Webinar: Intergenerational wealth transfer strategies using different structures and how debt can be created or debt/assets separated within these

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TOWNSENDS BUSINESS
& CORPORATE **LAWYERS**

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1. Testamentary Discretionary Trusts

1.1 A Testamentary Trust is a trust created in a Will. Most Wills say that the Executor holds the estate on trust and thereby create a testamentary trust. Such trusts are fixed trusts which lack the flexibility of a discretionary trust.

1.2 A Testamentary Discretionary Trust is a discretionary trust created by a Will [discretionary trusts created by a trust deed rather than in a Will are called 'inter vivos' trusts].

1.3 The benefit of all discretionary trusts is that legal ownership of assets is separated from control of the assets which provides the flexibility and absence of fixed entitlements that make them ideal for a diverse range of purposes.

1.4 Discretionary trusts (whether family trusts or Testamentary Discretionary Trusts) are characterised by a set of potential beneficiaries who generally have no entitlement to the assets or income of the trust until the trustee exercises its discretion to give them that entitlement. With respect to the trust's income, that exercise of discretion by the trustee normally occurs immediately prior to the end of each financial year. With respect to the trust's assets, the trustee can exercise that discretion any time and certainly when the trust is wound up (called 'vesting').

1.5 Testamentary Discretionary Trusts have become popular in recent years because of the concessional tax treatment for income distributed to minors from a Testamentary Trust under Division 6AA of the *Income Tax Rates Act 1986 (Cth)*. But they have other important uses.

1.6 Testamentary Discretionary Trusts can provide a range of benefits including:

- asset protection;
- family asset retention (so-called ‘bloodline trusts’);
- protection of vulnerable beneficiaries;
- providing for the spouse from the second marriage while ensuring the deceased’s children from their first marriage ultimately get estate capital;
- ensuring the deceased’s children ultimately receive estate capital and preventing the surviving spouse’s later husband or wife getting access to that capital via that later marriage; and of course
- tax benefits for minor beneficiaries.

1.7 ***Asset protection -*** A Will can provide that the deceased’s estate is held in a Testamentary Discretionary Trust with a number of potential beneficiaries, including spouse, children, grandchildren and later issue, siblings, aunts, uncles, nieces, nephews etc. If any of those beneficiaries has the prospect of having their assets seized by their creditors, the discretionary nature of their interest in the Trust could provide protection of their entitlement to benefit from estate assets. This would be achieved by the trustee simply refusing to exercise any discretion in their favour until the claims against them were resolved and no longer existed – even after a period of bankruptcy if that was necessary. This could be extremely useful for beneficiaries in high-risk occupations such as medicine, law, accountancy, architecture and the like where there is always the chance of being sued by unhappy customers who might as a result get access to the beneficiary’s inheritance to pay a judgement debt.

1.8 ***Retention of assets in the family (bloodline trusts) -*** Many people are concerned to ensure that only direct family members (ie blood relatives) benefit from their estate. They seek to minimise the risk that their sons-in-law and daughters-in-law will benefit from the estate after a matrimonial breakdown or the premature death of your child. They may also seek to minimise the risk that their surviving spouse will re-marry and that later relationship partner will receive part of the deceased’s estate via that surviving spouse’s Will or via a Family Court order.

An appropriately drafted Testamentary Discretionary Trust can provide that, perhaps apart from the surviving spouse, only direct descendants can acquire an interest in the estate. If a son or daughter is a beneficiary of a Testamentary Discretionary Trust and that child is divorced or involved in a matrimonial property dispute, the assets in the Trust may be excluded from the pool of the matrimonial assets in respect of which the Family Court can make an order.

Similarly if the deceased gives their estate to a Testamentary Discretionary Trust in which the surviving spouse is a beneficiary, rather than directly to the surviving spouse, and that surviving spouse re-marries and then either dies or divorces, the assets in the Trust may be excluded from the surviving spouse's estate or from the pool of the matrimonial assets in respect of which the Family Court can make an order.

In very general terms the Family Court can only make orders in respect of property owned by the parties to the marriage or companies or trust which they control (see our comments regarding *Kennon v Spry* below).

Note however, that while the Court may not order that assets in the trust should be transferred to a beneficiary's spouse, it may be able to take those assets into account in considering the financial resources available to that beneficiary and then make a disproportionate distribution to that ex-spouse from other assets of the marriage.

1.9 ***Protection of Vulnerable Beneficiaries -*** Through the use of a Testamentary Discretionary Trust, a person may be able to protect the estate interest of their vulnerable beneficiary – that is, a beneficiary who might not otherwise be totally competent to deal with a significant estate bequest.

Vulnerability comes in many different forms:

- mental illness,
- physical disability,
- alcohol or drug abuse,
- gambling addiction,
- particularly naïve or trusting personality making the child especially vulnerable or unworldly and in need of protection,
- controlling partner

… and so on.

Through a Testamentary Discretionary Trust the deceased can make income available to the beneficiary but not capital.

Or can make capital available via loan (rather than distribution) to the beneficiary once the purpose of the capital is approved by the trustee of the trust.

1.10 ***Maintenance of Estate Capital*** - A Testamentary Discretionary Trust is particularly useful where

(a) the willmaker has a current spouse as well as children from a previous relationship and wants to ensure that the spouse has adequate income to live on but wishes to preserve the capital for the children, or

(b) the willmaker is concerned that their inheritance not end up in the hands of their surviving spouse's later relationship partner via the death of that surviving spouse or the breakdown of that later relationship, or

(c) the willmaker wants the current spouse to be able to remain in the matrimonial home for the rest of their life but wants the children to receive the eventual value of the willmaker's interest in the home (testamentary discretionary trusts are preferred for that purpose rather than the more difficult life estate)

1.11 ***Concessional taxation of distributions to minors –*** Possibly the most well-known benefit of a testamentary trust is the tax advantage for children under the age of 18. Note that this concessional rate applies to all testamentary trusts not just Testamentary Discretionary Trusts.

Section 102AG(2)(a) of the Income Tax Assessment Act 1936 (Cth) means that the minor beneficiary is taxed on their share of net income according to the full adult tax marginal rates. This means that the first almost $20,000 is tax free. Compare that with the punitive tax rate of almost $9,000 applying to distributions of $20,000 to children from a normal family trust under Division 6AA of the 1936 Act.

By spreading income among all the minor children or grandchildren the Testamentary Discretionary Trust allows the family to earn roughly $20,000 per child of income before paying income tax.

1.12 ***How much asset protection do Testamentary Discretionary Trusts really provide?*** Waxing lyrical about the benefits of a Testamentary Discretionary Trust should be tempered by a clear recognition of the limits on the efficacy of trusts like this to protect the beneficiary's assets.

The main two areas of asset protection are in relation to a beneficiary's creditors and their estranged spouse. In both areas there is informative case law.

(a) **Re: creditors** – The Richstar Case (2006), Smith's case (2008), Fordyce v Quinn (2016)

In *Richstar Nominees* the court held that ASIC could appoint a receiver and freeze the assets of a family trust in which the bankrupt was a beneficiary and in control of the corporate trustee and the trust appointor. This effectively meant that the assets of the trust were the assets of the bankrupt and the protections of the trust were negated. The

decision was distinguished by and not followed in later cases of *Public Trustee v Smith* and *Fordyce v Quinn*.

The current position is that there is no general principle of law that where the beneficiary controls the trustee the assets of the trust constitute property of the bankrupt.

The protection of a person's assets by a discretionary trust against actions by that person's creditors or bankruptcy administrator therefore still exist.

(b) **Re: estranged spouse** – *Kennon v Spry (2008), Morton v Morton (2012), Bernard v Bernard (2019)*

In *Kennon v Spry* the High Court held that a wife who was not a beneficiary of a family trust (having been removed as such by the settlor/husband some time previously) was nevertheless entitled to property from the trust following the divorce. The decision undermined the very basic fundamentals of a trust and the right to receive distributions.

The case was distinguished in several following cases in 2012 and 2019. It should be remembered that the case applied family law pursuant to the legislation rather than the common law applicable to trusts.

The most recent summary suggests that whether an ex-spouse will be entitled to receive a distribution from a trust controlled by their estranged spouse would depend on a number of factors.

A) ***Origin of asset test***

Whether assets are acquired during the marriage (whether from inheritance, through efforts of one or both spouses, whether before or during the marriage) will play a role.

B) ***Control test***

Control by a party, whether directly or indirectly is relevant (in *Bernard & Bernard* the husband had no control either as Trustee or as Appointor to remove the Trustee).

C) ***Practice test***

Clear evidence of carrying out controller's wishes, minutes of meetings, major decisions for the purchase or restructure of trust assets, the history of distributions of income and/or capital, etc may all play a role.

D) ***Trust and Equity Law***

A discretionary beneficiary has a right to have his/her interest protected by a court and this 'right to due consideration' can be regarded as property.

How much asset protection do Testamentary Discretionary Trusts really provide? As much as you can arrange for them to provide by:

(a) having all or at least some independent trustees or trustee directors
(b) having all or at least some independent appointors
(c) administering the trust at arm's length
(d) having a binding financial agreement in respect of inheritance
(e) evidencing 'due consideration' in decision-making

1.13 ***Testamentary Discretionary Trusts Add Complexity -*** There is little doubt that Testamentary Discretionary Trusts add a level of complexity to the administration of a person's estate. The question must therefore always be whether that level of complexity is worth the benefit that the trust may provide.

The most obvious area of complexity is the beneficiaries' understanding of what the Testamentary Discretionary Trust in the Will means and why it has been put there. Rather than simply give the estate assets to their beneficiaries, and thereby make those assets available to the beneficiaries' creditors, estranged spouses or indeed the profligate or imprudent actions of the beneficiaries themselves, the willmaker has established a trust that stores those assets within its virtual walls and makes them only available when it is perceived safe to do so. It is an attempt by the willmaker to protect their beneficiaries' inheritance.

Secondly there is the on-going administration of the trust that will involve the maintenance of trust accounts and tax returns, investment issues, trustee meetings and deliberations and all the other issues associated with trust administration.

However, although it may seem very complicated and difficult to grasp initially, once the trust is operational for a while it is likely that most participants will come to a workable understanding of its nature and purpose. A trust that could offer material benefit to the family should not be rejected simply on the basis of perceived complexity alone.

1.14 ***Combined or separate trusts –*** A single Testamentary Discretionary Trust for all the deceased's beneficiaries may be able to more easily meet the criteria listed above for a trust that is independent of any particular beneficiary and therefore more likely to be effective to protect the assets or interests of that beneficiary.

Such a single trust however comes with the uncertainties as to whether discretionary distributions will be allocated to the correct group of beneficiaries at the relevant time. There is also the other major trade-off of the loss of personal financial privacy as all the siblings will know the financial situation of all other siblings.

A separate Testamentary Discretionary Trust for each child or beneficiary ensures that each child or beneficiary can effectively control their trust without the intervention of their siblings or other third parties and allows greater privacy between siblings in respect of their financial affairs. That level of control is both a benefit and a curse as it may weaken asset protection as noted above.

1.15 ***In summary -*** Testamentary Discretionary Trusts can be a very useful tool for the right type of person. It is important to appreciate however, that they are not necessarily appropriate for everyone due to the added complexity of the estate. The willmaker needs to determine if they have or could have beneficiaries who could materially benefit from the features these trusts offer thereby, on balance, making such a trust a worthwhile addition to the estate planning strategies.

2. Bequests to an existing family trust – pros and cons

2.1 Often clients ask "why should I set up a new discretionary trust in the Will when I've already got a family trust - can't I just give the estate to that family trust?" The answer is: yes, you may, but let's consider the pros and cons first.

2.2 ***Pros***

(a) *Only one trust ultimately*: Giving the estate to an existing trust means that there is no other trust to be set up with all the additional costs of administration. There is only one trust for the family to deal with.

(b) *The set-up has been completed already*: The trust is already set up so no need to worry about establishment issues.

(c) *Trust terms not in Will and therefore more separate and private*: One of the issues with Testamentary Discretionary Trusts is that the Will is effectively the trust deed and when the beneficiaries need to produce the terms of the trust for investment or commercial purposes that means producing a copy of the Will which may contain a lot of other non-trust issues that the family would prefer were kept private. This is not an issue if the estate is given to an existing trust.

(d) *The trustee is in place*: The trustee is already in place so again no additional trustees required.

(e) *The same basic protections as a TDT*: An existing discretionary trust provides all the same protections and benefits as a Testamentary Discretionary Trust in respect of the inherited assets (as opposed to the pre-death assets of the existing trust).

2.3 ***Cons***

(a) *Only partially a testamentary trust*: Recent pronouncements by the ATO confirm what we already knew: that the s.102AG tax concessions for minor beneficiaries available to a testamentary trust are not available in respect of all the assets of a pre-existing family trust simply because assets from the willmaker's estate are gifted to the family trust. Only the estate assets qualify for the concessions.

(b) *Need to segregate testamentary and non-testamentary assets*: There is therefore the ongoing need to segregate estate assets from the non-estate assets and the income derived from each which adds to administration costs.

(c) *Need to ensure non-testamentary assets not included in testamentary benefits*: There is the resultant need to ensure that distributions are managed carefully so that income from estate assets is only streamed to those beneficiaries wanting to access s.102AG. Does the existing family trust deed permit such streaming?

(d) *Makes inheritance available to creditors of current trust*: Does the existing family trust have material creditors? For example does the existing trust have substantial borrowings? Once the estate assets are gifted to the family trust they become available to the trust's creditors who are entitled to ignore any distinction between testamentary and non-testamentary assets.

(e) *Ensuring control of existing trust shared by all beneficiaries*: The existing family trust comes with its own set of controls that may not be relevant to protecting all the beneficiaries' interests in the estate. Who is the current trustee of the family trust and how will 'trusteeship' be transferred? Who is the current appointor of the family trust and how will that office be transferred? Will the willmaker provide guidance on changes to the family trust? Will that guidance have to be followed? Is there any potential for some family members to take control of the trust to the detriment of the other possible beneficiaries? Is all this happening at the time of the estate plan or is it being left to the Executors who may or may not appreciate the issues and or remember to do something about them following the willmaker's death?

3. How to safely transfer control of a discretionary trust

3.1 The questions posed in the last point of the previous section segue nicely into a discussion of how precisely does a willmaker ensure that they effectively transfer a family trust? The important thing to remember is that a trust is not a legal entity – it is a relationship between the trustee who owns the legal title to the trust assets and the beneficiaries who are entitled to the benefits of those assets.

3.2 The key to transferring a trust is the transfer of the <u>control</u> of the trust, which is effectively exercised via the trustee and ultimately the appointor.

3.3 Control of an individual trustee sits with the appointor who can remove and replace that trustee. Control of a corporate trustee sits firstly with the directors and the shareholders of that company and secondly with the appointor who can remove and replace that corporate trustee.

3.4 As with everything to do with trusts, the first and most important thing to do is CHECK THE TRUST DEED. What does that deed say about replacement and removal of a trustee and or an appointor? Is that sufficient? If not can the deed be amended to change those provisions?

3.5 Once it is clear how the deed deals with the issue the next step can be determined.

3.6 A willmaker (and their spouse) who want to appoint their beneficiaries as ***directors*** of their family trust's corporate trustee need to keep in mind a number of issues.

(a) *Directorship is an office and is not property*: This means that directorship can't simply be 'gifted' in a Will. Because a company is a separate legal entity with its own constitution, there are many rules both in that constitution and in the corporate law more generally relating to the removal, resignation and appointment of directors and a willmaker cannot simply by-pass those rules by designating who will or won't be a director.

(b) *Directors' resolutions not irrevocable*: While one solution may be to pass resolutions now to have the necessary effect when the willmaker dies, the law is not clear on whether or not a directors' resolution can be made irrevocable. If they cannot then any resolutions passed now may be changed in the future.

(c) *The constitution may be set in stone*: It may be easier to put all the necessary protections inside the constitution and work towards ensuring that the constitution can't be changed.

(d) *Still dependent on directorship eligibility*: No matter how the directorship is effectively "transferred" whether or not the nominated persons can actually take up their role as a director depends on their age, mental capacity, bankruptcy status or previous ASIC disqualification and if any of those criteria are not appropriate the nominated person may not be able to take up their position as director.

3.7 A willmaker (and their spouse) who want to appoint their beneficiaries as ***shareholders*** of their family trust's corporate trustee need to keep in mind a number of issues.

(a) *Can shareholders' resolutions be irrevocable?* Shareholders may be able to agree that their resolutions are irrevocable. That would permit the necessary resolutions to be passed now to take effect on the death of the willmaker. If a rogue shareholder later resiles from that agreement a court may order damages or even undo the rogue shareholder's actions.

(b) *Gifting the shares*: Power over the directors resides in the shareholders who can remove and replace directors. To give the beneficiaries the control over the board of the corporate trustee of the trust, the willmaker has to give the shares to the beneficiaries thereby giving them the power over the board and de facto control over the trustee.

(c) *Separate parcels of shares to each beneficiary*: It is vital to avoid joint ownership of shares in the corporate trustee. As joint owners of shares cannot vote their fraction of the share the common approach is for the constitution to say that the right to vote the share vests in the first-registered joint owner. This gives enormous power to that person. The better way is therefore to ensure that separate parcels of shares are given to each beneficiary so that each beneficiary has their own right to vote their particular shares. If the number of issued shares does not permit easy division among those beneficiaries then additional shares should be created either by issue or by share splitting.

3.8 A willmaker (and their spouse) who want to appoint their beneficiaries as an ***appointor*** of their family trust need to keep in mind a number of issues.

(a) *The role of 'appointor' is not property*: This means that the role of appointor can't simply be 'gifted' in a Will. The rules relating to the appointment of a successor appointor must be in the trust deed of the trust and a willmaker cannot simply by-pass those rules by designating who will or won't be their successor appointor. So the appointment of a successor appointor is not about gifting an asset but rather about making the necessary

arrangements in compliance with the trust deed as they relate to the appointment of the new person as the successor appointor. Those arrangements might be made under the trust deed or in some other document provided they comply with the trust deed. If the trust deed does not contain appropriate provisions consider amending the deed now.

(b) *Is there an appointor?* Although most family trust deeds have an appointor, there may be very old versions that do not so check to ensure an appointor has been appointed or is capable of being appointed.

(c) *How is a new appointor appointed?* How is a new appointor appointed under the deed*?* What formalities need to be followed?

(d) *Is any third-party consent required?* Either in respect of the original appointment or in the appointment of a replacement. Can that consent be obtained?

(e) *Can the deed itself be amended?* If there are obstacles to the appointment of a replacement appointor can the deed be amended to remove those obstacles? Is such an amendment a re-settlement of the trust (probably not)? What are the formalities to amending the deed?

(f) *Appointing the replacement appointor in the Will*: Once all the measures above are satisfactory the willmaker may be able to give control of the trust to their beneficiary through the willmaker's Will by appointing that beneficiary as their successor appointor provided that such an appointment meets the formalities discussed above.

(g) *Change the trust deed now to lock in the new appointment:* Alternatively the change can be made now by amending the trust deed to appoint the willmaker's successor appointor. Such deed amendment must be done in accordance with the trust deed and as much as possible made irrevocable, which may require careful investigation of some of the issues referred to above.

(h) *Still dependent on eligibility of successor appointor*: No matter how the role of appointor is effectively granted to the willmaker's chosen successor, whether or not the nominated beneficiary(s) can actually take up their role as an appointor depends on their age and legal capacity and if either of those criteria are not appropriate the nominated person may not be able to take up their position as successor appointor. The role of appointor is not a legislative position and the eligibility of the nominated successor is much more dependent on the trust deed and the common law of trusts than any legislation or regulator pronouncement.

4. Use of Loan Strategies

4.1 There are many different reasons for using a loan as an asset protection or virtual asset distribution strategy and it is neither possible nor desirable to list all of them in this paper. They depend on the circumstances of each case and the imagination of the client's advisors.

4.2 Some common examples can be provided.

(a) *Secured long term loan to child as an estate preference over other children*: The willmaker wants to give a greater proportion of their estate to a chosen child in preference to other(s) of their children. The willmaker and the chosen child enter a long-term loan agreement (say, 30 years) which is secured over the chosen child's assets (existing and future) so that on the death of the willmaker their Executor (and the other beneficiaries) are bound by the long-term loan until is expires.

(b) *Secured long term loan to child to protect from child's creditors*: The willmaker (or their family trust) gives their child a loan to buy their house and takes a registered security over the property preventing access to that asset by creditors until the loan is repaid.

(c) *Secured loan to child and their relationship partner to protect asset from family law claim*: The willmaker (or their family trust) gives their child and that child's spouse or relationship partner a loan to buy their house and takes a registered security over the property thereby limiting access for either party's creditors and to protect from family law claims because the child's spouse is a joint and several co-borrower and liable to repay the loan in full.

(d) *Loan from family trust to beneficiary secured over beneficiary's residence rather than capital distribution from trust*: Protects from creditors and possibly family law claims.

(e) *Secured loan from Testamentary Discretionary Trust to willmaker's beneficiary:* Either because that beneficiary is too young to be given their inheritance outright at that point and or as a way of protecting the inheritance from the beneficiary's creditors and perhaps their estranged relationship partner.

(f) *Asset protection for family home:* The home owner contributes an amount equal to their equity in their home to their family trust. The family trust then loans that amount back to the home owner and takes security over the home. The home owner's creditors (not including the bank which took the first mortgage) sit behind the bank and the family trust in receiving money from the sale of the home. The home owner's equity is protected but

there is a need to continue to increase the loans as the equity increases with the bank loan pay down.

4.3 What do these loan strategies have in common?

(a) They secure the loan over the client's property so that creditors and potentially the estranged spouse cannot get passed the lender whose loan to the client is secured.

(b) Some may involve the family trust as a way of shifting control rather than legal ownership.

(c) They don't involve any transfer duty or CGT liability.

(d) They MUST be fully documented with the normal arm's length documents and must be registered either on the local land registry and or on the PPSR.

(e) A parent should never give a loan to their child without all the arm's length documents.

(f) Ensure that the terms of the loans are market-linked. Whether the lender actually claims that money and or decides to return any money paid as a gift to the borrower is up to that lender.

(g) On the death of the willmaker-lender, the estate should not forgive the loan. Rather the loan should be assigned to the child-borrower's trust which trust becomes the lender to the child-borrower and as much as possible continues the protections that existed during the life of the willmaker-lender.

5. The Role of Superannuation

5.1 The death of a member requires the transfer of control of the fund either to the remaining member/s or to the deceased member's legal personal representative and a number of issues are worthy of comment:

(a) trustees of self-managed superannuation funds must have the fund's assets in their name which is why all super professionals recommend SMSFs have corporate trustees – that way on the death of an individual trustee/member the fund assets don't have to be transferred into the name of the other member/s and much less effort and paperwork results;

(b) the deceased member's death benefit must be paid out from the fund as soon as reasonably practicable – the default period is 6 months after which the ATO will start asking some pointed questions;

(c) transfer of control of a super fund raises many of the same issues as transfer of control of a family trust with the added restrictions that apply to superannuation;

(d) appointment of a member's legal personal representative (executor) as a trustee in place of the deceased member is not automatic under any legislation or common law and reliance must be put on the trust deed and the pre-death arrangements so ensure such appointments can be made after the member's death.

5.2 Discussion of loan strategies in respect of superannuation are of necessity limited because an SMSF cannot loan to a member or a member's associate (including family and related trusts) and on the borrowing side there is little potential for superannuation funds to incur debt. The only material exception is a Limited Recourse Borrowing Arrangement ('LRBA') which is specifically permitted by legislation on strictly limited terms.

5.3 The major benefit of an LRBA is the fact that the loan is secured only over the fund's asset purchased with the loan. The major detriment is the need for liquidity on the death of a member in order to pay the member's death benefit or reversionary pension despite the fact that the fund holds an illiquid asset such as a piece of real estate.

5.4 How can the client ensure sufficient liquidity or do they have to accept the need to sell the property to achieve that liquidity or even arrange an in-specie transfer of the property?

5.5 Possibility #1 - The fund could take out life insurance on each member covering the debt. On the death of a member the life policy proceeds could be allocated to the deceased member's account and used to pay a death benefit pension to the surviving spouse member to enable them to repay the loan. Many things to consider such as the parties transfer balance caps and basic pension drawdown rules.

5.6 Possibility #2 – If the two members of the fund do not qualify as the death benefit dependents of each other then the life policy proceeds can't be allocated to that other as a death benefit and the proceeds would then need to be given to the deceased's estate for distribution to the non-dependant via the deceased's Will. But the death benefit may still exceed the fund's cash which would mean that the fund would need to liquidate an asset (ie the property) in order to be able to pay out the death benefit.

5.7 Possibility #3 – The life policy could be held outside super and the surviving beneficiary/member could make a contribution to the fund using the life policy proceeds in order to fund the pay down of the loan. But this is subject to that contributor's contributions caps.

5.8 Possibility #4 – The same as #3 except that the survivor doesn't put the proceeds into super but uses them to refinance the loan. The life policy proceeds are used to payout the current lender and the surviving member becomes the lender of a related party loan. This may be a neat solution if the numbers match, but the fund may still have liquidity issues in paying out the deceased member's death benefit.

5.9 Two previously-used strategies no longer accepted by the ATO are:

(a) funding the life premiums in the fund via a reserve account which then holds the proceeds and pays out the loan (the ATO says this strategy breaches the sole purpose test); and

(b) cross insurance so that on the death of the member the proceeds are paid to the surviving member's account (in 2014 the ATO decided the strategy was inconsistent with the superannuation principles as set out in the SIS regulations).

5.10 Intergenerational transfer from the client's superannuation fund involves the use of a death benefit nomination. It is to be remembered that the member does not own their superannuation benefits; they are owned by the trustee of the fund and held on their behalf. So when a person dies it is the trustee who decides where their benefits go. That trustee discretion is limited only when the member gives the trustee a binding death benefit nomination which the trustee is obliged (under the law and depending on the trust deed) to follow.

5.11 It is not the purpose of this paper to discuss death benefit nominations in great detail but the following summary points can be made:

(a) Always check the trust deed when creating the nomination to ensure absolute, strict compliance with the requirements of the deed in respect of the formal issues such as witnessing, service on the trustee, trustee acknowledgement etc. – don't ever think you can use a so-called 'standard' or 'off-the-shelf' nomination without ensuring its compliance with the terms of the deed.

(b) Consider whether the nomination should be binding or non-binding or both. For a public offer fund a binding nomination is the only way to ensure the trustee will do as desired by the member. In the SMSF context, given the surviving/successor trustee is likely to be a close relative, perhaps a non-binding nomination will provide flexibility.

There is also the prospect of, say, making the nomination non-binding in respect of the spouse but binding thereafter if they pre-decease the member.

(c) Consider whether the nomination needs to be renewed every three years in accordance with the SIS regulations which in that respect only apply to public offer funds and not SMSFs. Many public offers now sidestep this requirement following case law which confirmed that the deed has precedence and so if the deed stipulates otherwise the three-year will not apply. Conversely most SMSFs are not subject to the rule, though poorly drafted deeds which import all the SIS Act obligations can inadvertently bring the three-year rule into the self-managed fund's obligations. Never assume either way – always check.

(d) Death benefit nominations in the self-managed space do not have to follow the rigid, basic forms of the public offer funds and can involve considerable bespoke drafting to provide conditions, to permit cascading nominations and to deal with contingencies in the manner of a mini-will. Consider switching some part of the member's super benefit in a public-offer fund to a self-managed fund simply for the better estate planning possible as a result.

(e) Can the member's super death benefits be re-balanced against their non-super estate among their chosen beneficiaries depending on the tax issues relating to distribution of each sort of estate?

5.12 Intergenerational transfer includes strategies such as

(a) *Gifting (nominating) the client's superannuation death benefit to the client's children*: Such a gifting occurs via the death benefit nomination.

(b) *Making the kids financial dependants*: Even independent adult children can receive their parent's superannuation death benefit tax free if they are financially dependent on the parent at the time of their parent's passing. The case law is replete with examples where relatively small amounts contributed by the parent can make the adult child financially dependent but such amounts must be significant in the context of the child's overall financial position, must have been regular and must exist at the time of the parent's death. If strategies are put in place now to create that financial dependency can they continue until the parent's ultimate demise? If not can they be revived at the appropriate time prior to that passing?

(c) *Gifting (nominating) the estate*: There are pros and cons of a member nominating their estate to receive their super death benefit. The main positive is that the death benefit can

be put into a Testamentary Discretionary Trust set up for the children and gain the protections and benefits of such trusts discussed above. The main detriment is that the money becomes subject to the estate's debts which they are not otherwise exposed to while they are in the super fund or if they are paid directly from the fund to the death benefit nominee. The wording of a nomination in favour of the estate has been the subject of judicial review and must be correct to ensure the nomination to the estate is valid.

(d) *The Superannuation Proceeds Trust (SPT):* This is a trust set up to receive the superannuation death benefits of the willmaker following their death. Generally the trust is similar to a Testamentary Discretionary Trust however the beneficiaries are limited to people who are death benefit dependants of the willmaker which means no tax is payable by the estate on the receipt of the death benefit. Other assets of the estate can then be distributed to a second Testamentary Discretionary Trust for non-death benefit dependants. As with other testamentary trusts, minors who are beneficiaries under the SPT are taxed at ordinary adult rates. Other benefits of a testamentary trust theoretically apply though the limitations on who can be beneficiaries of an SPT may limit some of the extended benefits of such a trust and some consideration may need to be given to that in the individual instance.

5.13 The Bankruptcy Act states that, if a person becomes bankrupt, funds held in their regulated super fund are protected and unavailable to creditors. A bankrupt person can even withdraw money from their super funds, subject to the SIS regulations. If they acquire an asset with that money and a major portion of the acquisition cost comes from their super funds, the asset is also protected from creditors.

5.14 There is a major caveat. If a person, prior to becoming bankrupt, makes large, 'out of character' contributions to their super funds with money that could be paid to creditors, these payments could be clawed back. The protection afforded by the Bankruptcy Act to super benefits held in only commences when the person becomes bankrupt. So if an individual, prior to declaring bankruptcy, withdraws money from a super fund and purchases an asset those withdrawn funds and that asset are not protected and can be taken by the trustee for the benefit of creditors.

6. Buy/Sell Arrangements and Business Succession

6.1 Buy/sell arrangements are agreements which set the ground rules between co-owners of a business as to what is to happen if a co-owner dies, becomes totally and permanently disabled ('TPD') or even unable to work in the business for an extended period. Fundamentally they deal with when and how the other co-owners will acquire the interests of the outgoing or disabled co-owner in the business.

6.2 The term 'co-owner' refers to a person who owns a business jointly with another party regardless of the legal structure - partners in a partnership, shareholders in a company, unit holders in a unit trust or a mixture of these. The term 'business interest' is therefore a share in a partnership or in a company or a unit in a unit trust.

6.3 There are two key aspects to a buy/sell arrangement:

(a) how the business interest will be transferred to the continuing co-owner(s); and

(b) how the continuing co-owner (s) will fund the money necessary to buy out the outgoing co-owner's share.

6.4 It is not the purpose of this paper to discuss buy/sell in great detail but to consider the concept in the context of intergenerational wealth transfer. As such this means a buy/sell arrangement between members of a family operating a family business or perhaps a rural holding.

6.5 Funding of buy/sell arrangements is most often through life insurance. A number of different models can apply which address issues like:

- who is to own the policy and pay the premiums?
- are premiums tax deductable?
- how to deal with different levels of premium for different co-owners?
- who is the beneficiary of each policy (ie deceased's family who then transfer the business interest at a nominal amount or the surviving co-owner/s who use the proceeds to pay for the business interest)?

6.6 It is important to understand the tax implications of the different models that might apply both in respect of the transfer arrangements and the funding arrangements.

6.7 A person's legal obligations do not die with them. A buy/sell arrangement entered by the willmaker remains an obligation of the estate which can be enforced against the estate by the surviving co-owners.

6.8 Accordingly the willmaker cannot gift business assets in their Will if those assets are the subject of a pre-existing buy/sell arrangement and when assisting a willmaker to consider their estate planning an advisor must consider any such buy/sell arrangement.

6.9 Where no buy/sell arrangement is in place the surviving co-owner/s face the prospect of having the willmaker's surviving family as co-owners in the business regardless of competence or expertise. Those new co-owners may want the business to be liquidated to convert their inheritance into cash.

6.10 Surviving co-owners will then need to obtain the consent of the willmaker's family to any arrangements in relation to the transfer of the willmaker's business interests.

6.11 The message to co-owners is therefore: always have a buy/sell arrangement. If life insurance is not available to fund the purchase then the owners may need to reach other agreements about funding such as time payments or partial asset sell-off.

6.12 Informal succession arrangements that fall short of proper buy/sell are regularly the source of litigation. They are most common in the rural sector where mum and dad tell the eldest son that if he continues to work on the property they'll gift it to him in their Wills. When the time comes they forget to do so or after their death the other children sue the estate for a greater share, not accepting the son's contention that he should have the farm because he worked it based on the promise and the other children did not. Similar problems can apply in respect of family businesses.

6.13 These situations can give rise to very difficult issues and really the only way to resolve them is for the family to address them well in advance of the time when the issue becomes real. Family conferences chaired by the family's accountant or lawyer can sometimes lead to resolution as professional advisers bring a level of experience and expertise to the problem-solving that may not otherwise be available to the family.

6.14 One thing is clear: if the family does not resolve the succession issues beforehand, unhappiness, frustration, family breakdown and litigation will likely result.

7. Can a family provision claim undo all the good planning?

7.1 The phrase "challenging a will" is layman's terminology that covers a number of different actions that have in common the fact that a person asks the Executors or the Court to administer the estate of a deceased person in a manner different from what would otherwise have been the case.

7.2 "Challenging the will" involves either

(a) claiming that the Will is formally defective in some respect and is therefore not a valid Will under the law and should not be followed, or

(b) claiming that the Will should have given a larger share of the deceased's estate to the claimant (a 'family provision' claim).

The first ground is not about estate planning and we will not comment further on it in this paper.

7.3 The second ground is called variously 'family provision' or 'testator's family maintenance' depending on which state or territory is relevant. Every state and territory have their own legislation dealing with the field and even though they tend to be similar it is still a minefield, particularly for lawyers trying to sum up the situation Australia-wide.

7.4 NSW has the unique legislated concept of 'notional estate' – assets the deceased controlled but didn't own on their death or assets the deceased intentionally divested themselves of with a view to preventing or limiting the inheritance of an eligible claimant.

7.5 In NSW eligible claimants include spouses (existing, prior, formal or de facto), children (including adopted children but not step children), grandchildren (who've lived with the deceased and been dependent on them) and other people who were dependent on the deceased. Other jurisdictions may have different eligibilities.

7.6 Although some years back the attorneys-general of the various states and territories agreed that there should be a national set of family provision rules and that they would adopt NSW approach on the notional estate, it is still to happen. No other jurisdiction has such laws.

7.7 To avoid someone challenging the will the willmaker needs to consider

(a) who in their sphere is eligible to make a claim – spouse? children? dependents?
(b) are there particularly problematic circumstances such as second marriages or estranged children?
(c) are any of those people eligible for a gift based on the criteria relevant in the law of the willmaker's state/territory?
(d) have those people been catered for in the will?
(e) is the level of their inheritance of an amount the courts consider appropriate?
(f) does the willmaker have a valid reason for omitting them from the will or limiting their entitlement?
(g) would providing them with some gift be better than nothing at all?
(h) what could the willmaker do while they are alive to decrease the prospects of a successful claim eg. move interstate? gift now? long-term loan? statutory declaration evidencing the relevant reasons for the willmaker's decisions?

end

28/10/21