

Major Reasons for a Default Beneficiary Controlled Testamentary Trust

Increased relationship protection – in the event that the primary beneficiary’s marriage or de facto relationship breaks down. # Excepted income (low “adult” marginal rates for beneficiaries under 18). # Asset protection for “risk” beneficiaries, eg directors of trading companies, professionals. # Flexibility – each year the trustee can decide which family members or associated entities are to benefit (that choice is more limited if a family trust election is made). # Protection of assets from primary beneficiary’s hostile family members.

Trustee & Ultimate Control

The trustee is usually either the primary beneficiary or a company nominated by the primary beneficiary. Limited liability issues may influence choice of trustee. Unlike other Australian testamentary trusts, the primary beneficiary (rather than the executor) effectively controls the trust (if, and once, the option to use it has been taken up), unless bankrupt or lacking decision making capacity (when control reverts to the executor). Special rules apply to the trust after the primary beneficiary dies.

Trust Income and Capital

Generally, beneficiaries (rather than the trustee) are taxed on the income of the trust, based on any specific entitlements they may be given (eg to net capital gains or franked dividend income) or by the proportion of income they are allocated. The beneficiaries receive credit for any income tax already paid, eg via dividend franking credits. Any trust income that is accumulated by the trustee is taxed at 46.5%. Capital profits (usually subject to a 50% discount) are taxed both when trust assets are disposed to 3rd parties and on winding up of the trust. Loans to the trust may be interest free or interest bearing.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and non-excluded beneficiaries of the trust.

BCTT Will

Wills creating BCTTs are effectively both

- # A relatively short revocation, control & division document
- # An extensive trust document, akin to a family trust or an SMSF Deed

Part A

**Revocation,
Control &
Division**

Part B

**Adjustment
& Executor
Discretion**

Part C

**BCTT Terms
& Executor
Powers**

Part D

Definitions

Will Creating Australian BCTTs

While the format of a Will creating one or more BCTTs can vary in the way it is set out, a typical format is one where the Will is broken into parts. Such a format has the revocation, control and division aspects of the Will at the front (these Part A clauses are personal to the Willmaker and can vary considerably from Will to Will), followed by the more standard administrative aspects of the Will.

Part B

Part B also gives the executor discretionary powers in respect of the formation of any of the BCTTs, eg in respect of some or all of the deceased estate assets:

- by-passing the default BCTT;
- establishing a flexible life interest, with the nominated primary beneficiary as primary life tenant and the primary beneficiary's children as the capital beneficiaries; and
- establishing more than one BCTT for a primary beneficiary, ie parallel BCTTs.

Part B frequently includes a clause instructing the executor to adjust estate distributions to reflect benefits that 2 or more primary beneficiaries such as children might receive from non-personal estate sources, eg:

- superannuation – account balances and (if applicable) SMSF reserves;
- family trusts (usually including unpaid allocations of trust income);
- wages and capital contribution foregone in helping develop a family business; and
- lifetime gifts.

Parts C and D

Part C of the Will includes the terms of the default BCTTs and the administrative powers of executors and trustees. The trustee is usually given the power to choose the definition of trust income for a particular financial year. Part D sets out the definitions applying to particular words that are used in the Will, eg "child" and "dependant".

Part A Clauses in a Will Creating BCTTs

- Part A is the part of the Will that is personal to the Willmaker (*see notes*)
- Part B varies depending on the number of primary beneficiaries (other than a surviving domestic partner) & the extent of non-personal assets such as superannuation

Parts C and D are often very similar to other Wills creating BCTTs

Clauses Frequently Appearing in Part A of a Will Creating Australian BCTTs

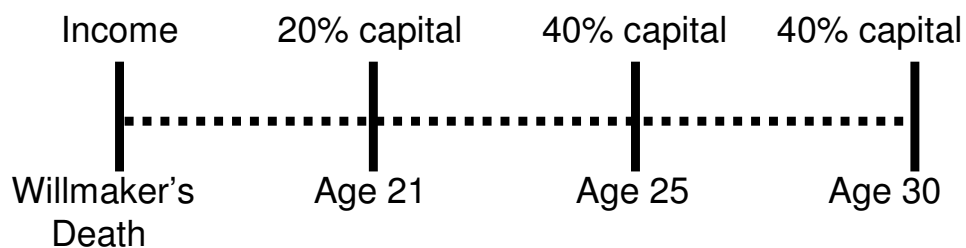
- Introduction to the Will identifying the Willmaker and dating the Will.
- Revocation of previous Wills and codicils and the setting out of limitations, eg limiting the Will to Australian assets or excluding assets in a particular country.
- Contemplation of marriage clauses preventing a Will from being revoked if the willmaker marries a particular person.
- Appointment of immediate and reserve executors, as well the nomination of any preferred advisors (the executors are responsible for the initial administration of the deceased estate and are also usually trustees of all trusts created by the Will other than the BCTTs).
- Initial administration of the deceased estate, including payment of all enforceable debts.
- Specific bequests, eg of personal chattels or cash, to individuals or charities.
- Provisions (if applicable) dealing with the control of self managed superannuation funds, family trusts and other non-fixed trusts (these clauses are always subject to the trust Deed governing the particular fund or trust).
- Creation of the alternative of a right of occupation or life tenancy in respect of a family home owned solely or as tenants in common (to ensure retention of CGT and land tax exemptions).
- Creation of a default BCTT with the willmaker's domestic partner as the primary beneficiary.
- Guardianship of young children – often accompanied by a clause providing for funding of the care of those children.
- Creation of one or more primary, secondary and/or tertiary education funds for children, grandchildren or other beneficiaries.
- Creation of default BCTTs for children or other primary beneficiaries.
- Reserve benefit clauses, eg in the absence of surviving descendants.

BCTTs – Staggered v Single Release of Funds

Wills creating BCTTs set an age or time for release of funds by an executor to BCTT trustee

Willmaker can choose **single time release** dates for each primary beneficiary, eg age 18, 21, 25 or 30 years

Alternatively, a **staggered time release** can be chosen, eg



Types of Australian Beneficiary Controlled Testamentary Trusts (“BCTTs”)

There are 3 main types of Australian BCTTs, ie:

Fully Discretionary (Sole Trust or Parallel Trusts)

Subject to the options for the primary beneficiary to nominate to the executor (as set out in the Will), a separate trust is established for each primary beneficiary, eg partner, children sharing the deceased estate. If there is to be a single minimum age or time release of the deceased estate capital, a single age or date is set in the Will for the transfer of control of funds from the executor to the BCTT trustee. If there are to be staggered ages or time releases of the deceased estate capital, 2 or more ages or dates (plus percentages) are set for the transfer of control of funds to the BCTT trustee.

Parallel trusts are an option provided for in the Will, in the event that a primary beneficiary wants to utilise separate trusts, eg one BCTT providing security to a bank and the 2nd BCTT free of such security.

Flexible Life Interest

An alternative or additional option set out in the Will to the default option of a fully discretionary BCTT – with this option the trust capital is held for eventual payment to the children of the primary beneficiary. Often this option is utilised with the possibility or probability of a new domestic relationship in mind. A beneficiary controlled flexible life interest operates in the same way as an executor controlled flexible life interest, but with the primary beneficiary acting as (or choosing) the trustee.

Superannuation Death Benefits Testamentary Trust

This is a (usually) fully discretionary trust, but with a class of discretionary beneficiaries limited to all or some of the death benefits dependants of the deceased.

Prospective Primary Beneficiary Testamentary Trust

2 stages for executor to administer

- While primary beneficiary is **under 18 years** – income paid to guardian or direct payment of expenses, eg school fees
- Once primary beneficiary is an **adult** – income paid to primary beneficiary or direct payment of expenses, eg rental of house, HECS fees

Once control age attained, eg age 25, 30, 35 or 40, discretionary BCTT then commences

Prospective Testamentary Trusts

If the intended primary beneficiary under a Will has not attained the passing of control age (eg 25 or 30 years of age) when the initial administration of the deceased estate is complete, then the provisions of the Will create a prospective primary beneficiary testamentary trust as a precursor to a default BCTT.

A prospective primary beneficiary testamentary trust is administered by the executor of the Will. If the prospective primary or outright beneficiary dies before attaining the control age specified in the Will, the benefit under the Will does not pass into the deceased estate of the prospective primary beneficiary. Instead the benefit is dealt with under the terms of the Will. The benefit may pass, for example, to the children of the prospective beneficiary or prospective primary beneficiary. Those children are in turn usually subject to a similar control age and prospective provisions.

For as long as the prospective primary beneficiary is under 18 years of age, the income (and any capital that the executor is authorised to utilise) is either:

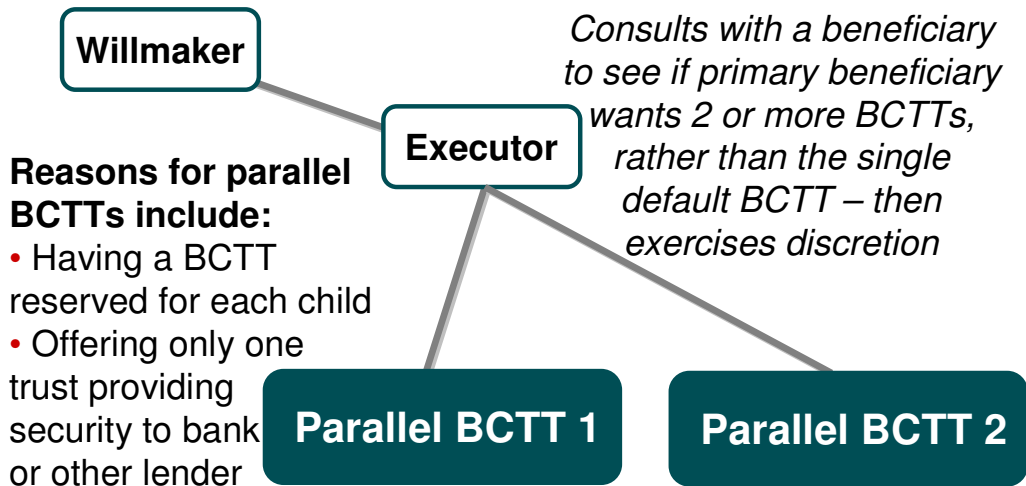
- paid to the guardian of the beneficiary to be spent on the beneficiary or as a reimbursement for expenses already incurred
- used to pay expenses that are of benefit to the beneficiary, eg primary or secondary school fees.

For as long as the prospective primary beneficiary is between 18 years of age and the control age, the income (and any capital that the executor is authorised to utilise) is either:

- paid to the beneficiary
- used to pay expenses that are of benefit to the beneficiary, eg rental of a house or other accommodation, tertiary institution fees.

The executor is often empowered by the terms of the Will to provide the beneficiary with a secured or unsecured loan, eg to acquire a home. Such a loan is usually free of interest.

Parallel BCTTs



Executor Options re Alternatives to Default BCTTs

The executor, with the primary beneficiary's consent, has the power both to by-pass the default BCTT for all or part of the assets and to exercise various options. Examples (from Will Precedent Document Templates – 9th edition), include:

Right of Occupation

“Option: to hold a residence that would otherwise have formed part of a trust established under this Will on trust with the Capital reserved for any one or more of the beneficiaries that would otherwise have been the beneficiaries of the trust under Part C of this Will, with a personal right of occupation in favour of the Primary Beneficiary or any other beneficiary, the terms and conditions of which may be stipulated by my Executors” .

Parallel Testamentary Trusts

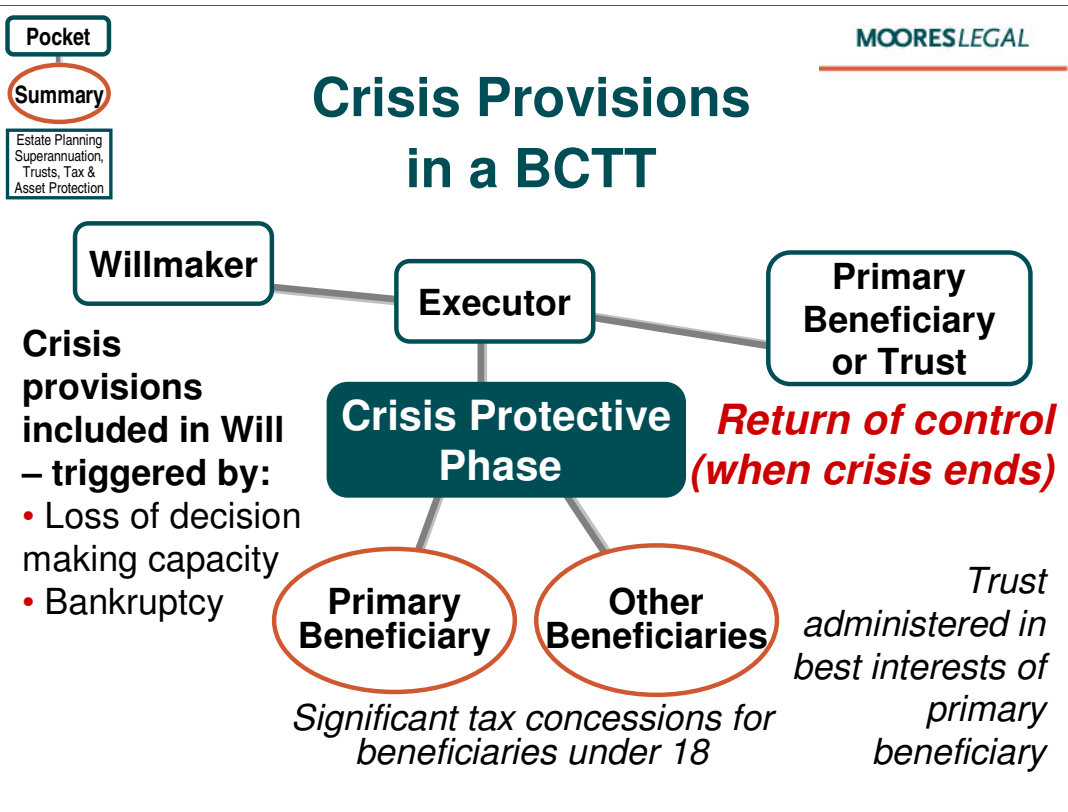
“Option: to hold on two or more separate trusts with the:

- Primary Beneficiary or any other person named by the Primary Beneficiary as Primary Beneficiary of each such trust; and
- income and/or capital beneficiaries of which are confined to all, some or any of the beneficiaries that would otherwise have been the beneficiaries of the trust under Part C of this Will.”

Capital Reserved Non-fixed Testamentary Trusts or Life Interest

“Option: to hold on one or more trusts with the Primary Beneficiary or any other person nominated by the Primary Beneficiary as Primary Beneficiary and in respect of which the:

- Capital is reserved for the fixed and absolute benefit of the Primary Beneficiary or another beneficiary of the trust; and
- income beneficiaries of which are confined to all, some or any of the beneficiaries that would otherwise have been the beneficiaries of the trust under Part C of this Will; or in any form of life interest.”



Loss of Capacity

The primary beneficiary of a BCTT may have (permanently or temporarily) as a result of an illness or injury lost the capacity to handle their own affairs and, importantly, to administer an otherwise beneficiary controlled testamentary trust where the trustee has the discretion to choose income and capital beneficiaries.

Rather than allowing the BCTT to continue on regardless, the crisis provisions in the Will require the executor to assume control of the BCTT and administer those assets in the best interests of the primary beneficiary until the primary beneficiary regains capacity or dies.

Bankruptcy

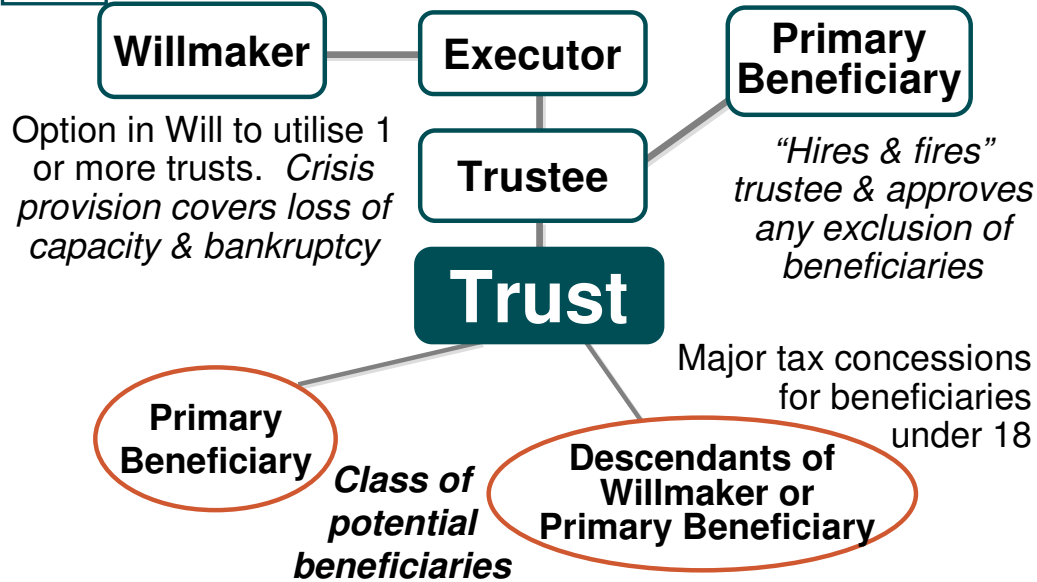
An unfortunate possibility of an outright inheritance from a solvent deceased estate is that if the intended beneficiary is bankrupt in Australia, eg because of the enforcement of a personal guarantee, the inheritance is paid to the bankrupt's creditors.

Given that the Willmaker is not the one owing the debt, the Willmaker can choose to place terms and conditions on the inheritance and include a crisis "trigger" in the Will if the intended beneficiary is bankrupt or unable to benefit from the inheritance. The executor assumes control of the trust and administers those assets in the best interests of the primary beneficiary until the primary beneficiary regains solvency or is free of the financial crisis.

The sections in the Australian *Bankruptcy Act 1966* that follow s 302 that effectively override clauses in a agreement, contract or Deed that purport to thwart a trustee in bankruptcy from taking control of assets do not apply to the provisions of a Will in creating trusts for beneficiaries.

By contrast to the situation of a primary beneficiary of a BCTT, where a willmaker dies insolvent or the deceased estate of an willmaker becomes insolvent, the terms of a Will cannot prevent the bankruptcy provisions applying to the deceased estate.

Descendants Only BCTT



Limitations of an Australian Descendants Only BCTT

A descendants only beneficiary controlled testamentary trust (“BCTT”) prevents the trustee allocating income or capital to the domestic partners or stepchildren of the descendants of either the Willmaker or the primary beneficiary (or both). At first instance this often appears to be an attractive option for both the Willmaker and the primary beneficiary.

In practice, however, there are 3 major drawbacks to having a narrower class of beneficiaries than is usual for a BCTT, ie:

- higher rates of income tax are often paid by the beneficiaries as the opportunity to split income with domestic partners is blocked;
- the Family Court has the power to order that a payment be made by the trustee of the descendants only BCTT to a beneficiary and then from the beneficiary to the beneficiary’s domestic partner; and.
- for willmakers subject to the notional estate rules of either the ACT or NSW, the ACT or NSW Supreme Court can view the assets of a descendants only BCTT as part of the notional estate of the primary beneficiary.

Often, where the scope of notional estate is a concern for the willmaker’s intended beneficiary, there are better alternatives to consider. In a flexible life interest, for example, the principal life tenant can be given no access to the capital .

Subject to the narrower class of income beneficiaries, a descendants only BCTT is administered in the same way as a standard BCTT.

Related companies and trusts and/or charities are sometimes included in the class of beneficiaries, provided that the beneficial ownership of those companies is confined to income beneficiaries of the descendants only BCTT.

BCTTs – Further Reading

**Australian Master Estate
Planning Guide –
Chapter 21**

**You Can't Take It
With You –
Chapter 11**

**The latest version of this Pocket Summary is at
www.mooreslegal.com.au/services/estateplanning/pocketsummaries**

Further Reading

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by CCH in 2012.
- *Estate Planning Documents* – Allan Swan, Moores Legal *L* (includes many of the Pocket Summary series).
- *You Can't Take It With You* – Andrew Simpson, Wrightbooks.
- *Tax Issues in Family Law Property Settlements* – Peter Szabo, Moores Legal.

Australia-wide Seminar, Workshop & other Presentations – Allan Swan

EPSTTAP Introductory: • Estate Planning – The A-Z (includes pages 1-7 of this Pocket Summary) • SMSFs – The A-Z • Trusts – The A-Z (1).

EPSTTAP Advanced: • Estate Planning – Case Studies • Estate Planning Masterclass (1 & 6-7) • Superannuation – Death Benefits & Binding Nominations • Testamentary Trusts – Drafting the 6 Major Types (All) • Trusts & Deceased Estates – Income & Capital Distributions (1) • AMEPG Chapter Workshops.

Allan's local Moores Legal client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations • Tax & Business Structures Overview (1) • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.