



CURRENT ISSUES IN PERSONAL ESTATE PLANNING

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Introduction

What is estate planning?

- This session is about personal estate planning
- Different issues arise for business succession planning
- Estate planning is :-
 - the art of structuring the ownership and control of property and other financial resources of an individual
 - to achieve the required control, asset benefits and asset protection and tax benefits

Now-during life

- to allow the person the direct or indirect use of those resources as they choose;
- to deal with those resources in a tax effective manner; and
- to protect those resources as far as practicable from others (ie creditors and ex-spouses and other domestic partners)

Later-after death

- to allow a tax effective transfer of the control or ownership of the resources; and
- to ensure the transfer of the control or ownership of the resources is to the chosen beneficiaries

Planning is the keyword!

Alice: Would you tell me, please, which way I ought to go from here?

The Cat: That depends a good deal on where you want to get to

Alice: I don't much care where.


The Cat: Then it doesn't much matter which way you go.

Alice: ...so long as I get somewhere.

The Cat: Oh, you're sure to do that, if only you walk long enough



Trust and tax issues are central

- Common for family wealth to be held in a family discretionary trust
- Growth in use of testamentary discretionary trusts
- So such trusts at the  of estate planning
- Also many superannuation issues both in life and death becoming more of a problem as balances grow. Super funds are trusts.

Trust law and tax issues

- Many trust issues concern:
 - The control of trust (property)
 - Identity of beneficiaries
 - Breach of trustee duties/beneficiary claims
- Taxation of trusts (or more accurately taxation of tax “receipts”)
 - major problems and uncertainties
 - getting worse not better

Current common problems

- Bad planning
 - Ignorance or negligent advice
 - Not planning at all
- Legal disputes with beneficiaries
- Validity of wills
 - informal wills
 - testamentary capacity
- Unhappy beneficiaries (especially of wills - inheritance claims, super)
- Conflict of interest and misuse of trustee powers/ensuring power of Attorney

To be discussed

- A little bit on tax (a few warnings mainly)
- Superannuation issues
- Family Discretionary Trust issues
 - including asset protection issues
 - Bankruptcy
 - Family law
- Wills and Testamentary Trust issues



Tax and trusts

Tax and trusts -generally

- Taxation of trusts –major problems and uncertainties
- Accountants often don't understand trust law
- Current review of taxation – delay (lack of Treasury resources!)
- Division 7A Part III ITAA 1936 where corporate beneficiary and unpaid distributions-some complex tracing and surprise tax hits!
- New HORRIFIC streaming laws for capital gains and franked dividends-new concepts, very complex in many cases

Tax issues in estate planning

- See later for some current tax issues for
 - Super
 - Deceased estates
 - Testamentary trusts



Superannuation

Superannuation - on death

- Super is often largest or 2nd largest asset of the deceased so important
- Many issues : much ignorance
- Can't directly leave super death benefits in your Will
- May have it paid into the Estate and then can leave through Will
 - Not always a good idea-eg Estate susceptible to inheritance claim
 - Tax result is same-ie it depends on who ends up with it



Payment of death benefits

- Who can get DBs (ie SIS dependants)
 - Spouse, former spouse, children of any age (but pension restrictions for adults), Estate
- Who gets them tax free (tax dependants)
 - Spouse, former spouse
 - Minor children
 - Financial dependant (eg adult child where D paid mortgage)
 - Interdependant relationship (close personal relationship - care, personal financial support- eg siblings living together)

SMSF issue - Trustee

- Remaining trustee/control of trustee on death decides who gets death benefits (between estate and SIS dependants) unless bound by BDBN or clause in super deed
- Super Complaints Tribunal no jurisdiction for SMSF
- Need to change trustee validly and document properly
- Can get dreadful result eg *Katz v Grossman* [2005] NSWSC 934.

Katz v Grossman

- Ervin and Evelyn Katz trustees of SMSF, Evelyn died.
- Ervin appointed Linda (Grossman) his daughter as additional trustee
- Ervin died in 2003
- Linda appointed her husband Peter also
- Ervin left NBDBN dividing between Peter and Linda
- Daniel Katz tried to stop Linda & Peter claiming an interest in their father's SMSF/ challenged appointment as trustees
- **LINDA GOT IT ALL (\$1M)**



Super on death

- “**SMSF WILL**” – terms in the Deed, puts executor in as trustee
- **BDBNs (validity issues, no flexibility during term)**
 - If Deed allows
 - Validity issues
- **NBDBNs** (better than nothing but not binding)
- **Also**
 - The Will can allow the benefits through Will to be reduced if receive super
 - Can often decide if paid as pension or lump sum

Superannuation - during life

Excess contributions to fund

- Complex rules keep changing making errors inevitable
- Resulting in major tax problems which can't be fixed in most cases if exceed contributions (minor relief only)

SMSFs

- problems with trustee's ignorance of strict laws so breaching sole purpose, in house asset rules etc
- Resulting in major tax problems



Discretionary trusts

Trusts and Social Security

- Complex and problematic legislation introduced in 2002 for means and asset testing for private trusts & companies
- Govt worried that used to hide assets (and claim pension unworthily) eg where get to use trust assets (lifestyle assets)
- Transfer of assets into the trust will still be treated as owned
- Looks to control of company/trust (defacto owner of trust assets)-including where associate eg a child is the apparent controller. Can go too far

Trust issues

- Using trusts **properly** to get the available flexibility, tax benefits and asset protection benefits (bad use of trusts = problems!)
- Risky areas for achieving ‘asset protection’ for assets held in trusts (bankruptcy and family law)
- Hints in achieving ‘asset protection’
- Care in giving or passing control of trust

Starting point

- Trustee/controller client must know and understand
 - fiduciary duties of trustee
 - difference between control and ownership
 - why trust used for them



First step

- What are client's priorities?
 - keeping a high level of decision making and control of the trust property;
 - allowing flexibility in who can benefit from the resources;
 - saving or deferring tax; or achieving asset protection
- Plan for changes



Asset Protection Bankruptcy

Asset protection (general)

- Client can undo a good plan
 - Inheritances (from parents, spouse or even adult children unexpectedly dying first);
 - Personal guarantees for business debts (or for a relative's debts);
 - Unpaid present entitlements (UPEs) or loan accounts;
 - Sham instead of reality in using the structure;
 - Costly (alleged) bad or illegal behaviour;
 - Divorce (eg *Worsnop*)
- Don't forget financially risky **personal** behaviour

Asset protection from creditors

- On bankruptcy of beneficiary
 - bankrupt's property vests in the trustee in bankruptcy for creditors
- When is a trust asset the property of the bankrupt
 - real or personal property of every description ...(s5 BA)
 - But not if held on trust (s.116(2))
 - Power of appointment of a new trustee **not** property (*Wily v Burton* and *Dwyer v Ross*)

Asset protection from creditors

- Interest as an object of a discretionary trust is an expectancy only (*Livingston and Gartside*) – this is property vesting in bankruptcy but not = trusts assets and not of much/any value
- Asset protection in discretionary trusts: the orthodox view
 - Corporate trustee (\$2 company)
 - No personal guarantees
 - Relies on *Gartside* (but NB independent trustees) and *Livingston*

Gartside

No doubt in a certain sense a beneficiary under a discretionary trust has an 'interest': the nature of it may, sufficiently for the purpose, be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. ...

But that does not mean that he has an interest which is capable of being taxed by reference to its extent in the trust fund's income: it may be a right, with some degree of concreteness or solidity, one which attracts the protection of a court of equity, yet it may still lack the necessary quality of definable extent which must exist before it can be taxed.

Erosion of orthodox view

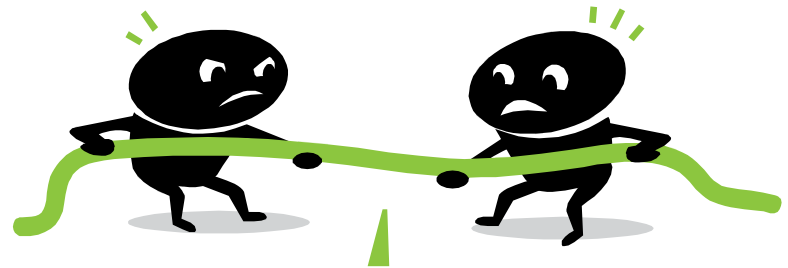
- The growth of the trustee as the **alter-ego** of beneficiary/bankrupt /spouse
- Cases are not bankruptcy cases but concern contingent property
- Richstar (interlocutory decision only)

At least by analogy it may be observed that a beneficiary who effectively controls the trustee of a discretionary trust may have what approaches a general power and thus a proprietary interest in the income and corpus of the trust

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 ...

Asset protection from creditors

- *Kawasaki and Lygon Nominees*
 - restate orthodox view
 - *Rafferty v Time 2000 West Pty Ltd (No 2)* (interlocutory decision only)
 - Freezing order on trustee (re commercial dispute)
 - *Public Trustee v Smith*
 - Will dispute-trust asset
 - Review of all authorities
 - Restates orthodox view
- Orthodox judges vs. those willing to push the envelope?



Claw back and reversals

- Claw back of trust property by trustee in bankruptcy of beneficiary
- Ss 120-122 BA strong powers to recover property disposed of at any time by the bankrupt with the intention to defeat creditors
- Div 4A -Can recover property gifted or transferred for less than market value and to recover property that is not owned by the bankrupt but is held in the name of a third party, was acquired by the third party in the lead up to the bankruptcy due to a substantial contribution from the bankrupt, and from which the bankrupt continues to enjoy a benefit (eg *Birdseye*)
- Warning about “automatic” removal by deed of beneficiary’s rights (s.302B BA)



Asset Protection Divorce

Spouse

- Wide interpretation
 - Defactos
 - Same sex
- So multiple challenges
 - Sequentially
 - At same time!

Asset protection from ex 'spouse'

- Property in the FLA
 - **property**, in relation to the parties to a marriage or either of them, means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion (s.4(1))
 - family discretionary trust property often treated as the property of the parties or one of them.
 - made part of pool to be divided
 - S.79 FLA...altering the interests of the parties to the marriage in the property if just and equitable
 - Ct then makes orders that directly take the trust property into account but not usually against trustee (but can if necessary-Part VIIIA, ignoring trust deed restrictions)

Asset protection from ex spouse

- Setting aside transactions- S.106B very powerful

(1) In proceedings under this Act, the court may set aside or restrain the making of an instrument or disposition by or on behalf of, or by direction or in the interest of, a party, which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.

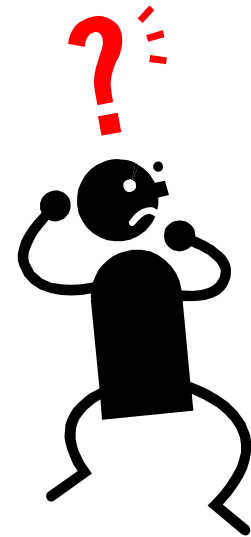
...

3) The court must have regard to the interests of, and shall make any order proper for the protection of, a bona fide purchaser or other person interested



Asset protection from ex spouse

- Beneficiary's rights to trust property is already their property -under ordinary law
 - UPEs
 - Beneficiary loans
 - Other loans
 - Absolute entitlement
- So no special looking through needed



Trust as a financial resource

Hard to avoid

- Can reasonably expect would be available to him or her to supply a financial need or deficiency (*Re Kelly(No 2)*)
- No division or alteration but can effect % split of property
- Family trusts even if not property are often treated as financial resource (eg of effect see *Simmons, Milankov*)
- Even if simply appointor or even just expectation of benefit (without any control)

Trust property as divisible property

Contrary to justice and equity to allow a spouse with control of assets to quarantine them from property settlement proceedings by preserving them for the benefit of the beneficiaries in circumstances where the controlling spouse has the power legitimately to determine at any point to whom income and/or capital will be distributed, including to themselves

Beeson v Spense

Trust cases –Kennon v Spry

- Spry Husband
- Kennon trustee of children's trusts
- H is Trustee (personal),
- Ct restored Wife as B (s.106B)
- Ct restored assets that were transferred to children's trusts(s.106B)
- Assets added to pool
- No direct orders but H would have to use trust assets
- High Court



Stephens (enforcement)

Stephens (Enforcement)

- Cashed up trust
- Threats of fire- Alleged theft
- S said couldn't use trust assets to pay W.
- Ct said Part VIIIA order OK

‘an order may be made that enables a party to the marriage who is in control of the trust to satisfy his or her personal liability to the other party to the marriage who is an object of the trust from the assets of the trust’



Ashton

- H is appointor, 1 of 2 shareholders in T not B but actually was getting a benefit through other beneficiaries
- W is a B
- Ct ordered H to appoint self as T and cause trust to pay W
- Said “defacto ownership” of trust property
- Full Ct said “whole of the trust was in reality the husband’s property”

Davidson

- H is appointor, controls T company not B
- Said breach of trust if trust assets to him
- Family Ct said H could lawfully take the trust assets to himself as T is his creature
- HCt refused special leave...more fights in NSW Supreme Court ...lost all



Other cases

- *Goodwin*
- *BP v KS*
- *Simmons*
- *Pittman*
- *Essex*
- *Leader*
- *Ogden*
- Brereton J in 2010 article says *K v S* is orthodox
In distinction from the ordinary case, the Trustee's interest is valuable, because it is in his or her power to procure a distribution of the whole of the Trust assets, if not to himself or herself, then to the other spouse, and thus to make it property of one or other of the spouses available for division between them.

Protecting trust assets from spouse

- Plan in advance (BFA/deed clause not decision of trustee removing B and T)
- Taking it outside of the “ordinary” might help
- Testamentary trusts/Parent’s trusts
 - The Court though will generally look at how the trust operates and if a party actually benefits or has a real expectation of benefit. Source of trust property less important (*Coventry*)
- How might property in testamentary trusts be treated?
 - if it looks and quacks like a duck...
- Children’s trusts
 - If in reality ...



More on Death- Wills and Testamentary Trusts

Passing control of trusts

- Try to do it during life (maybe with governing director)
- Choice of person
 - Can be problem (trustworthy and knowledgeable)
- Remove appointor clause?
 - Simply keep trustee?
 - Take care with who gets shares
- Avoiding the Will
 - To make inheritance claims etc harder
 - Keeping separate avoids confusion



Effective use of testamentary trusts

- Should you use a testamentary trust?
- 3 uses
 - Estate planning
 - Excellent tax benefits especially for income to minors
 - Asset protection (from use of a discretionary trust and duck problem)

Some issues -testamentary trusts

- Testator needs to own assets (consider-is there an asset protection problem during life)**
- Inject new assets from outside the Will?
 - Furse
 - Lose minors tax benefit for that income
- Drafting issues
 - Pro forma?
 - How complex?



- Will drafters must be done knowing about super and if control discretionary trust
- Growing use of separate testamentary trusts
- Ongoing use of 'complying' TT for minors as tax concession still excellent (minors 'taxed' at adult rates->\$20,000 tax free in 2012/13)
- Disconnect between financial planner/accountant/lawyer drafting Will, super deeds, resolution etc

Tax issues

- Selling main residence (2 year period can be extended by COT) - new
- “Passing” Div 128 (being redrafted to ‘principle based’)

Think and plan!

