

“DO YOU TRUST ME? – TESTAMENTARY TRUSTS AND FAMILY PROVISION”

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A testator may be rightly concerned about the financial acumen, skills and prudence of a beneficiary and may seek to structure the beneficiary’s provision to ensure that the provision lasts for the beneficiary’s lifetime (and perhaps for the beneficiary’s dependants’ lifetimes). A testamentary trust may appear to be the solution. However, a testamentary trust may create its own issues.

nature of a testamentary trust

Testamentary trusts are not a distinct legal type of trust, but merely an express trust created by a will. A testamentary trust, like any express trust, must satisfy the three certainties of a trust – certainty of intention, certainty of subject matter and certainty of object.¹

A will involving a testamentary trust involves complex legal issues including the nature of a trust, the split between legal and equitable ownership and the role of trustee. A solicitor preparing a will that includes a testamentary trust needs to be comfortable that the testator has the capacity to understand the testamentary trust and know and approve the contents of the will including the testamentary trust. Capacity depends on the particular transaction,² and a testator may have capacity to understand a simple will but may not have capacity to understand a will including a testamentary trust and a corporate trustee.³

fixed or discretionary

Generally speaking, a testamentary trust may be a fixed trust or a discretionary trust.

A fixed trust provides that the trustee holds the trust property on trust for the beneficiaries of the trust. The beneficiaries have a current vested interest in fixed shares in the trust property. If the trust property is real property, the beneficiary has an equitable proprietary interest so the beneficiary has a caveatable interest. The beneficiary is shielded from the whims of a trustee.

This has a number of consequences

First, the beneficiaries are presently entitled for the purposes of income tax, so the trust is taxed at personal rates not trust rates.⁴ There is also no discretion to structure the trust’s distributions so that distributions may be made to beneficiaries with lower effective tax rates.

Second, the beneficiary’s entitlement is part of their personal estate, including for family law, bankruptcy and probate. The trust property is not shielded from a relationship breakdown or bankruptcy.

Third, a beneficiary who has capacity may call for their interest and collapse the trust.⁵ This may include one of a number of beneficiaries calling for their aliquot share except if the trust property is real property, or if it is personal property and there are “special circumstances”. Special circumstances in this context means prejudice to the beneficiaries who oppose the *Saunders v*

¹ *Knight v Knight* (1840) 3 Beav 148, 173; (1840) 49 ER 58, 68; *Clay v Clay* (2001) 202 CLR 410, 431 [42] (Gleeson CJ, McHugh, Gummow, Hayne and Callinan JJ); *Byrnes v Kendle* (2011) 243 CLR 253.

² *Guthrie v Spence* [2009] NSWCA 369; 78 NSWLR 225

³ *Hobhouse v Macarthur-Onslow* [2016] NSWSC 1831

⁴ Section 97 Income Tax Assessment Act 1936; Section 115-215 Income Tax Assessment Act 1997 (CGT)

⁵ *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282; *CPT Custodian Pty Ltd v Commissioner of State Revenue* 224 CLR 98 at [43]-[48].

Vautier direction, for example, because the trust property is a controlling interest in a privately owned company and there is evidence that the value of the remaining interest would fall.⁶

Therefore, a fixed trust may be recommended if the beneficiaries are under a legal incapacity, for example the beneficiaries are minors until they reach capacity, but may not be recommended if the testator wishes to shield the trust assets from credit risk and relationship risk.

In contrast, a discretionary trust provides that the testator lists a number of objects who are potential beneficiaries and the trustee has a discretion to choose between the objects as to who receives a distribution and how much they receive (or if they receive anything at all).

The objects may be one list of persons, or may be different classes such as primary objects, secondary objects etc. The trustee's discretion may be practically constrained by requiring that the trustee first distribute to the primary objects and only if there are no primary objects to the secondary objects etc, or by requiring that a certain named person (who may be one of the primary objects) must consent to any distribution to a particular class of objects. If the trust property may involve residential land, the objects of the trust should specifically exclude any foreign person being an object, so there may be no possible transfer to a foreign person so that there is surcharge purchaser duty,⁷ or surcharge land tax.⁸

This means that the trustee has the flexibility to structure the trust's affairs in a tax effective manner, and may shield the trust assets from an object's bankruptcy, family law settlement, or general financial imprudence. However, each object has no vested interest, no caveatable interest and no enforceable right to any distribution at all.

trustee

The fact that the trustee has such a broad discretion means that the testator's choice of trustee is critical.

The testator may appoint the executor as the trustee, or may appoint a person as executor and appoint another named person (including a company) as the trustee.

The executors and trustees are not compelled to continue being the trustee. Executors cannot renounce -an executor who wants to cease being an executor can only appoint the NSW TG or a trustee company,⁹ or the executor may be removed by a court as part of the court's inherent supervisory jurisdiction.¹⁰

However after the executors have administered the estate, the executors can transition from executorial mode to trustee mode by registered instrument,¹¹ appoint new trustees to ensure that there are at least two trustees,¹² and then retire as trustee.¹³ The new trustees may be appointed

⁶ *Beck v Henley* at [37] to [43].

⁷ Section 104JA Duties Act, section 104L Duties Act. Some solicitors have expressed concern about preparing wills that irrevocably exclude beneficiaries based on provision of the Duties Act that may or may not apply when the trust ultimately becomes operative and there may be other options

⁸ Section 5D Land Tax Act, section 5A Land Tax Act

⁹ Section 75A Probate and Administration Act 1898

¹⁰ *Mavrideros v Mack* (1998) 45 NSWLR 80

¹¹ Section 11 Trustee Act 1925

¹² Section 6(2)(d) Trustee Act

¹³ Section 8 Trustee Act

by the appointor named in the instrument creating the trust, that is, the will, or if there is no appointor named in the will, then by the continuing trustees or the retiring trustees.¹⁴

The fact that the appointor selects any future trustee means that, ultimately, the appointor controls the trust. The testator must therefore choose someone carefully for that role.

The executors or the appointor should not appoint any person to be a trustee if they are a beneficiary, or an object of the testamentary trust as this may incur duty, and the will should expressly provide that none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust.¹⁵ This ensures that persons reading the will in the future do not inadvertently appoint an object as a trustee and expose the trust fund to duty when the new trustee is appointed.

The trustees have fiduciary obligations to exercise their powers in the best interests of all present and future beneficiaries of the trust and to act impartially towards beneficiaries and between different classes of beneficiaries,¹⁶ and to avoid a conflict of interest with the trust and not receive a benefit from their position as trustee.¹⁷

However, the trustees otherwise have a very broad discretion. The trustees must exercise their discretion honestly and bona fide, without improper motives and making fair consideration of the subject and the claims of the potential objects, real and genuine consideration and in accordance with the purposes for which the discretion was conferred.¹⁸ Subject to this, the trustee can decide who receives a distribution and how much they receive (or if they receive anything at all).

It is very difficult to prove a trustee has not acted bona fide. It is also very difficult to remove a trustee of a discretionary trust. The court may remove a trustee pursuant to the court's inherent jurisdiction to supervise trusts or pursuant to section 70 of the Trustee Act.¹⁹ However, the court will only remove the trustees if the trust property is endangered or the trustees have failed efficiently and satisfactorily to execute the trust, and friction or hostility between the trustee and the beneficiaries may not of itself a reason for the removal.²⁰ It is not sufficient that the trustee of a discretionary trust has declined and is likely to continue to decline to make distributions to the object or a particular group of objects.

Therefore, the testator needs to carefully consider family dynamics before appointing a trustee including

¹⁴Section 6(4) Trustee Act

¹⁵Section 54(3)(b) Duties Act

¹⁶Section 14B Trustee Act

¹⁷*Boardman v Phipps* [1967] 2 AC 46

¹⁸*Re Beloved Wilke's Charity* (1851) 3 Mac & G 440; 42 ER 330; *Karger v Paul* (1984) VR 161; *Manglicmot v Commonwealth Bank Officers Superannuation Corporation* [2010] NSWSC 363, *Icepine Pty Ltd: In the matter of the Bellamy Street Unit Trust* [2017] NSWSC 1701 per Sackar J.

¹⁹*Sir Moses Montefiore Jewish Home v Perpetual Trustees* [2012] NSWSC 210 per Ball J at [24]

²⁰*Miller v Cameron* (1936) 54 CLR 572 at 580-1 by Dixon J (Evatt and McTiernan JJ agreed); *Sir Moses Montefiore Jewish Home v Perpetual Trustees* [2012] NSWSC 210 at [28] and [32]; *Crowle Foundation v NSW Trustee & Guardian* [2010] NSWSC 647; *Jacobs Law of Trusts* [1585]

- a trustee's potential antipathy towards the object (including sibling rivalry and jealousy, a fear that the object will waste it, or will waste it unless it is drip-fed in small amounts, or that the object otherwise does not "deserve" it);
- a trustee's potential antipathy towards the object's spouse (and perhaps object's step-children) including fear that the distribution will ultimately go to the spouse who will waste it or give it to the spouse's own children, and "family money" will ultimately go outside the bloodline;
- a trustee's potential antipathy towards the object's parent (who is the testator's spouse, or worse, ex-spouse) and fear that the distribution will ultimately go to the parent who will waste it, or the parent is not raising the objects to be "properly respectful" and loving of the testator's family, or the parent should use their own money to support the object and not solely rely on the trust supporting the object;
- a trustee who may unreasonably burden the object with the obligation to provide comprehensive budgets, quotes and invoices before making any distribution to the object.

The testator also needs to consider whether the trust structure may itself create problems. For example, if the trustee's own issue are also default or secondary objects of the trust, this creates an unhealthy incentive for the trustee to make limited distributions (or no distributions!) during the primary object's lifetime so that the trust fund may ultimately pass to the trustee's own issue.

dates

The trustee of a testamentary discretionary trust, like the trustee of any discretionary trust, needs to ensure that they determine who is entitled to a distribution of the income every financial year or that the will otherwise contains a clause that there will be a default distribution every financial year, to ensure that the income of the trust fund is taxed at personal rates not trustee rates.²¹ The solicitor preparing the will needs to confirm with the testator who the default beneficiaries will be, as there is a strong risk that the trustee may inadvertently neglect to make a determination as to who is entitled to a distribution of the income.

Vesting dates always seem so far in the future, just within the 80 year limit of the law against perpetuities.²² However, it is critical to make note of the vesting date lest the trustee continue to operate the trust and make distributions according to the trustee's discretion, in circumstances where the trust has already vested, vested in certain beneficiaries or objects named in the will, in the proportions set out in the will. It may be prudent to mark the vesting date in BIG LETTERS IN RED on the front page of the will.

boilerplate

Several service providers provide precedents or templates of testamentary trusts such as the testamentary trust templates prepared by Allan Swan or Hutley's Australian Wills Precedents.²³

In any event, there are two provisions that should be included in the boilerplate.

²¹ Section 97 Income Tax Assessment Act 1936; Section 115-215 Income Tax Assessment Act 1997 (CGT)

²² Section 7 Perpetuities Act (NSW) 1984

²³ Birtles C and Neal R "Hutley's Australian Wills Precedents", 9th edition, Lexis Nexis 2016 (10th edition advertised for release January 2021)

First, there should be a power to amend. This will allow the trustee to amend the terms of the trust as legislation changes (for example, the recent NSW changes to foreign objects exposing the trust to surcharge purchaser duty).

Second, there should be a power of advancement to distribute income and/or capital for minors or other persons contingently entitled, because a trustee's power of advancement in section 44 Trustee Act is very limited.

Family Provision and Trusts

An object who is consistently not receiving any distribution from the testamentary trust, or not receiving significant distributions or only receiving drip fed distributions, may make a family provision claim that effectively collapses or partially collapses the discretionary trust.

There are three threshold issues.

First, the object may only make a family provision claim if they are an eligible person²⁴ – if a child and their family line – the child's children and grandchildren - are consistently being ignored by the trustee of the discretionary testamentary trust, then the child will be eligible, the child's children, the testator's grandchildren, will only be eligible if they were partially dependant on the testator, and the child's grandchildren, the testator's great-grandchildren, will not be eligible.

Second, there is a challenge that the application is likely to be out of time, because a family provision application must be made within 12 months of the testator's death unless sufficient cause is shown,²⁵ and the trend of distributions may only become apparent a year or two (or more!) after the testator passed away.

Third, the court will only make an order for provision out of the testator's estate as the court thinks ought to be made for the applicant's maintenance, education or advancement in life.²⁶ This may not be the same as the object's notional aliquot share of the whole of the trust fund. The object's notional share of the trust fund (noting that an object has not vested interest) may be \$2,000,000 but it is unlikely that a court would make a family provision order for \$2,000,000.

In *Hedman v Frazer*²⁷ and more recently in *Barbuto v Barbuto*,²⁸ Hallen J considered the intersection between discretionary trusts and family provision legislation. Hallen J cited Young J in *Gregory v Hudson (No 2)*²⁹ that provision through a discretionary trust is illusory provision, and Brereton J in *Taylor v Farrugia*³⁰ that provision through a discretionary trust will often, though not invariably, be inadequate or improper. However, the fact that proper provision has not been made through a discretionary trust does not automatically mean that the court ought to order provision. In *Barbuto*, Hallen J still dismissed one of the applicants even though he acknowledged that there was a prospect that the applicant may receive nothing by way of income, or capital, out of the deceased's estate. Hallen J said that the Court could not be satisfied that the provision was inadequate, because he had failed to make full and frank disclosure about his financial circumstances, and, in particular, his gambling; that he had no "needs" that could not be met

²⁴ Section 57 Succession Act

²⁵ Section 58 Succession Act

²⁶ Section 59 Succession Act

²⁷ *Hedman v Frazer* [2013] NSWSC 1915

²⁸ *Barbuto, Bradley v Barbuto; Barbuto, James v Barbuto* [2019] NSWSC 1023 at [330] to [338]

²⁹ *Gregory v Hudson (No 2)* (Supreme Court (NSW), Young J, 18 September 1997, unrep),

³⁰ *Taylor v Farrugia* [2009] NSWSC 801

from his own resources; and third, that to the extent that he has a “need”, such “need” was the result of his own choices.

Conversely, the court may make a family provision order *that includes* that the provision is held on trust, the purpose of the trust and the way in which it is to be constituted.³¹ This may include

- ordering that the provision is held pursuant to a trust that complies with the special disability trust regime in circumstances where the original provision in the will may not have technically complied;³²
- if the applicant does not have legal capacity or the court is otherwise concerned about the applicant’s financial improvidence;³³

However, the court will not make a family provision order creating a discretionary trust to shield the applicant’s provision from the applicant’s creditors.³⁴

family trust

The testamentary trust is distinct from a trust where the testator may be the trustee of the trust, controller of the corporate trustee of the trust, appointor of the trust or object of the trust (**“Family Trust”**). The trust property of the Family Trust does not automatically form part of the testator’s estate, and the testator cannot devise the Family Trust trust property by will.

The testator cannot require the Family Trust trustee to distribute the Family Trust trust property so that the sum of the provision in the testator’s will *and* the distribution of the Trust Property is roughly the same between all beneficiaries. This is because a testator cannot limit a trustee’s discretion. At its highest, the testator can leave a statement of wishes, which the trustee may (but is not required to) take into account.

However, the testator’s personal unpaid present entitlements from the Family Trust *are* part of the testator’s estate. The testator should monitor their personal unpaid present entitlements - the payment of a large amount of unpaid present entitlements may effectively require the Family Trust to be wound up.

The testator may exercise their power of appointment in the testator’s will to appoint the trustee of the Family Trust, or the testator may devise their shares in the corporate trustee to beneficiaries to effectively allow those beneficiaries to control the corporate trustee. Notably, the testator cannot appoint a director of the corporate trustee in the testator’s will because the role of director is a personal role³⁵ – the testator needs to appoint a director before the testator dies, or the testator needs to devise the shares in the testator’s will and then the beneficiaries *in their capacity as shareholders* may exercise their rights as shareholders to appoint a director.

Notably, if the testator is the sole trustee, sole director or sole shareholder of a corporate trustee, or sole appointor of a Family Trust discretionary trust, and the testator is also an object of the discretionary trust, then the assets of the Family Trust may be designated as notional estate for

³¹ Section 66(1)(b) Succession Act

³² <https://www.servicesaustralia.gov.au/individuals/services/centrelink/special-disability-trusts>

³³ *Hampson v Hampson* [2010] NSWCA 359 [102] and Appendix [118] to [124] per Campbell JA and the cases cited therein

³⁴ *Diver v Neal* [2009] NSWCA 115

³⁵ *Mancini v Mancini* [1999] NSWSC 799

the purposes of a family provision claim.³⁶ This is because the testator may have exercised their rights as sole trustee or sole director of the corporate trustee to distribute the assets of the discretionary trust to themselves, or exercised their rights as shareholder to appoint themselves as the director to distribute the assets of the trust to themselves, or exercised their rights as appointor to appoint themselves or a company that they controlled as trustee and then exercised their rights to distribute the assets of the trust to themselves.³⁷

Conclusion

A testamentary trust may appear to be a useful solution for testators who are concerned about their beneficiaries' financial management and/ testators who want to create a structure that allows the beneficiaries to manage their legacy in a tax effective way. However, a testamentary trust is complex, and requires the testator to have capacity to understand the issues and the potential consequences, and be willing to make the intellectual effort to give detailed instructions.

³⁶ Part 3.3, Notional Estate Orders, Succession Act

³⁷ *Wardy v Salier* [2014] NSWSC 473; *Kavalee v Burbidge* (1998) 43 NSWLR 422; *Hitchcock v Pratt* [2010] [79 NSWLR 687](#)