PROBLEMATIC TAXATION ISSUES IN ESTATE ADMINISTRATION

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General Overview

This paper focuses on discreet issues regarding the administration of an estate with a focus on tax (including duty, GST testamentary trust issues). The legal personal representative or representatives of an estate will therefore find this paper of most relevance, though beneficiaries will also find parts useful.

The information, however, can be used in the estate planning context as the issues of how the estate is ultimately administered and taxed both have a significant, and too often overlooked, impact on the preparation of estate plans and the drafting of clients' wills.

There are eight discreet topics considered herein. They are:

1. Executors / Executrixes and Administrators vs Trustees
2. Liability of the legal personal representative or representatives generally;
3. Stamp duty issues for beneficiaries;
4. Tax issues in estate administration;
5. Disclaimers by beneficiaries;
6. GST issues in estate administration; and
7. in some detail, Testamentary trusts.

By their nature – being discreet issues, albeit with relevance to each other – it is convenient to consider them separately.

Executors / Executrix's and Administrators vs Trustees

Given that this paper focuses on the administrative issues for the legal personal representative, and that a part of it will focus on testamentary trusts, it is appropriate to consider the similarities and differences between an executor or executrix or administrator, on the one hand, and a trustee, on the other hand, in the administration of estates and management of assets thereafter.

In doing so in this paper the term *legal personal representative* refers to an executor / executrix or administrator carrying out their functions up to the end of the administration of a deceased's estate. Once an executor / executrix or administrator becomes – for an asset of the deceased or a newly acquired asset – the trustee of a testamentary trust, their new role is referred to as a *trustee*.

1.1 Differentiating as between an 'executor' and a 'trustee'

Although both legal personal representatives and trustees are in a fiduciary relation (in particular, the duty to due administration) with respect to a beneficiary, the duties of a legal personal representative differ from the duties of a trustee of a trust created under a will. A legal personal representative is appointed by a deceased to execute, manage, administer, direct and dispose of a deceased's will. A legal personal representative is required to get in the assets of the deceased, pay expense, and distribute the residuary estate in accordance with the will (or intestacy or order of the court): see *Re Chirnside* [1956] VLR 295.

A legal personal representative only has a power to act in relation to a deceased's property after a grant of probate is obtained: *The Daily Pty Ltd v White* (1964) 63 WN (NSW) 262. That is, a legal personal representative's duties and powers are based on the principle that a legal personal representative is required to wind-up the deceased's estate. In contrast, a trustee has an on-going role, dependent on the term and duration in the trust terms (most often found in the trust deed).

With respect to a residuary estate, a change in character from a legal personal representative to a trustee occurs when an estate has been fully administered – that is, when all of the debts and liabilities have been discharged and the residuary is ascertained. Further, a legal personal representative (if property is retained after executorial duties are performed – see below) can become a trustee with respect to different assets of the estate at different times – acting in both the capacity of trustee and executor: see *Porteous v Rinehart* (1998) 19 WAR 495 at 503.

The duties of a legal personal representative are more circumscribed than those of other trustees. *Hansen v Young* [2004] 1 NZLR 37 is authority for the proposition that the primary responsibilities of legal personal representatives are those that relate to:

- the collection of the testator's debts;
- the identification of assets of the deceased;
- the payment of funeral and testamentary expenses; and
- the discharge of legacies provided under the will.

Lindley LJ in *Re Chapman* [1895] All ER 1104 observed that the role of an executor is:

> [S]imply to call to the testator's unsecured debts and to convert into money so much of his personal estate as was necessary to enable him to then pay his funeral and testamentary expenses and his debts and pecuniary legacies and to handover to trustees whatever personal estate was not wanted for those purposes.

Isaacs J in *Union Bank of Australia v Harrison, Jones & Devlin Ltd* (1910) 11 CLR 492 at 515-516 observed that:

> 'Death, while removing the individual, leaves the property, debts, and claims of the deceased still remaining. His nomination of an executor is a request to represent him for certain purposes including the payment of debts, and do what he can no longer do for himself. Wentworth … says that the office of executors is 'to execute the mind, will, and intent of their testator' … And for this reason that 'the main and principal part of an executor's office, and that which concerns the soul of a testator … is the payment of his debts: now who knows not that the very making of an executor is the continuing of such a person who is to pay all debts'.

Isaacs J at 515 further observed that a legal personal representative is '*… the minister and dispenser and distributor of the testator's property …*'.

In contrast, the essential duties of a trustee of a trust which is created under a will is to obtain control of the trust property. It was observed in *Hansen v Young* [2004] 1 NZLR 37 that the responsibility of trustees of trusts that are created under a will include:

- gather in funds due to the trust estate;
- preserve trust property, secure it from risk and loss; and
- conform to, and carry out the terms of the trust.

1.2 Similarities as between legal personal representatives and trustees

There are some similarities as between legal personal representatives and trustees. Specifically:

- both legal personal representatives and trustees owe a fiduciary duty of due administration to the beneficiaries: see *Johnson v Trotter* [2006] NSWSC 67;
- in the event of misapplication of trust property, then the equitable entitlement to trace subsists: see *Foskett v McKeown* [2001] 1 AC 102;

- trustee legislation include 'legal personal representative' within the definition of 'trustee': see for example section 5 of the *Trustee Act 1925* (NSW). As a result, the courts have a statutory (and inherent) power to remove trustees and executors: see for example *Gibbs v Gibbs* [2004] WASC 132. However, it should be noted that except in Victoria, the respective trustee provisions do not allow a court to appoint a new executor: see for example s 6(12) of the *Trustee Act 1925* (NSW).

- In most jurisdictions probate and administration legislation allows commissions to personal legal representatives and trustees of testamentary trusts: see s 86 of *Probate and Administration Act 1898* (NSW). Although not specifically provided for in NSW, commissions may be provided to NSW trustees under the 'expediency' jurisdiction.

1.3 Distinctions as between legal personal representatives and trustees

The powers and duties of legal personal representatives and trustees differ: see *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 324-325. Specifically:

- A legal personal representative is obliged to wind-up a deceased's estate, whereas a trustee has an on-going role. As a result, executors have a broader power of sale than trustees: see for example s 153 of the *Conveyancing Act* 1919 (NSW). However, a trustee has a broader power to carry on a business than a legal personal representative has.

- Both the legal and equitable interests in the estate is held by the legal personal representative. In contrast, only the legal interest vests in a trustee.

However, a legal personal representative still has fiduciary duties. Whilst both legal and beneficial interests are held by legal personal representatives, the full beneficial ownership is not held by the legal personal representatives, and they are still bound by fiduciary duties owned to beneficiaries of the estate: *Hosken v Danahar* [1911] VLR 214. Whilst beneficiaries of unadministered estates do not have an equitable interest in the estate, they have no right to caveat any property held subject to the estate: *Meynert v Leafdale Pty Ltd* [2005] WASC 102 at [32]-[39]. However, beneficiaries do have a right to secure proper administration of the estate: *Commissioner of Stamp Duties (QLD) v Livingstone* [1965] AC 694 and *Official Receiver in Bankruptcy v Schultz* (1990) 170 CLR 306.

Further, a legal personal representative who retains property after its executorial duties are performed will become a trustee with respect to the property: *McCaughey v Commissioner of Stamp Duties* (1946) 46 SR (NSW) 192. At that time, the equitable interest of the beneficiaries become vested, quantifiable and identifiable: *Probert v Commissioner of State Taxation* (1998) 72 SASR 48.

- In disposing trust property, trustees are required to act unanimously. However, individual executors can bind an estate, and can do so without concurrence of any other legal personal representatives: see *Johnson v Trotter* [2006] NSWSC 67 at [21], *Attenborough v Solomon* [1913] AC 76 and *Exception Holdings Pty Ltd (in liq) v Albarran* (2005) 223 ALR 487 at [20]-[26].

- During administration, executors cannot retire or appoint successor trustees. In contrast, appointment and removal of trustees is provided for in statute. However, an executor who holds an estate upon trust (i.e. after administration) may use the statutory powers: *Re Cockburn's Will Trusts* [1957] 1 Ch 438 and *Estate of Graham* [1910] VLR 466.

Further, in some jurisdictions, there are distinctions with respect to limitation of actions as between executors and trustees.

Liability of the Legal Personal Representative(s)

The liability of a legal personal representative in a Commonwealth tax context is dealt with in more detail at 1.10 below. Here the liability of a legal personal representative generally is considered.

1.4 Probate Legislation

Section 91 of the *Probate and Administration Act* 1898 (NSW) provides an indemnity to legal personal representatives, but it is limited to circumstances where the grant of probate is invalid, or otherwise affected, and that issue causes the liability of the executor.

1.5 Indemnity Generally

In certain circumstances trustees – and for many purposes legal person representatives of an estate are considered to be trustees – are indemnified from the trust's (or estate's) assets. However, that right of indemnity is a right to resort to and apply trust funds for the discharge of liabilities incurred in the *authorised conduct of the trust*: *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 371.

While it is true that case law establishes the indemnity applies in circumstances where the trustee was wrong, it is important to note that those cases apply where a third party – as opposed to the beneficiaries – sues the trustees. For instance:

- In *Re Raybould* [1900] 1 Ch 199 the trustee was carrying on a colliery business as part of the trust estate and, in the course of operations, he caused the subsidence of a neighbour's land and consequent injury to the buildings; it was held that the trustee's personal liability in damages could be recovered from the trust assets.
- In *Bennett v Wundham* (1862) 45 ER 1183 the trustees of a settled estate employed woodcutters to cut down some trees on the settled estate and during the carrying out of the work, a bough fell and injured a passerby who recovered heavy damages against the trustee. It was held that the trustee was entitled to indemnity out of the trust estate.

- In *Gastios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd (in liq)* [2002] ATPR 41-864 the NSW Court of Appeal held that the trustee of a trading trust, found to have contravened the *Trade Practices Act* 1974 (Cth) in the course of the trust business, was entitled to be indemnified.

Again, they were not beneficiaries suing the trustee. This is significant as the trustee – or in the case of a deceased estate, a legal personal representative – seeking indemnity from the estate when being sued by the beneficiaries would be self-defeating. The beneficiary's claim is for the effect the trustee's actions had on the estate. To indemnify such a claim from the estate would render the beneficiary's claim practically meaningless: see *Cherry v Boulthee* (1839) 41 ER 171. In that case it was held that a trustee that owes the trust cannot benefit from the right of indemnity until the debt owed is satisfied. That is, where the trustee has some obligation to the trust estate the right of indemnity of postponed behind the trustee's obligation. If the trustee is held to have breached the trust, and therefore is liable to the beneficiaries, the right of indemnity would be postponed to that claim.

Further, the question of authorisation is crucial. If the trustee's activities were not authorised by the trust instrument – or relevantly, the will – prima facie no right of indemnity can arise, and if they were authorised prima facie a right of indemnity does arise: *R W G Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385 at 396-7.

There can be specific examples where different rules apply. For instance, Geddes, Rowland & Studdert in *Wills, Probate and Administration Law in New South Wales*, LBC1996 Sydney at 404,[48.11] state:

> The remedies for devastavit by a personal representative are not the same as the remedies for breach of trust.

Somewhat unhelpfully the authors cite no authority in support of that proposition. However, it means that the restrictions on indemnity for breach of trust may not be directly applicable for devastavit (allowing assets of the estate to waste).

1.6 Indemnity clause in the will

There is a clear distinction between the liability of an executor to beneficiaries compared to creditors; since beneficiaries are bound by the terms of the will protection may be afforded, for instance an exclusion clause: *Armitage v Nurse* [1988] Ch. 241.

If a will contains an exclusion clause the legal personal representative will stand to benefit from that clause.

The starting point is that an exclusion clause concerning a trustee will be read no more broadly than its language requires on a fair reading: *Walker v Stone* [2001] 2 WLR 623 at 657 per Sir Christopher Slade.

Further, the exclusion is not available where the trustee has acted with mala fides or dishonestly: *Armitage v Nurse* [1998] Ch 241 at 252 per Millet LJ.

Finally, the context in which the clause appears, that is the whole document and setting, is relevant to its construction: *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500 at 510 per Mason, Wilson, Brennan, Deane and Dawson JJ.

1.7 If beneficiaries instigated the breach

Section 86 of the *Trustee Act* 1925 (NSW) allows indemnity to trustees if the beneficiaries have directed the conduct that is a breach. It provides:

> (1) Where a trustee commits a breach of trust at the instigation or request or with the written consent of a beneficiary, the Court may, if it thinks fit, make such order as to the Court seems just for impounding all or any part of the interest of the beneficiary in the trust estate by way of indemnity to the trustee or person claiming through the trustee.
>
> (2) The provisions of subsection (1) shall be deemed to empower the Court to impound all or any part of the interest of any beneficiary who receives any pecuniary benefit from the breach of trust.
>
> (3) This section applies notwithstanding that the beneficiary may be a married woman entitled for her separate use and restrained from anticipation.
>
> (4) This section applies to breaches of trust committed as well before as after the commencement of this Act, but shall not prejudice any question in any suit or other proceeding instituted before and pending at the commencement of this Act.

Consideration should often be given to this provision.

1.8 Relief for Breach

Section 85 of the *Trustee Act* 1925 (NSW) gives the court power to relieve a trustee of the consequences of any breach of trust they have committed. It provides:

> (1) Where a trustee is or may be personally liable for any breach of trust, the Court may relieve the trustee either wholly or partly from personal liability for the breach.
>
> (2) The relief may not be given unless it appears to the Court that the trustee has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the direction of the Court in the matter in which the trustee committed the breach.
>
> (3) (Repealed)
>
> (4) This section applies whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act.

Consideration should also often be given to this provision.

Stamp Duty Issues for Beneficiaries

Although the following stamp duty[1] is an impost, or saving, on the beneficiaries, it is dealt with first for two reasons:

1. It is a discreet point that can be dealt with succinctly; and

2. A beneficiary who seeks the legal personal representative's assistance in saving an otherwise unnecessary impost ought be assisted by the legal personal representative unless there are proper reasons for not doing so. That is, it is the legal personal representative's decision whether to exercise the appropriation power but that decision should be exercised for proper purposes and in a proper way.

Section 63 of the *Duties Act 1997* (NSW) (the '**Duties Act**') provides that:

> (1) Duty of $100 is chargeable in respect of:
>
> (a) a transfer of dutiable property by the legal personal representative of a deceased person to a beneficiary, being:
>
> (i) a transfer made under and in conformity with the trusts contained in the will of the deceased person or arising on an intestacy, or
>
> (ii) a transfer of property the subject of a trust for sale contained in the will of the deceased person, or
>
> (iii) an appropriation of the property of the deceased person (as referred to in section 46 of the *Trustee Act 1925*) in or towards satisfaction of the beneficiary's entitlement under the trusts contained in the will of the deceased person or arising on intestacy, and
>
> (b) a consent by a legal personal representative of a deceased person to a transmission application by a beneficiary, and
>
> (c) a transmission application to a devisee who is also the sole legal personal representative.

[1] Under the new *Duties Act* regime it is just "duty".

(2) If a transfer of dutiable property is made by a legal personal representative of a deceased person to a beneficiary under an agreement (whether or not in writing) between the beneficiary and one or more other beneficiaries to vary the trusts contained in a will of the deceased person or arising on intestacy, the dutiable value of the dutiable property is to be reduced by the portion of the dutiable value that is referable to the dutiable property to which the beneficiary had an entitlement arising under the trusts contained in the will or arising on intestacy.

(3) Section 25 does not apply to a dutiable transaction to which subsection (2) applies.

The Chief Commissioner of State Revenue for New South Wales gives the following example of an appropriate under 46 of the ***Trustee Act*** 1925 (NSW):

> Two beneficiaries (A and B) are equally entitled to the residue of a deceased estate which comprises:
>
> - The family home value at $500,000
> - Shares value at $500,000
>
> Each beneficiary is entitled to half of the family home and half of the shares. The trustee appropriates the family home and the shares so that the family home will be transferred 100% to A and the shares will be transferred 100% to B.
>
> Concessional duty of $50 will be chargeable on the transfer of the family home to A.
>
> This only applies where a trustee invokes their power under the Trustee Act 1925 to appropriate the property of the estate in or towards satisfaction of the beneficiary's entitlement under the estate. The $50 duty concession does not apply where the beneficiaries agree to vary the trusts contained in the will, or arising on intestacy.

It can be seen, then, there is a critical difference between the legal personal representative choosing to appropriate in accordance with their power under s 46 of the Trustee Act and that of the beneficiaries entering into a *Deed of Family Arrangement.*

In full s 46 of the Trustee Act provides:

46 Appropriation

(1) A trustee may appropriate any part of the property subject to the trust or of the real or personal estate of a testator or intestate in the actual condition or state of investment thereof in or towards satisfaction of a legacy or of any share or interest in the property or estate, whether settled or not, as to the trustee may seem just and reasonable, according to the respective rights of the persons interested in the property or estate, provided that:

(a) the appropriation shall not be made so as to affect prejudicially any specific gift devise or bequest,

(b) the appropriation shall be made with the consent, if any, required by this section,

(c) in making the appropriation the trustee shall have regard to the rights of any person who may thereafter come into existence or who cannot be found or ascertained at the time of the appropriation or as to whom it is uncertain at that time whether he or she is living or dead, and of any other person whose consent is not required by this section.

(2) The power of appropriation conferred by this section shall extend and apply to:

(a) property over which a testator exercises a general power of appointment,

(b) setting apart a fund to answer an annuity by means of the income of the fund or otherwise, provided that at the time of appropriation the fund would be sufficient, if it were invested in Government securities of the Commonwealth of Australia at par, to provide an income exceeding the annuity by at least fifteen per centum thereof,

(c) setting apart a sum of money in or towards the satisfaction of a legacy share or interest.

(3) For the purpose of an appropriation under this section the trustee may ascertain and fix the value of the respective parts of the property or estate and the liabilities to which the property or estate is subject as the trustee may think fit, and shall for that purpose employ a duly qualified valuer in any case where such employment may be necessary.

(4) An appropriation made pursuant to this section shall bind all persons interested in the property or estate, including the persons whose consent is not required, and to the extent to which the appropriation is made in or towards satisfaction of the legacy share or interest, the rights to which any person is entitled in

virtue of the legacy share or interest shall be restricted to the part of the property or estate so appropriated and shall not extend to any other part thereof which may be dealt with or disposed of freed from any such rights.

(5) An appropriation of property whether it is or is not an investment authorised by law or by the instrument, if any, creating the trust for the investment of money subject thereto, shall not, except as otherwise provided by this section, be made thereunder for the benefit of a person absolutely and beneficially entitled in possession, unless the person is of the age of eighteen years or upwards and of full capacity and the person consents in writing.

(6) An appropriation shall not, except as otherwise provided in this section, be made thereunder in respect of any settled legacy share or interest, unless either the trustee thereof, if any, not being also the trustee making the appropriation, or the person who may for the time being be entitled to the income, consents in writing.

(7) If the person whose consent is required under subsection (5) or subsection (6), not being the trustee of a settled legacy share or interest:

(a) is a minor, the consent may be given on the person's behalf by the person's parents or parent with whom the person resides or in whose custody the person is, as the case may be, or by the person's testamentary or other guardian, or if there is no such parent or guardian, by the Court,

(b) is an insane or incapable person, the consent may be given on the person's behalf by the person's committee or manager, or if there is no such committee or manager, by the Court,

(c) is an insane patient, the consent may be given on the person's behalf either by the Master in Lunacy or by the Court,

(d) is a person who cannot be found or ascertained, or as to whom it is uncertain whether he or she is living or dead, the consent may be given on the person's behalf by the Court.

(8) If the appropriation is of an investment authorised by law or by the instrument, if any, creating the trust for the investment of money subject thereto no consent save of the trustee, if any, of a settled legacy share or interest shall be required on behalf of:

(a) a minor, where there is no parent or guardian,

(b) an insane or incapable person or an insane patient, where there is no committee or manager,

(c) a person who may come into existence after the time of appropriation, or who cannot be found or ascertained at that time, or as to whom it is uncertain at that time whether he or she is living or dead.

(8A) Notwithstanding anything contained in paragraph (b) of subsection (1) or in subsection (5) or subsection (7) the consent of the annuitant shall not be necessary in any case in which the trustee, after having set apart a fund to answer the annuity, which fund at the time of appropriation would be sufficient, if it were invested in Government securities of the Commonwealth of Australia at par, to provide an income exceeding the annuity by at least twenty per centum thereof, has actually invested the fund in such securities.

(9) Where an appropriation is made under this section in respect of a settled legacy share or interest, the property appropriated shall be subject to all trusts for sale and powers of leasing disposition management and varying investments which would have been applicable thereto or to the legacy share or interest in respect of which the appropriation is made, if no such appropriation had been made, provided that nothing in this section shall relieve the trustee of the settled legacy share or interest, where the trustee is not the trustee making the appropriation, from the obligation to obtain payment or transfer of the property appropriated, if or when the same is so payable or transferable.

(10) Where the exercise of any power of sale conferred on a legal representative by section 153 of the *Conveyancing Act 1919* is subject to any condition or to the leave of the Court being obtained, the legal representative shall not be entitled to appropriate any part of the real estate under the powers conferred by this section, except with the leave of the Court.

(11) The trustee may make any conveyance or assent which may be necessary for giving effect to an appropriation under this section.

(12) Any appropriation or disposition of property made in purported exercise of the powers conferred by this section shall, in favour of a purchaser in good faith, be deemed to have been made in accordance with the requirements of this section, and after all requisite consents, if any, have been given.

The protection afforded by this subsection shall extend to the Registrar-General Crown Solicitor or other person registering or certifying title.

(13) In this section a ***settled legacy share or interest*** means a legacy share or interest settled by the trust instrument, if any, or by any other instrument, and includes any legacy share or interest to which a person is not absolutely entitled in possession at the date of the appropriation.

(14) In this section a ***manager*** means the person appointed under the *Lunacy Act 1898* to undertake the care and management of the property of an incapable person, and an ***insane patient*** means an insane patient within the meaning of that Act.

(15) This section shall not prejudice any other power of appropriation conferred by law or by the instrument, if any, creating the trust, and the powers conferred by this section shall be in addition to any such power.

(16) This section applies only if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have effect subject to the terms of that instrument and to the provisions therein contained.

(17) This section applies to trusts created either before or after the commencement of this Act.

General Comments on Appropriation

For the purposes of making an appropriation the legal personal representatives may ascertain and fix the value of the respective parts of the property or estate and the liabilities to which the property or estate is subject as they think fit and they may employ a duly qualified valuer in any case where it may be necessary: s 46(3) of the Trustee Act*.*

The power of appropriation, being a fiduciary power, must not be exercised so as to prejudice the interests of other beneficiaries.[2]

[2] See Ford and Lee, *The Law of Trusts,* 4th Looseleaf end at [16.200] citing *Wigley v Crozier* (1909) 9 CLR 425 at 439 per Griffith CJ.

The principle on which the appropriation of specific assets to a beneficiary is exercised is derived from the power to sell the asset to the beneficiary and to set off the purchase money against the legacy.[3]

The appropriation of an asset towards satisfying a beneficiary's entitlement entails the valuation of it at the date of the appropriation so as to render it into an accountable figure. However, once a proper appropriation is made subsequent changes in the value of the rest of the estate cannot affect its propriety or the manner in which the accounts should be finalised.[4]

In the case of realty, as here, where there is a trust to convert and divide, the trustees of a will may appropriate a separate parcel of the realty in satisfaction of the share of a beneficiary,[5] but not an undivided share, because that would make the disposition of the remaining undivided shares more difficult.[6]

If there is some dispute about appropriation then the administrators can apply to the Court for declaratory relief (which may involve joining parties).[7] Or, alternatively, judicial advice in respect of a proposed exercise of the power.

Duty Issues on Appropriation

A relatively recent case – *Bloore v Chief Commissioner of State Revenue* [2020] NSWSC 502 per Stevenson J – requires consideration in applying the s 63(1)(a)(iii) of the Duties Act concession. His Honour confirmed that the property being appropriated *must* be equal to or less than the entitlement for which the property is being allocated. That is, if one of the beneficiaries remaining interest in the Estate is more than the value of the property being appropriated the concession cannot be applied.

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[3] See Ford and Lee, *The Law of Trusts,* 4th Looseleaf citing *Re Lepine* [1892] 1 Ch 210 at 215 per Lindley LCJ; *Wigley v Crozier* at 438.
[4] Ford and Lee, *The Law of Trusts,* 4th Looseleaf end at [16.210].
[5] *Re Beverly* [1901] 1 Ch 681 at 685.
[6] *Biggs v Peacock* (1882) 22 Ch D 284.
[7] *Carr v Carr* (1987) 8 NSWLR 492.

This changed the earlier held view that exceed the value was permitted as the duty would only be applied on the excess; that is seems to no longer be the case and the entire appropriation becomes subject to duty.

Landholder Duty

It should also be noted that stamp duty on transfers of shares in private companies was abolished on and from 1 July 2016: s 34 of the Duties Act. Therefore, should the legal personal representative transfer shares in a company or units in a unit trust to a beneficiary, regardless of s 63 applying, there would be no duty anyway.

But if the company or unit trust is a *landholder* (e.g. $2 million or more of NSW land) and the transfer is a *relevant acquisition* (at least 20% of a private unit trust, 50% of a private company or 90% of a public entity is held *after* the acquisition), then landholder duty applies at *ad valorem* rates to the transfer under Chapter 4 of the Duties Act.

But, although s 163A(1)(d) of the Duties Act provides an exemption in the following terms:

> (d) if the interest was acquired solely as the result of the distribution of the estate of a deceased person, whether effected in the ordinary course of execution of a will or codicil or administration of an intestate estate or as the result of the order of a court, made under Chapter 3 of the *Succession Act 2006* or otherwise, varying the application of the provisions of a will or codicil or varying the application of the rules governing the distribution of the property of an intestate estate, or

arguably that does not include the appropriation equivalent as found in s 63.

Nominal Duty from deceased to the Legal Personal Representative

For completeness it is noted that there is only nominal duty on a transmission of assets from the deceased’s name to the legal personal representative’s name: ss 63(1)(a)(iii) and s 163A(1)(a)(iii) of the Duties Act.

Tax Issues in Estate Administration

As this paper focuses on the legal personal representative or representatives tax issues that arise in an estate's administration will be considered from that vantage point. That is, the tax issues for the legal personal representative in undertaking the estate administration, rather than the tax liabilities of the beneficiaries on assets passing to them from the estate, will be the paper's concern.

1.9 Deceased's Tax Liability Arises at Death

Even though taxpayers only have to pay tax when it is due for payment, often as a result of an assessment, their tax liability arises at year end; that is, before the income tax return is filed: s 4-10(1) of the *Income Tax Assessment Act* 1997 (Cth) (the '**1997 Act**'). But the obligation to pay depends on either the issue of a notice of assessment or the date specified in the relevant ATO *Legislative Instrument*[8] for lodgment of tax returns. When income tax is "due and payable", it becomes a debt due to the Commonwealth: s 208 of the *Income Tax Assessment Act* 1936 (Cth) (the '**1936 Act**') and s 255-5(1)(a) of Schedule 1 to the *Taxation Administration Act* 1953 (Cth) (the '**TAA**').

If income tax is imposed on income derived at year-end, as is the case with s 4-10 of the 1997 Act, a deceased person's liability arises at the time of death. This is despite the fact that there has been no assessment for that year: *Commr of Stamps (WA) v West Australian Trustee, Executor and Agency Co Ltd* (1925) 36 CLR 98. The assessment process is only a timing mechanism for payment and the basis for an objection or appeal.

1.10 Statutory Vicarious Liability

Division 260-E of Schedule 1 to the TAA sets out a special tax obligation and collection regime for legal personal representatives for outstanding tax-related liabilities of the deceased at the time of their death. The regime does not apply to tax liabilities that arise after death, which are the legal personal representative's separate responsibility.

[8] See the *Legislative Instruments Act* 2003 (Cth).

The term "tax-related liability" is defined to be '*a pecuniary liability to the Commonwealth arising directly under a taxation law – including a liability the amount of which is not yet due and payable'*: s 255-1 of Schedule 1 to the TAA. Once it is due and payable, it becomes a debt due to the Commonwealth and is payable to the Commissioner of Taxation: s 255-5(2) of Schedule 1 to the TAA.

The term "outstanding tax-related liability" of an entity at a particular time is defined in s 995-1 of the 1997 Act to be a tax related liability of an entity:

(a) that has arisen at or before that time (whether or not it is due and payable at that time); and

(b) an amount of which has not been paid before that time.

Subsection 260-140(2) of Schedule 1 to the TAA applies if a deceased had a tax liability at death – an outstanding tax related liability – and there has been either a grant of probate of the deceased's will or of letters of administration of the deceased's estate. It provides that the Commissioner of Taxation may, for the liability, deal with the legal personal representative as if the deceased person were still alive and the legal personal representative were that deceased person.

The relative onerous tax liabilities to which the legal personal representative or representatives are then subject are:

- to provide any returns and other information that the deceased person was liable to provide, or would have been liable to provide if they were still alive: s 260-140(3)(a);

- to provide any additional returns or other information relating to the liability that the Commissioner of Taxation requires: s 260-140(3)(b);

- to discharge, in the legal personal representative's capacity, the liability and any penalty imposed for the liability under a taxation law (including any general interest charge) that the deceased person would be liable for if they were still alive: s 260-140(3)(c).

The Commissioner of Taxation's practice is set out in *Practice Statement Law Administration* PS LA 2006/11 at [32.3.8]:

> A trustee is required to lodge with the Commissioner returns of all indirect taxes, as well as returns of all income, profits or gains of a capital nature or of any other nature prescribed by legislation derived by the deceased person in respect of the period to the date of death in which no return was lodged by the deceased person [s 260-140(3)]. Non salary and wage final returns should be accompanied by a full and true estimate of assets and liabilities valued at the date of death. This same information may be requested by the Commissioner in regard to salary and wage returns.

If the amount of the liability requires an assessment under a taxation law, but the assessment has not been made, and the legal personal representative fails to provide a return or other information the Commissioner of Taxation may assess that amount. If he does so, the assessment has the same effect as if it were made under that taxation law: s 260-140(4) of Schedule 1 to the TAA.

A legal personal representative has the same objection and appeal rights as if they were the deceased person: ss 260-140(4) and (5) of Schedule 1 to the TAA.

1.10.1 Indemnity Claim Against the Estate

Aside from a trustee's right under the general law to be indemnified – for which case law and relevant trustee legislation[9] provides – a legal personal representative has a statutory right under s 265-40 of Schedule 1 to the TAA to retain or deduct an amount from the deceased estate to compensate for any amount paid to the Commissioner of Taxation for the deceased's tax-related liability. The same rights also exist under s 254(1)(f) of the 1936 Act.

[9] *Trustee Act* 1958 (Vic), s 36(2); *Trustee Act* 1925 (NSW), s 59(4); *Trustee Act* 1925 (ACT), s 59(4); *Trustee Act* 1973 (Qld), s 72; *Trustee Act* 1936 (SA), s 35(2); *Trustee Act* 1962 (WA), s 71; *Trustee Act* 1898 (Tas), s 27(2); and *Trustee Act* 1980 (NT), s 26. These Acts include a legal personal representative within their definition of trustee (via the definition of trust estate). By the definition of 'trust' in the *Trustee Act* 1925 (NSW) s 5 the term includes '*the duties incident to the office of legal representative of a deceased person*'.

But that right to withhold must be exercised reasonably. If the potential tax liability is $200,000 it is arguably unreasonable to withhold a sum significantly higher than that. A reasonable allowance for the tax, potentially interest and penalties, and advisors' fees in dealing with the issue is what may be withheld.

If a legal personal representative makes a payment for a deceased person's tax liability up to the date of death, the payment will be a charge against the deceased's estate. Although the account of a deceased estate may separate the tax liabilities of the deceased for the period up to death and those arising after the date of death, the payment to the Commissioner comes from the one general estate.

1.10.2 Contribution Between Multiple Legal Personal Representatives

If there are multiple legal personal representatives they are jointly and severally liable for any obligation under s 260-140 of Schedule 1 to the TAA. If one of them has made payment to the Commissioner of Taxation, that representative has a statutory claim for contribution against the others: s 265-145 of Schedule 1 to the TAA.

1.10.3 Liabilities After Assets Distributed

If a legal personal representative has caused the distribution or diminution of the assets of a deceased estate, leaving it unable to pay its tax debts of which they were aware, the legal personal representative will be personally liable to the Commissioner of Taxation to the extent of the distribution or diminution: s 254(1) of the 1936 Act.

This most often arises after audit where fraud or tax schemes are involved.

The Commissioner of Taxation's approach is set out in *Practice Statement Law Administration* PS LA 2006/11 at [32.2.11] to [32.4.2].

1.10.4 Beneficiaries' Liability if No Assets Left to Pay Tax

The converse of the issue raised in 1.10.3 is whether a beneficiary, who has received a distribution from a deceased's estate that is later found to owe taxes but is insolvent, has a liability to make good that tax liability from their own assets up to the amount of the distribution. It seems not based on the Commissioner of Taxation's approach set out in *Practice Statement Law Administration* PS LA 2006/11 at [32.4.3].

This approach may be questionable, however, if the recipient beneficiary knew of the tax liability at the time of the distribution.

1.11 Where No Administration Starts

If a deceased has a tax liability at year end and no legal personal representative has been appointed within six months after the date of death, the Commissioner of Taxation can make a claim for the taxes by making a determination of the amount of outstanding tax-related liabilities that the deceased had at the time of death, publishing the claim and then seizing the deceased's assets to the value of the claim plus recovery costs: s 260-145 and 260-150 of Schedule 1 to the TAA.

The Commissioner of Taxation can also seek to be appointed as trustee under the applicable state law.

Anyone who has a claim against or an interest in an administered estate, or who later applies for probate or for letters of administration, and is dissatisfied with the Commissioner of Taxation's claim, has objection and appeal rights: s 260-145(5) of Schedule 1 to the TAA.

1.12 Insolvent Estates or Bankrupt Deceased's

If a deceased is bankrupt at the time of death, the bankruptcy process continues after death and the Official Trustee effectively administers the deceased's estate. Section 63 of the *Bankruptcy Act* 1966 (Cth) provides that the bankruptcy proceedings continue '*so far as they are capable of being continued, as if [the bankrupt] were alive.'*

If a deceased dies insolvent, the creditors of a debt not less than $10,000 may bring a petition for the administration of the estate under Part XI: s 244 of the *Bankruptcy Act* 1966 (Cth). This is often used by secured creditors. Service of the petition is usually on the deceased's legal personal representative: s 244(9) and (10) of the *Bankruptcy Act* 1966 (Cth). Part XI also deals with the situation where a debtor dies after the presentation of a creditor's petition: s 245 of the *Bankruptcy Act* 1966 (Cth). In both cases, the legal personal representative must make out a statement of the deceased's affairs and their administration of the deceased's estate: s 246 of the *Bankruptcy Act* 1966 (Cth).

A legal personal representative may present a petition for an order for the administration of the estate under Part XI of the *Bankruptcy Act* 1966 (Cth), accompanied by a state in duplicate of the deceased person's affairs and their administration of the estate.

1.13 The Family Home

It is appropriate to dwell shortly on the family home given its prevalence as an asset in most estate administrations.

There are some more common points that should not be in issue, such as that if the main residence exemption in Subdivision 118-B of the 1997 Act applies it will protect the beneficiaries from tax on any gain during the time it applied. But there are some specific provisions worth noting:

If an asset passes to beneficiaries no more than two years after the date of death, the gain in that period is covered by the main residence exemption: s 118-195 of the 1997 Act. But, if the transfer is more than two years, you need the Commissioner of Taxation's discretion to be exercised or the beneficiaries take with a cost base equal to the date of transfer the gain since the date of death is taxed. The Commissioner of Taxation says, on the ATO website, that:[10]

> In certain circumstances you're exempted from capital gains tax (CGT) on an inherited dwelling if you dispose of your ownership interest within two years of the person's death.
>
> You can apply to us to extend the two-year period. Generally, we would grant the extension if the delay is due to circumstances outside your control, such as:
>
> - the ownership of a dwelling or a will is challenged
> - the complexity of a deceased estate delays the completion of administration of the estate
> - a trustee or beneficiary is unable to attend to the deceased estate due to unforeseen or serious personal circumstances arising during the two-year period (for example, the taxpayer or a family member has a severe illness or injury)

[10] https://www.ato.gov.au/General/Capital-gains-tax/Deceased-estates-and-inheritances/Inherited-dwellings/Extensions-to-the-two-year-ownership-period/

- settlement of a contract of sale over the dwelling is unexpectedly delayed or falls through for circumstances outside the beneficiary's or trustee's control.

These examples are not exhaustive.

Another relevant point of note is the potential to lose the main residence exemption where a remainder interest is granted. In order to avoid the risk of a family provision claim, including via notional estate provisions, it is necessary to divest the asset to that it does not pass through the estate: see *Barns v Barns* [2003] HCA 9; (2003) 214 CLR 169. By giving a remainder interest to the intended beneficiary, and retaining a life interest for the original holder, the main residence exemption will not apply: *Private Ruling* 75086 (2007).

Finally, when considering a family home that was held by joint tenancy and the surviving spouse took the whole by survivorship, it is important to note that they remain separate CGT assets: s 108-7 of the 1997 Act.

1.14 When do Assets Pass

When an asset *passes* is relevant to a number of areas of the tax law:

- Division 128 of the 1997 Act, dealing with the effect of death;
- Subdivision 118-B of the 1997 Act, dealing with the main residence exemption;
- CGT Event K3 (s 104-215 of the 1997 Act), regarding gains or assets of a deceased.

There are also others. Of most relevance to the legal personal representatives, though, is Division 128 both because it is the relevant division and because its definition of *passes* is picked up by the entire Act in s 995-1.

Section 128-20(1) of the 1997 Act states that a CGT asset *passes* to a beneficiary of a deceased estate if the beneficiary becomes the owner of the asset in any of the following situations:

1. Under the deceased's will – or that will as varied by a court order;
2. By operation of an intestacy law – or such law as varied by a court order;
3. Because the asset is appropriated to the beneficiary by the deceased's legal personal representative in satisfaction of a pecuniary legacy or some other CGT interest or share in the estate (as to appropriation see the discussion above); and

4. Under a deed of arrangement entered into by the beneficiary to settle a claim to participate in the distribution of the deceased's estate, and any consideration given by the beneficiary for the asset consisted only of the variation or waiver of a claim to one or more other assets that formed part of the estate.

As to #4:

- There is no need for a claimant to actually commence litigation for the claim to be settled by Deed of Family Arrangement: See *Interpretative Decision* 2003/107; and

- it is therefore noteworthy that a deed of family arrangement affects the Commonwealth Tax position but not the Duties Act position.

1.15 Foreign Legal Personal Representatives

An issue can arise where one of the legal personal representatives is a non-resident. The issue arises because of s 14-200 of Schedule 1 to the TAA, which exposes a purchaser to tax on the purchase of a property if there is no clearance certificate at the time of sale.

That section applies if the following three matters are applicable to the transaction:

(a) You become the owner of a CGT asset as a result of acquiring it from one or more entities under one or more transactions;

(b) Subsection 14-210(1) (about foreign residents) applies to at least one of the entities; and

(c) At that time the CGT Asset is, amongst other things, taxable Australian real property.

The transmission from a deceased to the legal personal representatives is not within s 14-200 of Schedule 1 to the TAA because, although the legal personal representatives would become owners and the Property that is taxable Australian real property, the deceased is not a foreign person.

But the sale from the legal personal representatives to a purchaser is.

The way around this issue is to rely upon the fact that legal personal representatives (unlike trustee) can act severally, and need not act jointly, such that one only of the legal personal representatives can act on the sale. Therefore, the above issue can be avoided by the transmission of the Property being made to the resident legal personal representative(s) only, leaving out the non-resident legal personal representatives on this process.

Though this would oblige that resident legal personal representative(s) to account to the Estate for the proceeds of sale of the Property in the usual way. The non-resident legal personal representatives should satisfy themself that the process of the sale proceeds coming into the Estate is sufficiently certain before agreeing to this course.

But the on sale by the Executors to a third party is subject to s 14-200 of Schedule 1 to the TAA because the resident legal personal representative(s), who would be selling the Property to the purchaser. This removes the need for the purchasers to withhold 12.% of the purchase price of the asset.

1.16 No CGT Event A1 when the Deceased dies

Finally, and again for completeness, it is noted that although CGT Event A1 happens on the passing of assets from the deceased to the legal personal representatives[11], the effect of Division 128 is to remove any tax liability and move the deceased's cost base to the legal personal representative.

[11] Death is not an exception listed in s 104-10(7) of the Tax Act.

Disclaimer by Beneficiaries

Beneficiaries can often want to disclaim, including because an interest in an Estate or Trust affects their entitlements or because they do not want to receive from that particular deceased.

The Commissioner of Taxation considers no CGT event to occur in certain disclaiming situations: see *Taxation Ruling* TR 2006/14 at [29]-[32] for disclaimer of life interests and at [100]-[101] for disclaimer of remainder interests. But that ruling does not expressly deal with disclaiming a legal interest in fee simple as opposed to a life or remainder interest in the property.

That no tax consequences such a disclaimer in a trust context has also been confirmed: see *Ramsden v FCT* [2005] FCAFC 39.

There is no reason why the same does not apply to a deceased estate: see, for instance, *Re Straton's Disclaimer* [1958] Ch 42 per Jenkins LJ.

A relatively recent example of a disclaimer having the effect sought by someone to save their other social security entitlements occurred in *The Trust Company Limited v Gibson & Anor* [2012] QSC 183 per Mullins J.

But, there are two important timing issues that arise:

1. Any disclaimer must occur promptly if it is to be effective. For an example of things going wrong see *Alderton v FCT* [2015] AATA 807.
2. The disclaimer must occur *before* the relevant time that tax consequences would follow: see *Commissioner of Taxation v Carter* [2022] HCA 10; 2022 ATC 20-822.

GST Issues for Deceased Estates

The following GST rules apply on the death of a person who was registered for GST and for the legal personal representative after death.

1.17 Effect of death on registration

On the death of an individual who was registered for GST, the registration is canceled: s 25-55(2) of the *A New Tax System (Goods and Services Tax) Act* 1999 (Cth) (the '**GST Act**). The deceased's current period terminates on the day before the date of death: s 27-40(1) of the GST Act.

1.18 Effect of death on installment period

An installment period of a deceased registered for GST, who was an installment GST payer, does not terminate on death but there is no obligation to make any GST installment for the period starting after the date of death: s 162-85 of the GST Act.

1.19 Deceased's input credits

If the legal personal representative or a beneficiary of the deceased estate does not continue to carry on the enterprise of the deceased and is not registered for GST, the legal personal representative will be liable for an increasing cancellation of registration adjustment for the input tax credits claimed by the deceased: s 138-5 of the GST Act.

1.20 Legal personal representative or beneficiary carrying on the enterprise

If the legal personal representative or a beneficiary of the deceased estate continue to carry on the enterprise of the deceased and are registered for GST, the legal personal representative is not liable for an increasing cancellation of registration adjustment for the input tax credits the deceased claimed: s 137-17 of the GST Act. The legislation assumes that their GST registration is made immediately after the deceased's death.

1.21 In specie distributions to a beneficiary

If a deceased estate distributes enterprise assets to a beneficiary who does not carry on an enterprise, the GST input tax credits claimed by the deceased or the legal personal representative are cancelled and clawed back. This occurs by the legal personal representative calculating and making a GST increasing adjustment: s 139-5 of the GST Act.

The clawback does not apply if the legal personal representative or a beneficiary carries on or intends to carry on the enterprise carried on by the deceased: s 139-5(3) of the GST Act. For example, if an executor / executrix of a deceased who carried on the deceased's business distributes the trust assets to a beneficiary who carries on the same business.

Testamentary Trusts

A 'testamentary trust' is an 'express trust'[12], created under the terms of a will, or a codicil of a will. Testamentary trusts have the same attributes as other trusts. That is, they are a relationship as between a trustee and beneficiary[13] with respect to trust property. Further, and for the purposes of both trusts created inter vivos and those created under testamentary instruments, the following elements must be present in order for a trust estate to subsist:[14]

- first – there needs to be at least one trustee, who holds a legal (or equitable) interest in the trust property. The trustee has an obligation to deal with the trust property in terms of the trust;
- second – there must be property capable to be held on trust (*Port of Brisbane Corporation v ANZ Securities Ltd* [2003] 2 Qd R 661). Further, there must be certainty as to the property held subject to a trust (*Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271);
- third – there must be a beneficiary for whom the trust assets are held; and
- fourth – the trustee must be under a personal obligation to deal with the trust property for the benefit of the beneficiaries.

Testamentary trusts are also known as 'executory trusts'. Gummow J in *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271 observed at 280 that the term 'executory trust':

> … is used usually to describe situations where there is (a) an agreement or covenant for the subsequent execution of a trust instrument or (b) a direction or declaration (usually in a will) giving instructions or short leads from which the trustee is to prepare a formal written statement …

[12] There are three categories of trusts, being express trusts, resulting trusts and constructive trusts. An express trust is a trust created by express intention. A resulting trust is a trust created by implied intention. A constructive trust is a trust that is imposed to prevent person(s) from succeed in making an unconscionable assertion of ownership over property.

[13] Charitable trusts do not vest beneficial estates or interests in any persons, as they are established to promote a purpose, or purposes, and not for the direct benefit of persons as individuals or members of a class of individuals (see *Attorney-General for New South Wales v Perpetual Trustee Company (Limited)* (1940) 63 CLR 209 at 222-223).

[14] See paragraph 104 and following of *Jacobs' Law of Trusts in Australia*.

Lord Cairns in *Mortimer Sackville-West v Viscount Holmesdale* (1870) LR 4 HL 543:

> [T]he second codicil to the will of the testatrix … creates what is commonly described as an 'executory trust', that is to say, not a trust which remains to be executed, for in this sense all trusts are 'executory' at their creation, but a trust which is to be executed by the preparation of a complete and formal settlement, carrying into effect, through the operation of an apt and detailed legal phraseology, the general intention compendiously indicated by the testatrix. The codicil is, in fact, equivalent to directions or instructions for a settlement.

Broadly speaking, a testamentary trust displays the following characteristics:

- first – testamentary trusts are established under a testamentary instrument;
- second – testamentary trusts are funded by either:
  - the assets of a deceased estate; or
  - payments to the estate in consequence of death, such as superannuation death benefits or insurance proceeds paid to a deceased estate, rather than being paid to nominated beneficiaries under a will; and
- third – testamentary trusts are typically administered by the executor of the estate, or another person appointed as the trustee under the terms of the will. The testamentary trust is subject to the terms of the will.

1.22 Why establish testamentary trusts?

The main taxation benefit of a testamentary trust is the income tax concessions for minors, who are taxed as adults with the benefit of the tax free threshold under Division 6AA of the 1936 Act. Section 102AG of the 1936 Act provides for 'excepted trust income', being a category of income derived by minors.

'Excepted assessable income' includes Income derived by a minor from property of a deceased estate or which is transferred to a minor from a deceased estate (see paragraph 102AE(2)(c) of the 1936 Act).

'Excepted trust income' includes:

- paragraph 102AE(2)(c) of the 1936 Act – *'… assessable income of a trust estate that resulted from … a will, codicil or an order of a court that varied or modified the provisions of a will or codicil …'*; and
- paragraph 102AE(2)(d) of the 1936 Act - *'… is derived by the trustee of the trust estate from the investment of any property … that devolved for the benefit of the beneficiary from the estate of a deceased person …'*

That is, the essential requirement for minors to be eligible for the concessionally taxed income is that the income is *'… assessable income of a trust estate that resulted from … a will…'*. That is, it is essential to ensure that the trust under which the minor benefits is established under the testamentary instruments, and not subsequently declared or settled without the appropriate intentions / actions of the testator.

It was previously the law that as long as the trust itself was established under a will – no matter how nominal the sum – that was *the trust estate* for Division 6AA purposes: see *The Estate of the late AW Furse No 5 Will Trust v FC of T* (1990) 21 ATR 1123; 91 ATC 4007 per Hill J. That meant any amount of further assets could be added to a testamentary trust to benefit from the tax concessions. To address that issue s 102AG(2AA) was inserted into the 1936 Act to ensure it is only assets that went through the estate – or assets used from the income or growth of those estate passing assets – that benefit from the tax concession.

Further, it should be noted that a distribution to minor beneficiaries under the terms of a testamentary trust creates a legal entitlement in favour of the minor beneficiary. As a result, the distribution must either be physically paid to the minor beneficiary, or a loan account in favour of the minor beneficiary will be created, which will ultimately be payable to the minor either at demand, or when the testamentary trust vests.

As a result, and in the event that the testator wishes for the residuary estate be divided (ultimately) equally, and 'equalisation clause' may be required in the will. Such clauses allow for an allocation of 'non-will benefits' (e.g. insurance or superannuation proceeds) to be allocated to the other (non-minor) beneficiaries.

The purpose of the establishment of the testamentary trust will dictate whether it is 'discretionary' or 'fixed' in nature (or a combination of both), and as a result, the associated benefits which attach to the structure. A testamentary trust may be drafted so as to be (for example) on one hand:[15]

- *a restricted trust* – being established to protect particular vulnerable beneficiaries; and on the other
- *a discretionary testamentary trust* - under which there may be a wide range of potential beneficiaries under the terms of the trust.

Another example of a testamentary trust is a trust established with respect to certain property whereby (for example) a beneficiary has a life interest (i.e. an income beneficiary), with the remainder going to other beneficiaries (i.e. capital beneficiaries).

Macdonald[16] provides for the following reasons for establishing a testamentary trust:

- tax benefits on distributing income to minor children, grandchildren (see above);
- tax benefits on distributing income to lower taxed beneficiaries (see below);
- protection of assets from (future) ex-spouses;
- protection of assets from creditors;
- protection of assets from being wasted by spendthrift beneficiaries;
- protection of assets from being wasted by addicted beneficiaries; and
- a combination of all of the above.

Further, the terms of a testamentary trust may allow for the streaming of particular distributions to particular beneficiaries (e.g. franking credits, the 50% CGT discount, et cetera).

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[15] Perkins M and Monahan. Estate Planning – A Practice Guide for Estate and Financial Service Professionals. LexisNexis – Butterworths, Sydney, 2005 p 111.

[16] Arlene Macdonald. *Testamentary Trusts: Not Just 'Another' Trust?*. 14th National Intensive Retreat, 17-19 August 2006.

Further, and as also noted by Macdonald,[17] as a testamentary trust does not come in effect until the death of the testator, the terms of a testamentary trust may be varied at any time before the testator's death. Further, the property to be dealt with under the terms of the testamentary trust may change from time to time by the testator, until the testator's death.

The use and advantages of discretionary trusts in both tax planning and asset protection contexts have been well documented. In the usual form of discretionary trust, the trustee is given a 'discretion' to choose the share or amount of income which any one or more particular beneficiary (typically chosen from a specified class) of the trust is to receive. For example a trust deed may provide that '*… the trustee may distribute the trust income to the children of the Testator, and any members of the Testator's family according to the trustee's unfettered discretion*'.

It may be appropriate to vest a 'discretion' in the trustee when, for example, the needs of the beneficiaries may vary from time to time. From a tax planning prospective, such flexibility may enable the trustee to distribute the trust income in such a way (i.e. to those beneficiaries and in those amounts) so as to minimise the overall tax liability on the total trust income or on the total income of the family group for an income year.

Furthermore, as the beneficiaries of a discretionary trust are 'mere objects', then they have no rights to the assets held subject to the trust. As a result, the creditors of a beneficiary cannot prima facie attack the assets held subject to a discretionary trust.

Discretionary trusts are favoured because of the advantages attaching to their use. These include:

- when the trust property is held by the trustee, the assets are protected from claims by creditors of the beneficiaries and the beneficiaries are protected from claims by creditors of the trust. By comparison, in the case of a 'fixed trust' the (for example) unit holders have an item of property which may be attacked by the unit holder's creditors – being the unit in the unit trust;

[17] *ibid*

- trust income and capital can be distributed to beneficiaries in a tax effective way, the trustee having the discretion to accumulate trust income in the trust or to distribute it to beneficiaries; and
- the ability to transfer the use, enjoyment and benefit of (for example) the trust's assets free of transaction costs.

The tax disadvantages with the discretionary trust structure include that:

- losses are trapped within them (i.e. cannot be distributed);
- beneficiaries of a discretionary trust cannot claim a tax deduction for interest referable to borrowings which they might use to 'invest' in a discretionary trust.[18] This is because, as a result of a trustee's discretion to allocate income – a beneficiary in a discretionary trust has no expectation of receiving distributions of income. Rather, a beneficiary only has a right to be considered. If the Testamentary Trust is to be geared, then it would be necessary to do this in the trust – i.e. the trustee borrows and not the beneficiaries.

An issue to consider in the testamentary trust concept is how both the advantage, and the assets held subject to a testamentary trust remain with, and pass to the testator's family group. This may be achieved by:

- Ensuring that only those who are in the testator's family may benefit under the terms of the testamentary trust. In particular, it should be ensured that the capital default beneficiaries are those in the testator's family;
- Ensuring that the control (e.g. a position of 'appointor', 'guardian' or such other similar nomenclature) passes to the testator's family groups. As the position of appointor is personal, it may need to be ensured that the position passes under the will of those that will take the position is consistent with the testator's will; and
- Have an open beneficiary clause.

[18] The vexed issue (and not in the scope of this paper) is whether further settlements can be made on a testamentary trust after it has come into effect has been resolved by s 102AG(2AA) discussed above.

1.23 Formalities for establishing a testamentary trust

As testamentary trusts are created under the terms of testamentary instrument(s), the formal requirements for establishing a trust under a will are the same as the requirements for the creation of a valid will, or codicil. As a result s 6 of the Succession Act, which contains those requirements, need to be satisfied. Section 6 of the Succession Act provides:

(1) A will is not valid unless:

(a) it is in writing and signed by the testator or by some other person in the presence of and at the direction of the testator, and

(b) the signature is made or acknowledged by the testator in the presence of 2 or more witnesses present at the same time, and

(c) at least 2 of those witnesses attest and sign the will in the presence of the testator (but not necessarily in the presence of each other).

(2) The signature of the testator or of the other person signing in the presence and at the direction of the testator must be made with the intention of executing the will, but it is not essential that the signature be at the foot of the will.

(3) It is not essential for a will to have an attestation clause.

(4) If a testator purports to make an appointment by his or her will in the exercise of a power of appointment by will, the appointment is not valid unless the will is executed in accordance with this section.

(5) If a power is conferred on a person to make an appointment by a will that is to be executed in some particular way or with some particular solemnity, the person may exercise the power by a will that is executed in accordance with this section, but is not executed in the particular way or with the particular solemnity.

(6) This section does not apply to a will made by an order under section 18 (Court may authorise a will to be made, altered or revoked for a person without testamentary capacity).

That is, in order for a testamentary instrument (and therefore a testamentary trust under a testamentary instrument) to be valid:

- the testamentary instrument must be in writing;
- the testamentary instrument should be signed by the testator or by some other person in the presence of and at the direction of the testator;
- the testator's signature is made (or acknowledged) in from of at least two (2) witnesses; and
- at least two of the witnesses attest and sign the will in front of the testator.

Section 6 of the Succession Act, like section 23C of the *Conveyancing Act* 1919 (NSW)[19] is intended to prevent fraud.

As with other express trusts, in order to validly create a testamentary trust, there must be certainty with respect to:

- the intention to create the trust;
- the subject matter of the trust (i.e. the trust property); and
- the object(s) (i.e. the beneficiaries) of the trust.

Whilst all three of the certainties are often subject to dispute, the two most disputed aspects of testamentary trusts (and indeed testamentary instruments) include the capacity of a testator to make a will, and whether the testator was under undue influence when creating the trust instrument. It should be noted that as long as a testator has testamentary capacity, the testator (subject to illegality) may have a 'capricious' will - Young J in *Gregory v Hudson* (1974) 41 NSWLR 573:

[19] Section 23C of the *Conveyancing Act 1919* (NSW), which is modelled on the Statute of Frauds 1677 (Eng) has the objective of preventing hidden oral transactions in certain type of property, which defrauded those truly entitled to them (see *Vandervell v Inland Revenue Commissioners* [1967] 2 AC 291 at 311). This objective was accomplished by requiring the relevant transactions to be executed in writing or at least evidenced in writing.

There is nothing to stop a person making the most capricious will. A person could make a will which said that he gave all his property to X to be held on trust, the terms of which were that X was to arrange for a 0055 telephone number and was to pay the whole of the testator's estate to the hundredth person who rang that number, or for the first born child at a certain hospital in 1998. There is nothing to stop the testator directing that his executor convert the whole of the money into bank notes and proceeding to the corner of George and King Streets at 8 o'clock on a designated night and throwing the money away.

Further, there may be situations where the testamentary instruments show intention by the testator to establish a testamentary trust, but the precise terms of the trust are not provided. If the testamentary instrument provides that a trust is to be established, then a person taking a gift must hold the gift upon the trusts provided for, or upon trust for whom the law provides. It was observed in *Morice v Bishop of Durham* (1805) 32 ER 974 at 953 that:

> If he … [the testator] … says, he gives in trust, and stops there, meaning to make a codicil, or an addition to his Will, or, where he gives upon trusts, which fail, or are ineffectually expressed, in all those cases the Court has said, if upon the face of the Will there is declaration plain, that the person, to whom the property is given, is to take it in trust; and, though the trust is not declared, or is ineffectually declared, or becomes incapable of taking effect, the party shall be trustee; if not for those who were to take by the Will, for those, who take under the disposition of the law.

Similarly, in *Briggs v Penny* (1851) 42 ER 371 at 375, Lord Truro LC observed that:

> It is not necessary to exclude the legatee from a beneficial interest that there should be a valid or effectual; trust; it is only necessary that it should clearly appear that a trust was intended … Once establish that a trust was intended, and the legatee cannot take beneficially. If a testator gives upon trust, though he never adds a syllable to denote the objects of that trust, or though he declares a trust in such a way as not to exhaust the property, or though he declares it imperfectly, or though the trusts are illegal, still in all these cases, as is well known, the legatee is excluded, and the next-of-kin take.

For completeness, it should be noted that the rule against delegation of will-making power has been brought into line with the rule in equity regarding certainty of objects via section 44 of the Succession Act, which provides that:

> A power or trust to dispose of property, created by will, is not void on the ground that it is a delegation of the testator's power to make a will, if the same person or trust would be valid if made by the testator by instrument during his or her lifetime.

1.24 Importance of the terms of the testamentary trust

As well as establishing a testamentary trust, the testamentary instruments will also provide for the terms of the testamentary trust. As with trusts established inter vivos, the powers, duties, trusts and discretions that a trustee of a testamentary trust has is contained in the trust instrument – being the testamentary instruments. Indeed, Lord Westbury LC in *Wilkins v Hogg* (1861) 31 LJ Ch 41 at 43 observed that:

> The testatrix was at liberty to say 'Your duty shall require no more of you than this". The Court could not extend the office, or invest it with greater obligation.

As a result, both the rights and obligations of trustees of testamentary trusts, as well as beneficiaries will be provided for (primarily) in the testamentary instruments.

As a result, the usual tensions arise with respect to whether the powers and trusts under the trust are wide, and the potential resulting tensions that arise as between trustees (who control the trust estate) and beneficiaries. This may be an issue (for example) if there is property held subject to a testamentary trust by a sole trustee, for the benefit of more than one (adult) beneficiary.

Further, the flexibility of the use of the trust fund (for example, power of investment, amalgamation of trust fund et cetera) may be drafted narrowly for the purposes of protecting the trust fund, but may become an issue when dealing with the trust fund some time after the establishment of the testamentary trust.

1.25 Specific Power to Distribute to Minors

Picking up on the above heading, it is critical that the trust deed empower distributions to minors. Since a minor has no legal capacity to give a valid receipt or discharge, a trustee generally has no power to make a distribution of income or capital to them. A parent can not give a valid discharge to the trustee on the child's behalf: *Rotheram v Fanshaw* (1748) 3 Atk 628 at 629; 26 ER 1161 at 1162.

However, a trust deed may expressly grant this power: *Re Mears* (1905) 5 SR (NSW) 140.

And in certain cases a court may authorise a trustee to make a distribution to a minor for their maintenance and advancement, under either its inherent power (*Re Christian* (1882) 3 LR (NSW) Eq 13 and *Re Collins* (1886) 32 Ch D 229) or a statutory power. The Court so doing is an exception to the general approach that a court will not rewrite a person's will: see *Chapman v Chapman* [1954] AC 429 at 456-457; [1954] UKHL 1.

1.26 More than one testamentary trust?

A common issue that arises in the context of succession planning, particularly in the context of establishing testamentary trust(s) by a testator with a number of (adult) children, is whether one or more testamentary trusts should be established under a will.

For example, should one child be the trustee and appointor to hold the trust fund for the benefit of all of the children, should a testamentary trust be established for each of the testator(s) children, or a mixture of both?

This will depend on the individual circumstances of the family group, and will depend on circumstances outlined above.

1.27 The position of appointor

As with other trusts (e.g. *inter vivos* discretionary trusts), a method of ensuring control of a trust is maintained is by providing for an 'appointor', who may have rights with respect to (for example) the appointment and removal of trustees (i.e. overall control of a trust).

The considerations with respect to appointors of testamentary trusts are the same as those for *inter vivos* trusts.

It should be noted that the position of Appointor is a personal position, and is not an item of 'property'. In *Re Burton; Wily v Burton* - BC9405738, Davies J in the context of bankruptcy law, observed that '*… the power which Mr Burton holds as Appointor is not 'property' which vests in his trustee in bankruptcy nor a power 'as might have been exercised by the bankrupt for his own benefit'*. As a result, the position of appointor, because it is not an item of property but rather is a personal appointment, it was held that the position does not pass to a trustee in bankruptcy.

Similarly, in the context of succession laws, the position of appointor passes to a deceased's personal legal representative, and does not enter into a deceased appointor's estate. For example, section 40 of the *Probate and Administration Act 1898* (NSW) provides that the existence of 'property'[20] within the jurisdiction (i.e. NSW) is essential to grant probate and letters of administration: '*The Court shall have jurisdiction to grant probate of the will or administration of the estate of any deceased person leaving property, whether real or personal, in New South Wales.*' The only exception to this rule is a grant of administration to permit an application to be made under the Succession Act (formerly the *Family Provision Act* 1982 (NSW)): see section 41A of the *Wills, Probate and Administration Act* 1898 (NSW).

As a result, a position of appointor created under a testamentary trust, unless otherwise provided for, will pass to the appointor's personal legal representative and not the appointor's estate. The position of appointor will not be dealt with by (and for example) the *Probate and Administration Act* 1898 (NSW).

1.28 Secret Trusts

[20] It should be noted that the term 'property' is not defined in the *Wills, Probate and Administration Act 1898* (NSW). Rather, the terms 'real estate' and 'personal property' are defined in section 3 of the *Wills, Probate and Administration Act 1898* (NSW) as follows:

> **Real estate** extends to messuages, lands, rents, and hereditaments, of freehold or any other tenure, and whether corporeal, incorporeal or personal, and to any undivided share thereof, and to any estate, right, or interest (other than a chattel interest) therein, and in part 2 includes lands held under building leases or any lease for twenty-one years and upwards.
>
> **Personal estate**, except in part 2 as hereinbefore mentioned, extends to leasehold estates and other chattels real, and also to moneys, shares of government and other funds, securities for money (not being real estates), debts, choses in action, rights, credits, goods, and all other property whatsoever, which, prior to the coming into operation of the Real Estates of Intestates Distribution Act of 1862, commonly known as "Dr. Lang's Act," by law devolved upon the executor or administrator, and to any share or interest therein.

'Secret trusts' are a type of trust that may arise under a will. Secret trusts have been described as follows: [21]

> Secret trusts arise where a testator leaves property to X after communicating with X that X is to hold the property on trust. … Since a will is open for public inspection on the testator's death, a secret trust allows a testator to provide for an object he or she wishes to be kept secret.

However, it should be noted that 'secret trusts' may arise in wills under the terms of wills. In addition to the requirements required to establish an 'express trust',[22] secret trusts require the following three elements (see *Blackwell v Blackwell* [1929] AC 318):

- the testator's intention that the property is to be used according to its specifications;
- communication of intention to the intended trustee(s); and
- acquiescence on behalf of the trustee(s).

It should be noted that secret trusts arise in a will, but do not operate because of a will. Secret trusts arise outside of a will, and the beneficiary obtains its interest because of the trust and not the will: *Ledgerwood v Perpetual Trustee Co Ltd* (1997) 41 NSWLR 532.

1.29 Varying the terms of a testamentary trust

An issue is whether the terms of a testamentary trust may be changed. Whether a testamentary trust may be changed to appoint new beneficiaries has been a vexed point. The issue is whether such an amendment causes a resettlement to occur, or indeed if there is a delegation of trust power. It seems that the better view is that varying the terms of a testamentary trust to include a new 'class' of beneficiary will cause a resettlement to occur.

[21] G. E. Dal Pont and DRC Chalmers. *Equity and Trusts in Australia.* Law Book Co, Sydney, 2007 para18.45.

[22] That is, the 'three certainties' – being the certainty of intention to create a trust; certainty with respect to trust property; and certainty of objects / beneficiaries.

As with inter *vivos trust* estates, the first issue to determine when seeking to vary the terms of a testamentary trust is determining whether the trust instrument has a variation clause.

If the will does not contain a power of variation, then either the inherent jurisdiction of the court must be sought, or the terms of the *Trustee Act* 1925 (NSW) must be relied upon.

In *Chapman v Chapman* [1954] AC 429 at 456-457; [1954] UKHL 1, Lord Simmons explained four instances in which the court may exercise its inherent jurisdiction, which include:

- to change the nature of an infants' property holdings from personalty or realty, and vice-versa;
- to pay maintenance out of income where there is a direction to accumulate income;
- to effect a compromise on behalf of some infant beneficiaries; and
- to direct that, in the event of an emergency, a transaction unauthorized by the trust instrument should be carried out by way of salvage of the trust property.

Further, regard should be given to the court's statutory power to amend the terms of a trust. Relevantly, section 81 of the *Trustee Act* 1925 (NSW) provides that:

> (1) Where in the management or administration of any property vested in trustees, any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure, or transaction, is in the opinion of the Court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the instrument, if any, creating the trust, or by law, the Court:
>
> (a) may by order confer upon the trustees, either generally or in any particular instance, the necessary power for the purpose, on such terms, and subject to such provisions and conditions, including adjustment of the respective rights of the beneficiaries, as the Court may think fit, and

(b) may direct in what manner any money authorised to be expended, and the costs of any transaction, are to be paid or borne as between capital and income.

(2) The provisions of subsection (1) shall be deemed to empower the Court, where it is satisfied that an alteration whether by extension or otherwise of the trusts or powers conferred on the trustees by the trust instrument, if any, creating the trust, or by law is expedient, to authorise the trustees to do or abstain from doing any act or thing which if done or omitted by them without the authorisation of the Court or the consent of the beneficiaries would be a breach of trust, and in particular the Court may authorise the trustees:

(a) to sell trust property, notwithstanding that the terms or consideration for the sale may not be within any statutory powers of the trustees, or within the terms of the instrument, if any, creating the trust, or may be forbidden by that instrument,

(b) to postpone the sale of trust property,

(c) to carry on any business forming part of the trust property during any period for which a sale may be postponed,

(d) to employ capital money subject to the trust in any business which the trustees are authorised by the instrument, if any, creating the trust or by law to carry on.

(3) The Court may from time to time rescind or vary any order made under this section, or may make any new or further order.

(4) The powers of the Court under this section shall be in addition to the powers of the Court under its general administrative jurisdiction and under this or any other Act.

(5) This section applies to trusts created either before or after the commencement of this Act.

It should be noted that the power to vary trusts is narrower in New South Wales than in Queensland, Victoria, South Australia, Tasmania and Western Australia. The other States have provisions which specifically empower the courts to vary trusts.

Further, the New South Wales provisions only allow a court to vary if to do so, would be advantageous to the beneficiaries of the trust as a whole: *Riddle v Riddle* (1952) 85 CLR 202 at 220.