whether held in the superannuation fund or outside of it to be contributed later) each member would need to ensure that they are in a position to meet the cash flow requirements of the arrangement.

8 Testamentary Trusts

Trusts are commonly characterised along a dichotomy of life and death – that is, an *inter vivos* trust and a testamentary trust. A testamentary trust is a trust that is established under a will or other testamentary instrument.

A testamentary trust has significant taxation benefits in respect of the taxation of minor beneficiaries. Generally, the unearned income of persons under 18 years has a tax-free threshold of $416 (subject to any applicable low income rebates). After that all income is taxed at penalty rates of 66% so, eventually, the entirety of income is assessed at the top marginal rate.

Section 102AG of the 1936 Act provides that income of a trust estate that results from a will is "excepted trust income". Where excepted trust income is distributed to minor beneficiaries, it will be taxed in the hands of the minor beneficiaries at the normal adult marginal tax rates. This means that each minor beneficiary can receive a tax-free distribution of $6,000 and normal adult marginal tax rates apply after that.

Importantly, if a testamentary trust is established further amounts settled on the trust will also fall within the "excepted trust income": *Trustee for the Estate of the late A W Furse No 5 Will Trust v FCT* (1990) 91 ATC 4007 per Hill J. This means the testamentary trust is not limited to the amounts originally settled under the will or testamentary instrument.

[12] Being the member's $300,000 opening balance + $173,333 (1/3 of the rent and additional contributions) - $120,000 (1/3 of the loan repayments.

PT 2 – SUCCESSION: TRUSTS

1 Issues to consider when transferring wealth and control held subject to a trust

1.1 Importance of the terms of the trust

Typically the terms of trusts are provided in trust instruments. Such terms may include both the rights and obligations of trustees of the trust, such as the powers, duties, trusts and discretions that a trustee of a trust has, as well as the rights of beneficiaries.

As a result, the usual tensions arise with respect to whether the powers 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 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.

As such, 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.

1.2 Minor beneficiaries

It should be noted that a distribution to minor beneficiaries under the terms of a 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 trust vests.

1.3 More than one 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.

1.4 The position of Appointor

The position of Appointor is often a powerful position in a trust, as the Appointor has the right to hire and fire the trustee i.e. replace a trustee or add an additional trustee. A new trustee might be expected to bend to the will of the Appointor.

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'[13] 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 legislations (see section 91 of the Succession Act).

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* or the Succession Act.

1.5 Family provision legislation

Further considerations must be given to the interaction between the family provision legislation in succession planning. In New South Wales, the provisions contained in Chapter 3 of 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 Succession Act. That purpose is to:-

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[13] The term 'property' is defined in section 3 of the *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.*

> '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'[14].

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.[15]

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.

1.5.1 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[16]. 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[17].

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.

1.5.2 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.

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

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

[16] section 59, Succession Act.

[17] section 59, Succession Act.

(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.'

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 domicile, or it terminated those rights ... If the former, there was obviously “another person” (cf s 22(4)(a)(ii)) who became entitled to exercise the deceased's power of disposition, and this occurred as a result of the deceased's omission to do so and his death.

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

> The respondents are correct in their submission that “the power” referred to in subpar (ii) must be the same power as that which was enjoyed by a deceased before he or she ceased to be entitled to exercise it. But the very fact that the subparagraph contemplates that “another person” may continue to be entitled to exercise the power shows that the provision embraces the situation of two or more persons having a concurrent power to dispose of property with one of those persons (being the deceased) ceasing to exercise it as a result of the prior omission to exercise it and death. ... The Founder's entitlement to exercise the power preceded the deceased's death and continued after it. This satisfied subpar (ii) if it were the case that the deceased's entitlement was non-transmissible.
>
> This alone is not sufficient to satisfy s 22(4)(a)(ii). It must also be shown that the continuation of the Founder's power came about “as a result of” the deceased's omission to exercise his concurrent power and of his death. The respondents submit that it is at this point that the appellant's argument breaks down. They submit that there is no link or connection between the continuation of the Founder's powers under the articles of the Foundation and the deceased's omission to dispose of the Foundation's assets (as he could have, through his power over the Founder that I have found to exist) before his death. And the respondents emphasise (correctly) that the same “power” is involved wherever it is mentioned in the paragraph.
>
> ... I would reject the respondents' argument for the following reasons. If the deceased had exercised the power which he held yet omitted to exercise, then the assets of the Foundation would have been effectively disposed of. For example, the deceased could have directed the Founder to make a by-law whereby the corpus of the Founder's assets (after payment of the “bequests”) were paid to one or more of the appellants. That by-law could have been made irrevocable ... The deceased did not procure this during his lifetime. It can therefore be said that his omission to do so before his death was a cause of the assets remaining in the Foundation. The Founder's concurrent powers of disposition (through making by-laws) remained as it stood under the articles. It continued after the deceased’s death. The provision does not require that the concurrent powers of disposition should be exercisable in identical ways. That continuation was causally linked to the deceased's omission in that the omission contributed to the continuation of the Founder's power of disposition under the (unamended) articles, and left the Founder with assets at its disposition in the Foundation.

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

> ‘23 It must, however, be recognised that the decision in 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.'

1.6 Bankruptcy Act considerations

Under the Bankruptcy Act, there are two main provisions which will allow a trustee in bankruptcy to claim back assets or their value when they are transferred to a trust (or for that matter any other entity, including a spouse).

1.7 Undervalue transfers

Section 120 of the Bankruptcy Act is concerned with transfers of assets from a person prior to bankruptcy at less than their market value. It is very much time dependant. Section 120 has been recently amended to alter the time limitations when transfers are made to an associated person.

The rules in section 120 are:

- If the transferor was solvent at the time of the transfer and the transfer was not to a 'related entity' then the trustee in bankruptcy is limited to transfers which occurred within two years before the commencement of the bankruptcy;
- If the transferor was solvent at the time of the transfer but the transfer is to a related entity then the clawback period is four years;
- In any other case the clawback period is five years i.e. where the transferee cannot prove that the transferor was solvent at the time of the transfer.

It should be noted that the commencement of bankruptcy can be up to six months prior to the date a petition is lodged[18].

The transferee has the burden of proving that the transferor was solvent at the time of the transfer.

[18] The bankruptcy commences at the time of the earliest act of bankruptcy committed within the 6 month period preceding the date the petition is lodged: Section 115 Bankruptcy Act. For the definition of 'act of bankruptcy' see section 40 Bankruptcy Act.

A new provision was introduced in 2006[19] that establishes a rebuttable presumption that the transferor was insolvent if it is established that the transferor:

> '(a) had not, in respect of that time, kept such books, accounts and records as are usual and proper in relation to the business carried on by the transferor and as sufficiently disclose the transferor's business transactions and financial position; or
>
> (b) having kept such books, accounts and records, has not preserved them.'

There are two safe harbours:

1. Plan early so that the clawback period will have expired if financial problems arise. The best planning is that which is never needed.

2. Have the transferee pay market value. This, of course, will not immediately reduce the net worth of the transferor. However, if the transferor consumes the value provided by the transferee on living, holidaying, school fees etc, there is nothing for the trustee in bankruptcy to recover. Meeting mortgage expenses of the spouse's home may not be a wise decision. This is discussed below.

As to planning early the proposition is simple, if time starts to run at the earliest opportunity the relevant time period for clawback by a trustee in bankruptcy may have expired when the triggering act of bankruptcy occurs. On the second point the transferee must give at least market value consideration for the transfer of the property. There are no special rules about determining the market value of property for bankruptcy purposes[20].

The decision of the Federal Magistrate in *Thomas v. Tyler (No 2)*[21] shows that the usual contest between opinions of valuers takes place in this context. It also illustrates another exceptionally important point. If the valuation is not correct and the property is transferred at an undervalue the appropriate order, unless it is an exceptional case[22], is that the property be reconveyed to the trustee in bankruptcy by the transferee. The transferee is repaid the amount of the undervalued consideration but the critical upshot is that any increase in the value of the property will accrue to the trustee in bankruptcy and not the purchaser.

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[19] Subsection 120 (3A) Bankruptcy Act.

[20] It was relevantly observed in the Explanatory Memorandum to the *Bankruptcy Legislation Amendment Bill* 1999 (Cth) that:

> '*The expression 'market value' is intended to refer to the value of the property concerned if it were disposed of to an unrelated purchaser bidding in a market on an ordinary commercial basis for property of the kind disposed of, without any sort of discount or incentive for purchase being offered. The expression is not intended to include a situation where the property was being disposed of at a fire sale, at discounted prices because of some immediate need on the part of the owner to liquidate his or her assets*',

Refer *Victorian Producer's Co-Op Co Ltd v. Kenneth* [1999] NSWSC 155.

[21] [2005] FMCA 342.

[22] cf the observation made by Raphael FM in *Thomas v. Tyler (No 2)* that the decision of Driver FM in *Schmierer v. Horan* [2004] FMCA 16 to cause the transferee to pay the trustee in bankruptcy the shortfall was motivated by a desire to maintain the bankrupt's family in the family home and, in any event, there was a small difference which on the balance of convenience justified the order, as exceptional.

A tactical reaction to this is that the transferee should purchase the property at its market value (with, in this case the market value determined at the high end of the scale). The transferor would provide vendor finance and then release all of the balance of the debt. The property transferred in that case at an undervalue is the debt which is released. The growth in the value of the property originally transferred remains with the transferee as there should be no order for reconveyance of the property.

Of course, there is always the question of whether the property has been truly transferred to the trustee of the trust[23] or the transactions are shams[24].

1.8 Transfers to defeat creditors

The other clawback mechanism available to a trustee in bankruptcy is section 121 of the Bankruptcy Act. This provision is driven by motive and is not time dependent. The High Court found in *Cummin's Case*[25] that transfers of property up to 15 years earlier were void as against his trustee in bankruptcy.

Section 121 provides that a transfer is void if:

- the transferor's main purpose was to prevent the transferred property from becoming divisible among the transferor's creditor (or to hinder or delay that process); and
- the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred.

The transferor is taken to have the required main purpose if it can be reasonably inferred from all the circumstances that the transferor was at the time of the transfer insolvent or about to become insolvent.

There is also the same rebuttable assumption about the failure to keep books, accounts and records, or to preserve them as in section 120[26].

If the transferee gave at least market value consideration for the transfer and did not know or could not reasonably have inferred that the transferor's main purpose was to defeat his or her creditors and that the transferor was or was about to become insolvent then the transfer is not void.

Again, if the transferee pays market value consideration and is innocent of the transferor's state of mind (and objectively so) then the value paid can be dissipated on consumption[27].

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[23] *Ramaldi v. Reeves* [2007] FMCA 408.

[24] *Sharment Pty Ltd v. Official Trustee in Bankruptcy* [1988] FCA 179 and *Hyhonie Holdings Pty Ltd v. Leroy* (2003) NSWSC 624 and (2004) NSWCA 72. In *Sharment* Lockhart J observed that in order to find a sham there needed to be a strong finding. The strength of that finding may have been very recently diluted by the decision of the High Court in *Raftland Pty Ltd v. FC of T* [2008] HCA 21.

[25] (2006) HCA 6.

[26] Subsection 121 (4A) Bankruptcy Act.

[27] For an extreme example of this see *Jessup v. Mountain View Farm* [2002] FCA 312.

There is an alternative approach. If it can be demonstrated that the bankrupt would have dissipated value actually transferred by the bankrupt (prior to bankruptcy) that value will not be caught by section 121. This is because it must be shown (by the trustee in bankruptcy) that the property would probably have become part of the transferor's bankrupt estate available to the creditors.

The main issue of concern with section 121 is whether it strikes at generic asset protection planning. Say a person about to engage in a financially risky enterprise eg. accounting or law, transfers assets to a discretionary trust before commencing business. In those circumstances can section 121 provide the trustee in bankruptcy with a clawback when there are no unsatisfied creditors and none looming?

Sackville J in the Federal Court decision in *Cummin's Case* considered this situation[28] and concluded that:

> 'It does not seem to me that Ex Parte Mercer necessarily means that a barrister who transfers assets in order to keep them out of the hands of clients or potential clients, who at some stage in the future might sue for professional negligence, is outside the scope of s121(1)(b) of the Bankruptcy Act should the transfer be subsequently impugned. It must be borne in mind that s121(1)(b) may be satisfied even if the transferor was solvent at the time of the transfer and even if the transferor had no creditors at that time. It seems to me that the answer to the question is likely to depend on the facts of the particular case. I am prepared to assume for the purposes of this case, without deciding, that if all that is known is that a professional person:
>
> - transferred the bulk of his or her assets to a family member for no consideration;
> - has no creditors at the time of the transfer (or retains sufficient to meet all liabilities known at the time);
> - has not engaged and does not propose to engage in any hazardous financial ventures; and
> - intends to protect the transferred assets from any actions brought by a client who might in the future sue for professional negligence (there being no such suit in the offing at the time of the transfer;
>
> then s121(1)(b) of the Bankruptcy Act does not render the transfer void against the person's trustee in bankruptcy. For the reasons that appear, I do not think that assumption is of assistance to the respondents in the circumstances of the present case.[29]'

It is difficult to gain any confidence from this statement, one way or the other. Perhaps there is a slightly favourable view being expressed. Unfortunately none of the judges in the Full Court of the Federal Court or the High Court sought to resolve the issue. The High Court simply concluded that it was good enough to be aware of impending liabilities and did not consider the wider question about general asset protection[30].

The issue is, however, readily resolved for practitioners. When there is no choice but to make the transfer to protect the family home and to keep the family from the poor house it must be done and the consequences (if any) suffered later.

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[28] *Prentice v. Cummins (No 6)* [2002] FCA 1503.

[29] [2002] FCA 1503 at paras. 102-103.

[30] [2006] HCA 6 at paras. 29-33.

In the context of section 121 motive is everything. It helps, therefore, if the transaction is driven by another significant motive such as commercial (including taxation) or family domestic reason.

In *Florance*[31] the Court was persuaded by the evidence of Mrs Florance, the non-bankrupt spouse and option holder, that she wished to retain the properties in question against her husband's desire to give up legal practice and move to the country, ie. purely 'domestic considerations'.

1.9 Asset protection: The current state of play following the fall out from the Richstar's case

The *Richstar Enterprises Case*[32] concerned the collapse of the Westpoint Group. The Australian Securities and Investment Commission ('**ASIC**') had already obtained orders that receivers be appointed to the property of a number of Westpoint directors and companies controlled by them. The point of these actions was to preserve property of the individuals and companies to prevent it being dissipated pending the ASIC enquiries.

The question before the Court was whether a receiver could be appointed to property held in trust. The relevant provision was section 1323 of the Corporations Act. This section allowed the Court on application by ASIC or an aggrieved person to appoint inter alia a receiver to property of a person, who is subject to an investigation being carried out under the ASIC Act or the Corporations Act. 'Property' is defined as meaning:

> 'any legal or equitable estate or interest (whether vested or contingent) in real or personal property of any description and includes a thing in action'.[33]

The Court was satisfied that it could make such an order where the property was held as trustee by the persons being investigated and in relation to superannuation funds where the individuals were members. In each instance it was considered that the individuals subject of investigation had an 'interest' (legal or equitable).

The 'interest' of the individuals in discretionary trusts posed a more difficult question because the objects have nothing more than a right to be considered by the trustee as a potential beneficiary of the trustee's largesse as to income or capital.

French J (as his Honour then was) undertook a detailed (but in the writer's view not exhaustive) review of the case law on the powers of trustees and their controllers. The two most telling observations made by the Court were these:

> 'in the ordinary case the beneficiary of a discretionary trust other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of 'property' in s9 of the Act and be amenable to control by receivers under

[31] Re *Florance Ex parte: Andrew v. Florance* [1983] FCA 357.

[32] *Australian Securities and Investments Commission: In the matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v. Carey* (No 6) [2006] FCA 814.

[33] Section 9 Corporations Act.

> s.1323. I distinguish the 'ordinary case' from the case in which the beneficiary effectively controls the trustee's power of selection. Then there is something which is akin to a proprietary interest in the beneficiary.'[34]

And:

> 'I am inclined to think that a beneficiary in such a case … at arm's length from the trustee, does not have a 'contingent interest' but rather an expectancy or mere possibility of a distribution … On the other hand, where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because, in the words of Nourse J 'it is as good as certain that the beneficiary will receive the benefits of distributions either of income or capital or both'.[35]

In a wealth preservation and tax planning context it might well be said that 'it is as good as certain that the beneficiary <u>will not</u> receive the benefits of distributions …'

The Court concluded that a Mr Beck who was the sole director and secretary of a corporate trustee of a discretionary trust had an interest in property of the trust (it did not matter that his wife was the Appointor):

> 'Mr Beck is a beneficiary of the Agribusiness Annuity Trust of which Eagle Bluff Nominees Pty Ltd is a trustee. He is the director and secretary of that trustee company. He is the original appointor under the trust and his wife, Anne Beck, the current appointor. The trustee has a wide discretion including the power to prefer one or the other beneficiary to the total exclusion of any other beneficiary. Mr Beck would appear, through his trustee company, to have effective control of the assets of the trust. At the very least he has a contingent interest in the sense used earlier. His interest would appear to amount to effective ownership of the trust property. The property of that trust is, in my opinion, amenable to control by the receivers and s.1323'.[36]

Does this decision sound the death knell of discretionary trusts as wealth preservation mechanisms?

In this writer's view – no and for two reasons. The first, technical differences between the legislation under consideration in *Richstar* and the Bankruptcy Act. The second reason, a practical one, lack of assured funds on the part of trustees in bankruptcy.

The property of a bankrupt at the time the person became a bankrupt passes to the trustee in bankruptcy.[37] However, property held on trust for another is specifically excluded.[38] In addition, the power of appointment of the trustee is not property which passes to the trustee in bankruptcy.[39]

Division 4A of the Bankruptcy Act specifically contemplates and makes provision for the circumstances where a bankrupt controls a trust.[40] In these circumstances it can be vigorously argued that the Bankruptcy Act recognises that the interest of the bankrupt in a discretionary

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[34] *Richstar* at para. 25.

[35] *Richstar* at para. 36.

[36] (2006) FCA814 at para. 41.

[37] Subsection 116(1) Bankruptcy Act.

[38] Paragraph 116(2)(a) Bankruptcy Act.

[39] *Re Burton; ex parte Wily v. Burton* (1994) 126 ALR 557.

[40] Division 4A relates to entities controlled by the bankrupt and 'entity' includes a trust.

trust is not attainable by a trustee in bankruptcy. For a somewhat contradictory view see the paper prepared by Justice Branson for the ITSA Bi-Annual Congress 2006.[41]

This differs from the specific context of 'property' as defined in section 9 of the Corporations Act that French J was considering. That case, (No. 6), was also an interlocutory matter that did not permanently settle rights of the parties.

In any event, if the contingent interest that French J has identified passed to the trustee in bankruptcy – what is the true practical effect. The right as a beneficiary is to be considered and no more. That is not an attractive outcome for a trustee in bankruptcy.

The more practical aspect is that a trustee in bankruptcy personally takes on the risk of litigation. If he or she fails then there is a personal loss. This is a significant deterrent to pursuing cases which have a significant risk of failure.

It is recognized that a trustee in bankruptcy may have access to litigation funding. However, a litigation funder would take a very considered view of the implications of *Richstar* (after having first identified significant assets which might be accessed).

In the writer's view the decision is not one which will cause the trust edifice to crumble. However, it may in truly risky environments be wise take French J's structuring message into account. Actions which might be taken are:

- the risk exposed person might be excluded as a direct object of the trust. An indirect benefit might be obtained through another discretionary trust brought into the objects clause through the spouse or children;
- the risk exposed person might be one only of a number of directors of the corporate trustee and the decisions need genuinely to be made jointly;
- the risk exposed person would not be the Appointor or, if an Appointor, is one of a number of such persons and does not have a casting vote. An Appointor stripping clause may also be appropriate.

Careful attention to the trust deed may avoid the implications of the decision in *Richstar.*

2 Cloning and splitting of trusts – the state of play

Trust '**cloning**' or '**replication**'[42] and trust '**splitting**' are currently very popular mechanisms for family succession planning. Ostensibly they are quite straightforward. However, there are significant tax and trust law traps for the unwary.

For the purposes of this paper:

[41] 'The Bankrupt, His or Her Spouse and the Family Trust: A consideration of Part VI Division 4A of the Bankruptcy Act.'

[42] The term '**cloning**' will be used in this paper.

- '**splitting**' means maintaining the one trust relationship but appointing separate trustees for different assets of that one trust. The trust obligations are undertaken according to the trust relationship spelled out in the trust deed establishing the trust;

- '**cloning**' involves the establishment of a new trust relationship in respect of assets held by the trustee. That trust relationship may come about by settling the asset on the new trustee or bringing into existence a new trust relationship and transferring the asset to the trustee of that new trust relationship.

Although trust cloning has been a popular mechanism for the purposes of succession planning in the context of discretionary trusts given the (perceived) availability of exemptions from capital gains tax (more particularly, exemptions from CGT events E1 and E2), Press Release No. 092 of the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs (dated 31 October 2008) announced the abolition of the possible exemption.

However, it should be noted that the *Tax Laws Amendment (2009 Measures No. 6) Bill 2009* (Cth) ('**the TLAB6**') which was introduced to the House of Representatives on 25 November 2009, was passed by the Senate on 11 March 2010 and received royal asset on 24 March 2010. The TLAB6 amends the 1997 Act by removing the capital gains tax trust cloning exception and providing a limited CGT roll-over where assets are transferred between fixed trusts (i.e. unit trust) that have the same beneficiaries with the same entitlements and no material discretionary elements. The roll-over has effect on or after 1 November 2008.

It is therefore expected that splitting will probably be the preferred method of ensuring the effective passing of control of trusts between generations.

2.1 Why split or clone?

During the latter part of the 20th century and early 21st century the use of trusts and, in particular, family discretionary trusts, has proliferated. Tax laws have to an extent driven small to medium business operators away from using corporate vehicles as such.[43] However, very often the second or third generations are left with trust structures that do not provide appropriate family succession outcomes.

Some of the things that lead to this conclusion are:

- the family members may be incapable of making joint decisions;

- family members may vary greatly in business acumen, intellect, risk adversity and time opportunities;

- second and third marriages can lead to imperfectly blended families;

[43] The overwhelming factor in selecting a discretionary trust (or unit trust) structure rather than a corporate structure is the availability of the 50% CGT discount where the business assets are sold rather than the ownership interests in the entity. A capital gain made by a company in its own right is not a discount capital gain: section 115-10 1997 Act.

- family members will often have different financial needs eg. accumulation vs. present consumption;
- it may be desirable to separate assets to more fully protect some of them from potential creditors' claims.

The splitting and cloning approaches are generally played out in the context of the one family relationship. Overwhelmingly discretionary trusts are established for the one family, the members of which may wish to go their separate ways (for the reasons discussed above). On rare occasions a discretionary trust is established for separate family groups (it is ill advised to do so) and splitting or cloning may have application. However, if family trust elections have been made (or interposed entity elections are required to be made) the transactions become problematical. The writers' experiences have been that splitting and cloning of discretionary trusts is inevitably about single-family relationships but often with the added complexity of children from multiple marriages who owe allegiances to different parts of the family.

Unit trusts are commonly used for business (or investment) joint ventures by unrelated family groups. Cloning or splitting unit trusts have their own unique issues in this context and these are addressed briefly below.

Cloning and splitting hybrid style trusts also have their own unique problems. Often such hybrid trusts will involve members of completely different families. These issues are also considered but briefly in this paper.

2.2 Splitting – The Drivers

Splitting in the way described above rather than cloning is very often driven by stamp duty outcomes. It delivers imperfect separation of control and financial exposure for family members. Why stamp duty? The stamp duties legislation in all jurisdictions will exempt (or impose nominal duty only) on the replacement of a trustee, addition of a trustee or retirement of a trustee.

In the Australian Capital Territory, subsection 54(2) of the *Duties Act* 1999 (ACT) provides:

> '(2) Duty of $20 is chargeable in respect of a transfer of dutiable property to a person as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Commissioner is satisfied that, as the case may be –
>
> (a) except for a responsible entity of a managed investment scheme—none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust; and
>
> (b) except for a responsible entity of a managed investment scheme—none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust; and
>
> (c) except if a responsible entity of a managed investment scheme acquires a beneficial interest in the managed investment scheme solely as a consequence of its appointment as the responsible entity—the transfer is not part of a scheme for conferring an interest, in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person; and
>
> (d) the transfer is not made in connection with a tax avoidance scheme;

> and, if the Commissioner is not so satisfied, the transfer is chargeable with the same duty as a transfer to a beneficiary under and in conformity with the trusts subject to which the property is held.'

In New South Wales subsection 54(3) of the *Duties Act* 1997 (NSW) provides:

> 'Duty of $50 is chargeable in respect of a transfer of dutiable property to a person other than a special trustee as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Chief Commissioner is satisfied that, as the case may be:
>
> (a) none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust; and
>
> (b) none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust; and
>
> (c) the transfer is not a part of a scheme for conferring an interest in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person.
>
> If the Chief Commissioner is not so satisfied, the transfer is chargeable with the same duty as a transfer to a beneficiary under and in conformity with the trusts subject to which the property is held, unless subsection 3A applies.'[44]

Subsection 33(3) of the *Duties Act* 2000 (Vic) provides that:

> 'No duty is chargeable under this Chapter in respect of a transfer of dutiable property to a person other than a special trustee if the Commissioner is satisfied that the transfer is made solely:
>
> (a) because of the retirement of a trustee or the appointment of a new trustee or other change in trustee; and
>
> (b) in order to vest the property in the trustee for the time being entitled to hold it.'

In Queensland section 117 of the *Duties Act* 2001 (Qld) provides the exemption:

> 'Transfer duty is not imposed on a dutiable transaction for the sole purpose of giving effect to a change of trustee if:
>
> (a) the transaction is not part of an arrangement:
>
> (i) involving a change in the rights or interest of a beneficiary of the trust; or
>
> (ii) terminating the trust; and
>
> (b) transfer duty has been paid on all trust requisitions for which transfer duty is imposed for the trust before the transaction.'

In Western Australia paragraph 119(3)(a) of the *Duties Act* 2008 (WA) provides the exemption:

> 'Nominal duty is chargeable on a transfer, or agreement for the transfer of dutiable property –
>
> (a) to a trustee as a consequence of the retirement of a trustee or the appointment of a new trustee if the transfer is not a scheme or arrangement, or part of a scheme or arrangement, for conferring an interest, in

[44] Subsection 54(3A) is not relevant in the circumstances.

> relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person; or …'

These provisions contemplate nominal or no duty if the transfer of dutiable property is to give effect to the retirement of a trustee or the appointment of a new trustee. Both provisions require there to be no conferring of an interest in the trust property on the new trustee or any other person to the detriment of the beneficial interest or potential beneficial interest of any other person.

In Victoria the legislation is interpreted in a slightly different way in that under subsection 33(3) of the *Duties Act* 2000 (Vic) the Commissioner must be satisfied that the transfer is made solely because of the appointment of a new trustee and in order to vest the property in the trustee.[45] In Revenue Ruling DA030 the State Revenue Office suggests that the Commissioner will not be satisfied if the transfer forms part of a transaction or series of transactions that have a separate commercial objective whether or not the transaction has the effect of avoiding the payment of duty. It is not clear what is meant by 'a separate commercial objective'. A splitting of a family trust arrangement has no commercial objective. It is a family arrangement.

All of the stamp duty legislation in other Australian jurisdictions have provisions that exclude transfers to effect a mere change of trustee.[46] Most of them have similar anti-avoidance aspects.

In a land rich context Australian Capital Territory,[47] New South Wales,[48] Victoria[49] and Queensland[50] exempt changes of trustees.

From a stamp duty perspective extreme care needs to be taken that the express words of the exemption are complied with. There is a view about that it is necessary to appoint a co-trustee in respect of all of the assets of the trust and then have the original trustee resign (and presumably the new trustee resign in respect of those assets to be exclusively held by the old trustee) from their position in relation to those assets which are to be under the exclusive control of the new trustee. This is a reaction to the perceived disjunction between retirement of a trustee and appointment of a new trustee. This may be an over-reaction.

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[45] a '*new trustee*' is '*a trustee appointed in substitution for a trustee or trustees or a trustee appointed in addition to a trustee or trustees*': subsection 33(1) *Duties Act 2000* (Vic).

[46] NT — Item 6 in Schedule 2 *Stamp Duty Act*

TAS — section 37 *Duties Act* 2001 (Tas)

[47] Section 91 imposes a nominal duty to interests that are subject to landholder duty under Part 3.2 of the *Duties Act 1999* (ACT) that is acquired under section 54 (change in trustee).

[48] Land rich duty under Chapter 4 of the *Duties Act* 1997 (NSW) will not apply if the provisions of section 54 would have imposed nominal duty of $50 only: subsection 163A(f).

[49] Subsection 85(1) *Duties Act* 2000 (Vic) exempts the acquisition of an interest in a land rich entity if the transaction, had it taken place in relation to the underlying land, would have been exempt.

[50] Section 191 of the *Duties Act* 2001 (Qld) excludes land rich duty if the relevant acquisition is for the sole purpose of giving effect to a change of trustee, if the acquisition is not part of an arrangement involving a change in the rights or interests of a beneficiary of the trust or terminating the trust, the acquisition is not part of an arrangement to avoid the imposition of duty and transfer duty has been paid on all trust acquisitions for which transfer duty is imposed for the trust before the acquisition.

The requirement that the arrangements do not confer a benefit in relation to the trust property on the new trustee or any other person must be at least considered in the light of the decision of the High Court in *CPT Custodian.*[51] The High Court has made it plain that the trustee has an equitable interest in the trust property and the beneficiaries' interest is subject to the priority of that interest. When a new trustee is appointed that trustee obtains a right to be indemnified – '*the right of the trustee under the general law to reimbursement or exoneration for the discharge of liabilities incurred in the administration of the trust*'.[52]

If, as is commonplace, the old trustee assigns its right to be indemnified out of the trust assets the new trustee will obtain a benefit in relation to the trust property. However, the potential for that benefit to eliminate the exemption is itself excluded by the requirement that there be a detriment in relation to the beneficial interest of some other person. No beneficial interest, save that of the retiring trustee, is altered detrimentally by the acquisition by the new trustee of a claim in respect of the trust assets. The retiring trustee does not suffer a detriment because the claims against it must be reduced as a result of its retirement (or it has a right to be indemnified by the continuing trustee).

Ordinarily this should not pose a problem but, again, great care needs to be taken with respect to the precise requirements of the relevant provision.

2.3 Splitting – Is there a Resettlement?

This subject can be described in this way — can a transfer of assets to another trustee, but subject to the precise terms of the trust instrument, bring into existence a different trust relationship? The argument that this is a new trust derives out of the rationale that a trust is a personal relationship in regard to property subject of the trust instrument between the trustee, the settlor and the beneficiaries. It follows in this argument that, if there is a new trustee, there must be a new trust relationship. This approach emphasises the relationship between the parties as the hallmark of a trust. The alternative view is that the true character of a trust relationship is to be found in the nature of the beneficial entitlements and the identity of the trustee is irrelevant. The writers prefer this latter approach – an appointment of a new trustee in respect of particular assets of the trust but adhering to the terms and conditions is not a new trust relationship but a continuation of the old relationship. Whether or not there is a resettlement turns on the question whether there is an alteration to the substratum of the trust sufficient to constitute it a new trust relationship. The observations of Megarry J in *Re Ball's Settlement*[53] are telling in this regard:

> 'If an arrangement changes the whole substratum of the trust then it may well be that it cannot be regarded merely as varying that trust. But if an arrangement, while leaving the substratum, effects the purpose of the original trust by other means, it may still be possible to regard that arrangement as merely varying the original trusts, even though the means employed are wholly different and even though the form is completely changed.'

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[51] *CPT Custodian Pty Ltd v. Commissioner of State Revenue (Vic)* [2005] HCA 53.

[52] [2005] HCA 53 at p.20.

[53] (1968) WLR 899 at 905.

The question is whether the changes, which have been made, constitute 'a new charter of future rights and obligations' as observed by the High Court in *Davidson v. Chimside.*[54]

In *Roome v. Edwards (Inspector of Taxes)*[55] it was said:

> 'There are a number of obvious indicia which may help to show whether a settlement, or a settlement separate from another settlement exists. One might expect to find separate and defined property, separate trusts and separate trustees. One might also expect to find a separate disposition bring the separate settlement into existence. These indicia may be helpful, but they are not decisive.'

The fact that a trustee newly appointed to the trust property declares that it holds the property subject to the terms of the original trust should not in the usual case be a resettlement ie. in Lord Wilberforce's words 'a settlement separate from another settlement'. This was the outcome in *Farrar's Case*[56] where a declaration was found to be a mere acknowledgment of a pre-existing trust in a New South Wales stamp duty context.

In many jurisdictions the particular provision in the *Trustee Act* allowing appointment of separate trustees prima facie contemplates that the trust property will be held on separate and distinct trusts.

In the Australian Capital Territory subsections 6(1), 6(5), 6(6) and 6(9) *Trustee Act* 1925 (ACT) provide:

'(1) A new trustee may by registered deed be appointed in place of a trustee, either original or substituted, and whether appointed by the Supreme Court or otherwise.

…

(5) The appointment may be made for the whole or any part of the trust property.

(6) The following provisions apply to appointments under subsection (1):

(a) 2 or more trustees may be appointed concurrently;

(b) the number of trustees may be increased up to 4;

(c) a separate set of up to 4 trustees may be appointed for any distinct part of the trust property held on trusts that are distinct from those relating to any other part of the trust property even if a new trustee is not to be appointed for the other part;

(d) any existing trustee may be appointed or remain one of the separate set of trustees;

(e) if only 1 trustee was originally appointed – a separate trustee may be appointed for the distinct part;

(f) it is not necessary to appoint more than 1 new trustee if only 1 trustee was originally appointed or to fill up the original number of trustees if more than 2 trustees were originally appointed.

…

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[54] [1908] HCA 65.

[55] [1982] AC 279 at 292-293 per Lord Wilberforce.

[56] *Farrar v. Commissioner of Stamp Duties* (NSW) (1975) 5 ATR 364.

(9) Every new trustee appointed under this section, as well before as after all the trust property becomes by law or by conveyance or otherwise vested in him or her, shall have the same powers and discretions, and may in all respects act as if he or she had been originally appointed a trustee by the trust instrument.'

In New South Wales subsections 6(1), 6(5) and 6(8) *Trustee Act* 1925 (NSW) provide:

'(1) A new trustee may by registered deed be appointed in place of a trustee, either original or substituted and whether appointed by the Court or otherwise.

…

(5) The appointment may be made for the whole or any part of the trust property, and on the appointment:

(a) two or more trustees may be appointed concurrently;

(b) the number of trustees may be increased, but not beyond four;

(c) a separate set of trustees may be appointed for any distinct part of the trust property, that is to say, for any part for the time being held on trusts distinct from those relating to any other part or parts, notwithstanding that no new trustees or trustee are or is to be appointed for other parts, provided that the number of trustees in any separate set shall not exceed four;

(d) any existing trustee may be appointed or remain one of the separate set of trustees.

…

(8) Every new trustee appointed under this section as well before as after all the trust property becomes by law or by conveyance or otherwise vested in the new trustee, shall have the same powers, authorities and discretions, and may in all respects act as if the new trustee had been originally appointed a trustee by the instrument, if any, creating the trust.'

Subsection 12(2) *Trusts Act* 1973 (QLD) provides:

'On the appointment of a trustee or trustees for the whole or any part of the trust property:

…

(b) a separate set of trustees may be appointed for any part of the trust property held on trusts distinct from those relating to any other part and whether or not new trustees are or are to be appointed for any other part of the trust property; and any existing trustee may be appointed or remain 1 of the separate set of trustees or if only 1 trustee were originally appointed then 1 separate trustee may be so appointed for the part of the trust first in this paragraph mentioned.'

Section 42 of the *Trustee Act 1958* (Vic) provides:

'On the appointment of a trustee for the whole or any part of trust property:

(a) the number of trustees may, subject to the restrictions imposed by this Act on the number of trustees, be increased; and

(b) a separate set of trustees, not exceeding four, may be appointed for any part of the trust property held on trusts distinct from those relating to any other part or parts of the trust property, notwithstanding that no new trustees or trustee are or is to be appointed for other parts of the trust property, and any existing trustee may be appointed or remain one of such separate set of trustees, or, if only one trustee was originally appointed, then, save as hereinafter provided, one separate trustee may be so appointed.'

The references to '*trusts distinct from those relating to any other part*' (Qld) and '*held on trust distinct from those relating to any other part*' (ACT, NSW and Victoria) raise concerns about whether the trust deed has to specifically provide for separate and distinct trusts before there can be separate trustees appointed in respect of separate trust assets. In the writers' view this appears to be an unjustifiable conclusion. It may be that the provisions simply require the particular trust property to be discernibly held subject to the terms of the trust. However as a surfeit of caution if a split is to be pursued the necessary provisions should be set out in the trust deed.

Subsection 6(15) of the *Trustee Act* 1925 (ACT) provides:

> 'This section applies to a trust except so far as the contrary intention appears in the trust instrument.'

Subsection 6(13) of the *Trustee Act* 1925 (NSW) provides:

> 'Except as otherwise provided in subsection (12), this section applies only if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have effect subject to the terms of that instrument and to the provisions therein contained.'

There is no specific exclusion in Victoria and Queensland. Those in pursuit of an effective split will want to make sure that the trust deed specifically allows a separate trustee to be appointed in respect of specific assets held subject to the trusts.[57]

2.4 Varying the Deed to Allow Separate Trustees

Can the power of amendment be used to allow for appointment of separate trustees where no such power existed or does the amendment amount to a resettlement. Common sense suggests, no (unless there is something in the deed which provides that a single trustee was an absolute requirement or that separation of assets and trustees was prohibited by the deed). Based on the views of Brightman J in *Hart v. Briscoe,*[58] Lord Wilberforce in *Roome v. Edwards*[59] and Mahoney J in *Kearns v. Hill*[60] the use of a power of amendment set out in the trust deed (and without any relevant imbedded limitations being breached) to allow the appointment of separate trustees to the trust assets is unlikely to be a resettlement so that a new trust estate comes into existence.

As David Raphael has observed[61]:

> 'Despite Kearns v. Hill and Re Lancedale Holdings case there is a body of law to the effect that a power of amendment is not likely to be held to extend to vary the trust in a way which would destroy its substratum: see Re Dwyer (1935) VLR 273; Re Ball's Settlement Trusts (1968) 1 WLR 899 at 904. The underlying purpose for the furtherance of which the power was initially created or conferred will be paramount: see Duke of Bedford v. Marquess of Abercom (1836) 11 My and Ca 312.

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[57] The legislation in Northern Territory and Western Australia is similar. It should be noted that in all States and Territories except NT, SA and TAS the number of trustees for a private unit trust is limited to four.

[58] [1978] 1 All ER 791.

[59] [1982] AC 279.

[60] (1990) 21 NSWLR 107.

[61] D Raphael: '*Variation & Resettlement of Trusts*' paper presented at a seminar conducted by the Taxation Institute of Australia: NSW Division on 7 April 2004 particularly at paras. 26 and 27.

> However, this general principle is unlikely to be an appropriate consideration where the evident purpose of the power is to ensure maximum flexibility such as would be the case in most modern superannuation funds or discretionary trusts or unit trusts. Indeed the converse is the case. Nonetheless, as I have said in relation to the Tax Acts, it is more likely than not that Re Ball's Settlement will be followed.'

2.5 Appointment of Separate Appointor

It is suggested immediately above that the segregation of assets to be held by separate trustees is unlikely to be a resettlement. What if the trust deed has an office of appointor and the deed is amended to provide for different appointors in respect of the different trustees. Would such an amendment be a resettlement?

The power of appointor is a fiduciary power, which must be exercised in the interests of the beneficiaries.[62] It gives the appointor no interest in the trust property.

An appointor has, simply by holding that office and wielding the power attached, no interest in the property of the trust.[63] This is notwithstanding that a Court might conclude for special purposes that the appointor is the '*owner*' of property of the trust.[64]

Provided the trust deed allows sufficient flexibility or it can be introduced by amendment the introduction of an appointor with powers restricted to appointing the trustee of say Parcel 2 assets while the limitation of the power of the original appointor to the appointment of the trustee to Parcel 1 assets appears to the writer to be an administrative matter not going to the substratum of the trust. It should not, either by using powers that already exist in the deed or by amending the deed, effect a resettlement of the trust property.[65] The principles are the same as discussed above.

David Raphael also points out that many trust deeds will not empower the trustee to amend the deed so as to affect the appointor's power or to allow further appointors to be engaged. This is because many trust deeds provide the trustee with the power to amend the trusts but not the powers granted by the deed.

2.6 Splitting and Family Trust Elections

The relationship between the two trustees and the trust assets remains the one trust estate. If the trustee of the trust has made a family trust election pursuant to section 272-80 in Schedule 2F to the 1936 Act that should continue to be effective notwithstanding the fact that an additional trustee has been appointed. The ramifications of having made a family trust election (or interposed entity election) flow from actions taken by the trustee of the trust from time to

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[62] *Re Wiley v. Burton* [1994] FCA 1146 and *Gilbert v. Stanton* [1905] HCA 1.

[63] See *Edwards v. Klaville Pty Ltd* [1996] FCA 411.

[64] As in the case of Section 1323 of the Corporations Act and ASIC: *In the Matter of Richstar Enterprises Pty Ltd ACN 099 071 968 (No. 9) v. Carey* [2006] FCA 1242.

[65] Though it is relevant to note the Commissioner of Taxation's view, expressed in his Statement of Principles (2001), that a change of Appointor is relevant to determine whether there is a new trust. The writers, and many others, disagree with this view.

time notwithstanding the fact that the trustee is not the same person as the trustee that made the election.[66]

2.7 The CGT Events

When the original trustee disposes of a CGT asset to the additional trustee there is a change in legal title i.e. a change of ownership for the purposes of subsection 104-10(2) of the 1997 Act. However, the change of ownership does not occur if it happens '*merely because of a change of trustee*'.

CGT event E1 will not happen if no trust is created by declaration or settlement.[67] All of the reasoning above has been to the effect that there will be no declaration of trust by merely appointing a new trustee or no resettlement. CGT event E2 is not relevant because there is no other existing trust to which the CGT assets are transferred.

CGT event E3 is not relevant. CGT event E4 could be relevant in the context of a unit trust or hybrid trust.

CGT event E5 operates on the basis of a beneficiary becoming absolutely entitled as against the trustee. In the splitting approach no beneficiary becomes absolutely entitled to a CGT asset of the trust.

CGT events E6, E7 and E8 are not relevant to a splitting.

Subject to there being no resettlement triggering a CGT event E1 there should be no relevant CGT event arising on a splitting.

2.8 Splitting – Tracing Assets

This is really an asset protection topic. What if the trustee in relation to Parcel 1 assets falls into financial difficulty (for example, experiences a call on its margin lending facility against its share portfolio). Is the trustee of Parcel 2 assets protected against the claims of the creditors of the original trustee?

If the creditors arose in respect of debts incurred by trustee 1 after the Parcel 2 assets were transferred to trustee 2 the answer appears to be reasonably clear. Unless there are special circumstances eg. misrepresentation or fraud, there is no right to recover. The trustee's right to indemnity from trust assets comes into existence when the liabilities are incurred. If trustee 1 incurs liabilities after the Parcel 2 assets have been transferred to trustee 2 the creditors have no right to be subrogated to claim against assets that trustee 1 no longer has legal title to nor had at the time the liability was incurred.

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[66] For example, a tax liability for family trust distributions tax arises when '*the trust confers a present entitlement to, or makes a distribution of income or capital of the trust*': subsection 27-15 1936 Act.

[67] Subsection 104-55(1) of the 1997 Act.

A trustee is only liable for its own acts and liabilities incurred. The Trustee Acts make this plain:[68]

- Subection 59(2) of the *Trustee Act* 1925 (ACT) provides:

  'A trustee shall be answerable and accountable only for his or her own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any bank, broker, or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through his or her own wilful neglect or default.'[69]

- Subsection 59(2) of the *Trustee Act* 1925 (NSW) provides:

  'A trustee shall be answerable and accountable only for the trustee's own acts, receipts, neglects, or defaults, and not for those of any other trustee, nor for any banker, broker, or other person with whom any trust moneys or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through the trustees own wilful neglect or default.'[70]

- Subsection 36(1) of the *Trustee Act* 1958 (Vic) provides:

  'A trustee shall be chargeable only for money and securities actually received by him notwithstanding his signing any receipt for the sake of conformity, and shall be answerable and accountable only for his own acts, receipts, neglects or defaults, and not for those of any other trustee, nor for any banker, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss unless the same happens through his own wilful default.'

- Section 71 of the *Trusts Act* 1973 (Qld) provides:

  'A trustee shall be chargeable only for money and securities actually received by the trustee, notwithstanding the trustee signing any receipt for the sake of conformity; and shall be answerable and accountable only for the trustee's own acts, receipts, neglects or defaults, and not for those of any other trustee, nor those of any financial institution, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the insufficiency, deficiency or loss occurs through the trustee's own default.'

As Dr John Glover has put it:[71]

> 'If the trust deed so provides, the powers of multiple trustees can be exercised without the concurrence of all or a majority of their number, or alternatively can be exercised by co-trustees acting unilaterally. Not infrequently one out of a body of co- trustees is given the sole responsibility for conducting a business and is made the sole signatory who can enter agreements on the business's behalf. Co-trustees, ordinarily, are not liable for the exercise of powers by other trustees to whom those powers have been exclusively allocated'

[68] See also: NT – section 26 *Trustee Act* (NT); SA – section 35 *Trustee Act 1958* (SA); TAS – section 27 *Trustee Act 1898* (Tas); WA – section 70 *Trustee Act 1962* (WA).

[69] This provision is expressly subject to the term of the trust deed: subsection 59(3) *Trustee Act 1925* (ACT).

[70] This provision is expressly subject to the term of the trust deed: subsection 59(3) *Trustee Act 1925* (NSW).

[71] Dr John Glover: '*Dissecting Trusts and Trusteeships: Capital Gains and State Taxation Consequences*': paper presented to Taxation Institute of Australia's 7th Annual States Taxation Conference (July 2007) at p.4 and also '*Dissecting Trusts and Trusteeship: CGT and Stamp Duty Consequences*' Vol. 36 No. 4 ATR (Nov 2007) p.201 at 203-204.

A trustee has an equitable lien over the assets of the trust as they existed at the time the trustee incurred liabilities on behalf of the trust. That lien continues notwithstanding the fact that the person is no longer the trustee but has been replaced. In *Coates v. McInerney*[72] it was argued that the right of indemnity was lost when the trustee was removed from office. Anderson J observed:

> 'It is said that under this clause only the trustee actually in office is indemnified. However, I must disagree. Any right of indemnity would arise upon the liability arising and the question is whether that right of indemnity, arising at that time, that is to say, during the holding of the office by the trustee who held office at the time that the liability was incurred, is then lost by subsequent loss of office.
>
> There is abundant authority that it is not so lost. I do not need to refer to all of the authorities. It is, I think, sufficient to refer to Kemtron v. Commissioner of Stamp Duties (1984) 15 ACR 627 at 634. The question is whether there is anything in clause 12 which would affect the general equitable doctrine that loss of office does not terminate the right of indemnity. In my view there is nothing in clause 12 which would modify the general equitable doctrine'.[73]

In *Rothmore Farms* Mansfield J, when confronted with the same issue, found that the trust assets secured the indemnity as they existed from time to time. Mansfield J appears to have allowed equitable tracing into the hands of those in whom the assets were ultimately vested.[74] Equitable tracing is a difficult topic and beyond the scope of this paper.

The reference in the decision of Anderson J in *Coates v. McInerney* to clause 12 of the deed raises issues about whether the trust deed can by its terms oust the right to indemnity. In South Australia the indemnity cannot be excluded.[75] In New South Wales the better view is that it cannot be excluded.[76] In Victoria the right to be indemnified can be excluded by the terms of the trust deed.[77] This is why it may be possible according to the terms of the trust deed to limit the right of the trustee to follow assets over which the trustee might otherwise have a lien.[78]

Notwithstanding whether or not a trustee may have a lien, the assets which trustee 1 held at the time the liability was incurred and then transferred to trustee 2 may be recoverable by the creditors of trustee 1 for a number of reasons:

- the creditors held security directly over those assets and the transfer was a breach of that security;

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72 (1992) 6 ACSR 748.

73 at p.749-750 of 6 ACSR 748. See also *Rothmore Farms Pty Ltd v. Belgravia Pty Ltd* [1999] FCA 745*; Moyes* v. *J&L Developments Pty Ltd (No. 2)* [2007] SASC 261 and *Collie v. Merlaw Nominees Pty Ltd* [2001] VSC.

74 [1999] FCA 745 at paras. 182 and 184.

75 *Moyes v. J&L Developments Pty Ltd (No. 2)* [2007] SASC 261 at paras. 37 to 48 per Debelle J.

76 *JA Pty Ltd v. Jonco Holdings Pty Ltd* (2000) 33 ACSR 691 at paras. 50 and 67 per Santow J. See also *Jacobs' Law of Trusts in Australia* (7th Ed) at p.2106.

77 *RWG Management Ltd v. Commissioner for Corporate Affairs* [1985] VR 385 at 394-5.

78 *Tindon Pty Ltd v. Adams and Window Concepts Pty Ltd* [2006] VSC 172.

- trustee 2 knew that the Parcel 2 assets were depended upon by creditors for the advance of funds and was equitably bound to disgorge them when the claim was made against trustee 1;
- trustee 2 undertook to indemnify trustee 1 when the Parcel 2 assets were transferred;
- trustee 1 is an individual and the provisions of section 120 and 121 of the Bankruptcy Act could apply to allow the trustee in bankruptcy of trustee 1 to recover assets transferred for less than market value consideration[79] or where trustee 1 transferred the assets for the main purpose of avoiding the assets becoming available to meet creditors' claims;
- in the case of a corporate trustee the Corporations Act becomes relevant. Section 588FC, in relation to insolvent transactions (the company being insolvent at the time of the transaction), subsection 588FE(4) in relation to uncommercial transactions and subsection 588FE(5) in relation to avoiding creditors are the most relevant.

A liquidator of trustee 1 (a corporate trustee) may be successful in clawing back property transferred to trustee 2.

The position of a corporate trustee in relation to an undervalue transaction differs from that of an individual acting as a trustee because the '**uncommercial transaction**'[80] must have been entered into when the company was insolvent or was a transaction which caused it to become insolvent. By contrast an individual acting as a trustee is exposed for up to 4 years regardless of their state of solvency where the transfer is to an associate.[81]

In relation to transactions intended to defeat creditors an individual is exposed forever.[82] By contrast a company is exposed only for 10 years.[83]

Trustee 2 may have a defence to the claim of the liquidator if it can show:

- it became a party to the transaction in good faith;
- there was no objective grounds for suspecting that trustee 1 was insolvent or about to become insolvent; and
- trustee 2 provided valuable consideration or changed its position in reliance on the transaction.[84]

[79] Subsection 120 will allow the trustee in bankruptcy to recover back an asset transferred by way of a undervalue transaction to a related entity for a period of up to four years from the date on which the bankruptcy commenced.

[80] An '*uncommercial transaction*' is one that it might be expected a reasonable person in the company's circumstances would not have entered into having regard to the matters set out in subsection 588FB(1) of the *Corporations Act*.

[81] It is only beyond 4 years to 5 years that insolvency becomes an issue extending the clawback period.

[82] See Trustees of the Property of John Daniel *Cummins v. Cummins* [2006] HCA 6.

[83] Subsection 588FE(5) *Corporations Act*.

As the controlling mind of trustee 2 is likely to be that of trustee 1 or they will be closely associated it is unlikely that this defence can be made out. It is possible that the third point could be satisfied if trustee 2 undertook the liabilities of trustee 1 associated with Parcel 2 assets. However, this may not be sufficient if the effect of the transfer is to make trustee 1 insolvent in any event.

The potential impact of section 197 of the Corporations Act needs to be considered. This provision imposes joint and several liability on Directors in respect of liabilities incurred by a corporate trustee when the trustee is not entitled to be fully indemnified out of trust assets because of:

- a breach of trust by the company;
- the company acting outside the scope of its powers as trustee;
- a term of the trust denying or limiting, the company's right to be indemnified against the liability.

In the case of a split of a trust none of these things is likely to occur. In transferring assets to the new trustee, trustee 1 will be acting within the terms of the trust deed (perhaps as amended). Nothing in the terms of the trust deed need limit the recourse of trustee 1 to the assets of the trust. However, if there is an explicit provision in the deed that does limit the right to be indemnified to those assets and there is no recourse to the assets held by trustee 2 there might be potential application of section 197. Arguably, however, the right to indemnity is limited as a matter of the general law to the assets actually held by trustee 1. If this is the case then it is the fact of transfer of the assets that has limited the recourse and not the terms of the trust deed.

2.9 Trustee's Duties

All trustees are subject to duties. In the case of a trustee of a discretionary trust some of those duties are to:

- consider the exercise of discretion from time to time or as required by the trust deed;[85]
- not act arbitrarily or in capricious disregard of the trustees' power;
- not to delegate the decision making but exercise it personally; and
- not act dishonestly or to commit a fraud on its power.

It is not possible to conceive of a transfer of assets from trustee 1 to trustee 2 pursuant to the terms of the trust deed in itself as in any way in breach of the trustee's duties bearing in mind that it is the one trust relationship.

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[84] Subsection 588FG(1) *Corporations Act*.

[85] I J Hardingham & R. Baxt 'Discretionary Trusts': (1st Ed) Butterworths (1975) pp.92-114.

In any event beneficiaries of discretionary trusts have great difficulty in establishing standing to take action against trustees.[86]

2.10 The Tax Return

One of the minor irritants of trust splitting is the need to have the trustees lodge an income tax return and BAS. The question also arises as to whether or not the trustees need separately to be registered for GST (if that is relevant in the circumstances).

Subsection 161(1) of the 1936 Act requires every '*person'* to lodge a return of income when required to do so by the Commissioner. A '*person'* is defined to include '*a person in the capacity of trustee of a trust estate*'. This appears to require/allow each trustee to lodge a return of income in respect of the income derived from assets it holds in relation to the trust.

Notwithstanding this possibility nothing will happen without a tax file number. Can each of the trustees acquire its own individual tax file number?

Section 202B of the 1936 Act provides that a '*person'* may apply to the Commissioner for issue of a tax file number. Based on the definition of '*person'* each trustee appears to be entitled to apply. If the Commissioner is satisfied that the person's identity has been established the Commissioner '*shall issue*' a tax file number to the applicant subject only to:

- the Commissioner being satisfied that the person already has a tax file number;
- there not being an interim notice.[87]

It would appear that it is mandatory for the Commissioner to issue a tax file number if satisfied as to the applicant's identity. The exceptions should not apply. The legislation would appear to allow the separate trustee to obtain its own tax file number in respect of its role as trustee of the trust.

Are the trustees required to be separately registered for GST? An '*entity*' includes a '*trust*'.[88] The trustee of a trust is taken to be an entity consisting of the person who is the trustee, or the persons who are the trustees, at any given time.[89] An entity carrying on an enterprise that meets the registration turnover is required to be registered.[90]

It would appear that the split trustees cannot be split for GST purposes. This would appear to be in contrast to the position for income tax. It poses a considerable difficulty for complying with the lodgement requirements in respect of BAS. From a practical perspective the Commissioner is likely not to complain if the trustees individually register.

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[86] See generally: K. Schurgott: '*Some Trust Oddities*', paper delivered to the Taxation Institute of Australia's 20th National Convention (March 2004 Perth) pp.29-37 and also C. Call: '*Trusts in the Court*' paper delivered to the Taxation Institute of Australia's (NSW Division) Trust Intensive (November 2005) pp.50-62.

[87] Section 202BA 1936 Act.

[88] Paragraph 184-1(1)(g) GST Act.

[89] Subsection 184-1(2) GST Act.

[90] Section23-5 GST Act.

2.11 Trust cloning legislation

On 24 March 2010 the TLAB6 received royal assent to give effect to the abolition of the trust cloning exceptions in CGT events E1 and E2 in the 1997 Act. The TLAB6 also contains the new fixed trust rollover rules. The changes contained in the TLAB6 will apply to CGT events happening on or after 1 November 2008.

The new fixed trust rollover may apply if assets are transferred from the trustee of a trust (***the transferring trust***) to another trust (***the receiving trust***) where certain conditions are satisfied and both the trustees of the transferring trust and the receiving trust chose to obtain the rollover relief. Paragraph 1.10 of the explanatory memorandum accompanying the TLAB6 states that:

> *'Broadly, the effect of the roll-over is to defer the making of any capital gain or capital loss in respect of the asset transfer. The cost base of beneficiaries' interests in the transferring trust is apportioned across their interests in both trusts.'*

Eligibility for the rollover relief depends on the following:

- both trusts are eligible trusts for the rollover;
- the same beneficiaries have the same interests in both trusts; and
- no exception applies.

2.11.1 Eligible trusts for the rollover

For both the transferring trust and the receiving trust to be eligible trusts, beneficiaries' interests in each trust must satisfy a number of requirements. The requirements are:

- each beneficiary's membership interests in each of the trusts must be interests in, or rights relating to, the income and/or capital of the trust; and
- the nature and extent of each beneficiary's membership interests in each of the trusts must be capable of being worked out solely from t he constituent document of the trust (ie, the trust deed); and
- there must be no power for any entity (that is, including but not limited to the trustee) to:
  - o material alter a beneficiary's membership interest in the trust;
  - o issue or redeem membership interests in the trust at a discount of more than 10% of their market value; and
- CGT event E4 is capable of happening to all of the units and interests in each of the trusts at the transfer time; and
- the receiving trust must be a 'cleanskin' trust, being either:

  - A newly created trust; or
  - A trust with no CGT assets other than a small amount of cash or debt; and
- both the trustees of the transferring and the receiving trust choose to obtain the rollover.

2.11.2 Same beneficiaries with the same interests

For the transferring trust and the receiving trust to have the same beneficiaries with the same interests, just after the transfer time the trusts must:

- have the same beneficiaries; and
- the receiving trust must have the same classes of membership interests that the transferring trust had just before, and has just after, the transfer time; and
- the sum of the market value of each beneficiary's membership interests of a particular class in both trusts must be the same as the sum of the market value just before the transfer time of the beneficiary's membership interests of that class in the transferring trust (disregarding any small amounts of cash or debt held by the receiving trust just before the transfer time in the calculation).

2.11.3 Exceptions

The rollover relief is not available if any of the following exceptions applies:

- the receiving trust is a foreign trust and the rollover asset is not taxable Australian property just after the transfer time; or
- either the transferring trust or the receiving trust is a trust to which section 102K or 102S of the 1936 Act applies for the current year (that is, either trust is a corporate unit trust or a public trading trust); or
- both trusts must have the same tax choices or election in force if the absence of the mirror choice would or could have an ongoing impact on the calculation of an entity's net income or taxable income for the current year or a later income year. The choice must be in force just after the transfer time unless the trustee makes the mirror choice before the first time the choice matters for tax purposes, or it would not be reasonable to require the mirror choice to be made.

3 Recent development – Clark v. Commissioner of Taxation

In the recent Federal Court of Australia decision in *Clark v. Commissioner of Taxation [2009] FCA 1401*, Greenwood J considered whether the discharge of the trustee's right of indemnity would cause a resettlement of the trust:

Continuity in the Trustee's interest in the trust estate

119 The second break in continuity is said to arise out of the discharge of the trustee's right of indemnity on the footing that the discharge altered the trustee's interest in the trust estate. The trustee's right of indemnity constitutes a beneficial interest in the trust assets: *Octavo Investments Pty Ltd v Knight* (supra at [107] of these reasons). The right of indemnity continues notwithstanding the trustee's retirement from office and creditors of the trustee are entitled to be subrogated to the trustee's right of indemnity. The new trustee takes the trust property subject to the right of indemnity of its predecessor in office. The right of indemnity is consistent with the right of reimbursement conferred by s 59(4) of the *Trustees Act* 1925 (NSW) which applied to the CU Trust. The Commissioner says that the right of indemnity conferred as a matter of law is not capable of being excluded from the trust instrument: *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* [1984] 1 QdR 576 at p 585. The Commissioner contends that the waiver of the right of indemnity was not brought about by any authorised amendment of the Trust Deed. Two things are said to flow from this. Firstly, the waiver of the former trustee's right of indemnity brought about a material change in the rights and obligations attaching to the trust property which was inconsistent with the continuity of the trust estate for tax purposes. Secondly, the release of the former trustee's right of indemnity is properly understood as an agreement which gave rise to a new trust in the same terms as the CU Trust absent the term as to indemnity and thus a new trust was brought into existence for the purposes of the general law.

120 The deed by which the former trustee abandoned or waived a right conferred upon it by the Trust Deed and by operation of law was not an impermissible exclusion of a right of indemnity from the trust instrument nor was it an impermissible amendment to the Trust Deed. The deed by which the right of indemnity was extinguished provided for a waiver of a vested right in the former trustee. The trust instrument conferred a right of indemnity reflecting the position at law. Like many rights enjoyed by a party at law, the right was capable of waiver, abandonment or discharge whatever the source of the right may have been. The election on the part of the former trustee not to assert a right of indemnity conferred upon it and give substance to that election by covenanting by deed to waive the right of indemnity did not amount to a variation or amendment to the Trust Deed or the resettlement of the trust property upon a new trust in the same terms as the CU Trust Deed absent a right of indemnity. The incoming trustee assumed the office of trustee on the terms of the Trust Deed which included a right of indemnity out of the trust assets in respect of liabilities incurred in performing the powers, obligations and duties of trustee. The election to discharge the right of indemnity brought to an end the former trustee's beneficial interest in the trust assets comprising the trust fund. I am not satisfied that the extinguishment of the right of indemnity brought about a material change to the trust property inconsistent with the continuity of the trust estate having regard to the totality of the 1993 arrangements which imposed extinguishment as a condition of appointment of a new trustee and made provision for further contributions to the trust fund to enable the trust to undertake the proposed property development projects.

121 The extinguishment of the right of indemnity was an element of enabling further contributions to be made to the trust fund to enable it to continue to embark upon property development projects as it had historically done up to the moment in time when Mr Denoon, due to the downturn in the Australian property market, was unable to continue to undertake projects by reason of the accumulated losses and an inability to raise capital or debt.

The Commissioner appealed this decision to the Full Court of the Federal Court.[91] Edmonds and Gordon JJ (Dowsett J dissenting) dismissed the appeal and said:

87 We cannot accept the Commissioner's contention. When the High Court in *Commercial Nominees* spoke of trust property and membership as providing two of the indicia for the continued existence of the eligible entity or trust estate, the Court was not suggesting that there had to be a strict or even partial identity of property for the first and objects for the second. It was speaking more generally: that there had to be a continuum of property and membership, which could be identified at any time, even if different from time to

[91] *Commissioner of Taxation v Clark* [2011] FCAFC 5

> time; and without severance of one or both leading to the termination of the trust in question. In the present case, the Commissioner never contended, nor on the evidence could he, that there was a severance in the continuum of trust property and objects of the CU Trust. Their identity changed from time to time, but not their continuum.
>
> 88 Such an approach is consistent with the position at general law in relation to the four essential indicia of the existence of a trust: the trustee, trust property, the beneficiary and an equitable obligation annexed to the trust property: JD Heydon & MJ Leeming: *Jacobs' Law of Trusts in Australia* (2006) 7th ed, at [104] – [110]. In *Commercial Nominees* both the Full Court, at [49] of its reasons, and the High Court, at [35] of its reasons, pointed out that there was nothing in Pt IX, nor in the 1936 Act generally, which imposed some statutory requirement of continuity for determining when there is a sufficient identity of the trusts involved. With respect, the same applies in the case of Div 6 of Pt III of the 1936 Act.

On 18 February 2011 the Commissioner filed an application for special leave to the High Court against the Full Court's decision. As of publication the High Court has not set down a hearing date for the special leave application.

4 Present entitlements and estate considerations

In the NSW Supreme Court decision in *Wood v Inglis* [2009] NSWSC 601[92], Brereton J considered issues relating to a deceased beneficiary's present entitlements accruing in his loan account. In that case, Dr William Inglis, his wife and children were beneficiaries of a discretionary trust. Before he died, Dr Inglis, along with his wife and one of his children, were the directors of the corporate trustee of his discretionary trust. The trust funds were invested in shares and income was distributed to Dr Inglis and his families by crediting their beneficiary loan accounts, on which they drew for expenditure. The trust accounts were prepared whereby movements in the net value of the investments of the trust were treated on income account and distributed to the beneficiaries.

The issue in *Inglis's case* concerns whether the trustee may lawfully treat and have in fact treated the movement in the investment as income. If that was the case, the question then becomes whether the trustee has in fact made the disputed distributions to Dr Inglis and if so whether the trustee has discharged the obligation arising from the distributions made. The case arose because Dr Inglis left his residue estate, which includes the debt due to him from the Trust on his beneficiary loan account, solely to his wife in his will. Therefore if the distributions have been validly made, then the trust will need to pay the distributions (unless otherwise discharged) to his estate, to which his wife is the only beneficiary. On the other hand, if the distributions were not validly made, then any increase in value in the trust investments would remain in the trust, which Dr Inglis' children may benefit from.

Brereton J first considered the question of whether the trustee could, consistent with the trust deed, lawfully treat movements in the value of investments as income, and distribute it to beneficiaries. After considering the terms of the trust deed, Brereton J held that:

> '14 I do not accept that it cannot be said that a profit has been made (or "incurred", for the purposes of clause 10 of the Trust Deed), just because it has not been realised. Comparison of the value of the assets of an entity at the end of the relevant period with their value at the beginning of that period is one well-recognised means of ascertaining profit [Re Spanish Prospecting Co Limited [1911] 1 Ch 92, 98; QBE Insurance Group v ASIC (1992) 38 FCR 270, 284-5 [53] – [57]].

[92] Affirmed in *Clark v Inglis* [2010] NSWCA 144 per Allsop P (McColl and Macfarlan JJA agreeing)

...

16 That conclusion is only reinforced by clause 6(f). I do not accept that the reference in clause 6(f) to "property or moneys held by the Trustee", coupled with the definition of "property", means that the reach of the clause does not extend to "unrealised capital gains"; the purpose of the clause is plainly to avoid disputation as to whether receipts, profits and distributions received by the trust are capital or income by empowering the Trustee to make that determination. The effect of treating "unrealised capital gains" as income is that so much of the value of a share (which is expressly within the definition of "property") as reflects that gain is treated as income. As has already been observed, the proviso contained in clause 6(f) demonstrates that the Trustee may chose to treat as capital in the Trust accounts what is income for income tax purposes (although a specific declaration to that effect is required); likewise it may (and without any such specific declaration) chose to treat as income in the Trust accounts what is capital for income tax purposes. In that context, submissions that "unrealised capital gains" are not income in the ordinary sense of the word are beside the point.

17 Accordingly, the Trustee was entitled to treat the movements in the net value of investments as income. Accounts prepared on that basis were nonetheless "proper accounts". Moreover, even if the "unrealised capital gains" were not income, they could be distributed as capital under clause 5(a), which gave the Trustee a discretion to apply capital in favour of any eligible beneficiary at any time before the Perpetuity Date.'

Brereton J then went on to held that the trustee did in fact determined to include the unrealised gains as income. His honour found that Dr Inglis was the controlling mind of the corporate trustee, and that he had implied actual authority to make decisions concerning the affairs of the trust. Therefore, the fact that Dr Inglis approved the trust accounts which adopted an accounting methodology which bring to account unrealised capital gains as income was indicative of the trustee determining to include the unrealised gains as income:

'66 Even though Mr Tierney's initial adoption of the "market value" methodology derived from a misapprehension, nonetheless the Company, as trustee of the Trust, by its agent Dr Inglis who had implied actual authority in respect of all affairs of the Trust, accepted the accounts so prepared by Mr Tierney for the purpose of clause 10 of the Trust Deed, and thereby validly determined to treat the increase in market value of investments as income for each of the financial years 1998/9 to 2005/6.'

Along the same lines, Brereton J also found that Dr Inglis acting on behalf of the corporate trustee has also validly and effectively made the distributions to his beneficiary loan account:

'67 There was a valid and effective irrevocable and absolute distribution of the whole of the income shown as such in the annual accounts for each year in question to Dr Inglis, to the extent that it was not validly distributed to William or Mrs Inglis, by default under clause 3(d) if not expressly under clause 3(a).'

In relation to whether the obligation of the trustee to pay Dr Inglis' deceased estate the amount outstanding in his beneficiary loan account, Brereton J held that the estate has never released the trustee from the debt on its loan account:

'44 Unilateral resolutions of the Trustee to change the amounts of liabilities recorded in its accounts cannot affect the rights of its creditors. Obligations owed to Dr Inglis in respect of his beneficiary loan account, could only be reversed with the concurrence of his estate. In that light, the essential question is whether the estate has released the debt owed in on Dr Inglis' loan account as at his death. Although much attention was given in the evidence and submissions to factual controversies surrounding the events which ensued after Dr Inglis' death, and the alleged conduct, motives and purposes of the protagonists, little turns on them.'

It is clear from *Inglis' case* that the issue of unpaid present entitlements must be taken into account in succession planning, as it will form part of the assets of the deceased estate and the executor of the estate will be entitled to call in on the trust to pay the unpaid present entitlements.

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