

LEGAL PROTECTIONS FOR THE VULNERABLE ADULT

A Practical Australian Analysis

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Overview

In Australia, the presence of a vulnerable family member, whether by reason of intellectual disability, gambling affliction, drug addiction or susceptibility to undue influence requires a different sort of estate planning if the needs of the intended beneficiary are to be catered for. The assumption that beneficiaries can eventually make their own decisions often needs to be discarded in favour of a more planned approach, with a shift in the balance between flexibility and prescription usually required. Funding issues; eg means tested eligibility, often also become more crucial.

This presentation focuses on a range of issues impacting on planning for on-going support of vulnerable family members.

Reasons for Adult Vulnerability

- ✂ Intellectual disability
- ✂ Mental illness
- ✂ Acquired injury
- ✂ Chemical addiction
- ✂ Gambling
- ✂ Emotional susceptibility



Dependants may also be at risk

Temple Grandin

Reasons for Adult Vulnerability

Among the people for whom financial decision making vulnerability (be it permanent, temporary or episodic and clear cut or difficult to determine) can be an issue are adults who have:

- congenital or other intellectual illnesses or conditions such as Down's Syndrome or one of the autism spectrum disorders;

- disabilities that occur, develop or become apparent during their lifetime and may or may not be treatable so that vulnerability does not become or remain an issue; eg a stroke, Alzheimer's disease, schizophrenia;
- physical disabilities; eg caused by muscular dystrophy, cerebral palsy;
- a temperament that makes them susceptible to financial difficulties;
- drug or chemical addiction problems serious enough to prevent them making rational decisions; and/or
- suffered head injuries as a result of an accident, eg workplace injury.

Likely exploiters of vulnerability



Vincent van Gogh

- ✂ Self serving relatives – rarely the parent(s) who raised the now adult child
- ✂ Opportunistic domestic partners
- ✂ Dubious financial/legal advisors
- ✂ Bureaucracy

Planning Issues (1)

Key planning issues for that may need to be addressed for a vulnerable adult include access to:

- care – the quality of the lives of many people's lives is often hugely influenced by the quality of appropriate care for the vulnerable individual (the cost of care is often underestimated when care has hitherto been the prime responsibility of a parent);
- food; eg special dietary needs;
- equipment; eg wheelchairs, pressure relieving beds, hearing aids;
- medication (not necessarily available at Government subsidised rates);
- accommodation – for some individuals, the problem is a lack of affordable accommodation; for others the need is greater as accommodation may need to be

tailored to meet their particular needs, eg because of limited mobility or risk of self harm.

Ongoing Support by Families

- ✂ Direct care, eg by parents (very expensive to replace)
- ✂ Financial support
- ✂ “Watchdog” role
- ✂ Assisting with dealings with bureaucracy



(Memorial to) Kurt Cobain

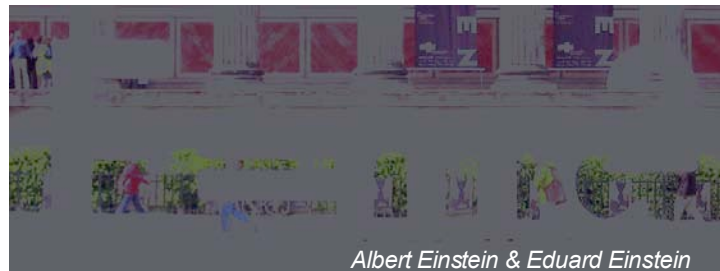
Planning Issues (2)

Further key planning issues for that may need to be addressed for a vulnerable adult include access to:

- transport – ranging access to public transport to modified motor vehicles to (in the case of individual's with very low vision) guide dogs;
- continuing education (including attaining life skills);
- supported or other employment;
- day programs;
- recreation and entertainment – an individual's quality of life can often be neglected when planning is solely focused on necessities of life (the Special Olympics held every 4 years is but a high profile example); and
- representation – many vulnerable adults benefit from people advocating on their behalf and may have great difficulty dealing with bureaucracies.

Government Response to Vulnerability

- ✂ Administrator system, eg public trustees, tribunals
- ✂ Often reactive, ie respond after a crisis has occurred
- ✂ Dubious recent Govt initiatives, eg, simplistic super, special disability trusts



Problematic Govt Initiatives

Two recent initiatives by the Federal Government have been problematic when assessing financial options for vulnerable options. These are:

1. Superannuation has been become 100% accessible by a pensioner; and,
2. Special disability trusts have failed to deliver significant benefit to target beneficiaries.

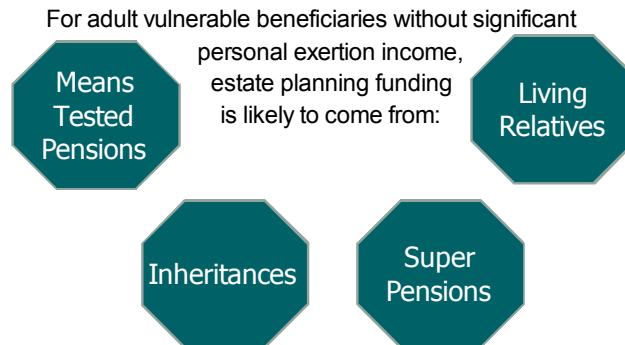
General Financial Vulnerability

Note: in Australia even high net worth individuals may be financially vulnerable, eg because of personal guarantees they have given or because of the:

- financial risk associated with their business or profession;
- financial risk associated with their directorship of a trading company or incorporated association; or
- financial risk associated with their level of personal debt; eg as a result of lifestyle expenditure exceeding income.

(See the Appendix for planning options (Standard Protective Options) for further points as to how to address these issues).

Vulnerable Beneficiaries



Cashflow – Funding Estate Plans

While unlimited funding would usually mean a range of possibilities for supporting a vulnerable beneficiary, the reality for most people is that the options open to them are limited by funding constraints and the fact that there are often other intended beneficiaries to consider; eg other children. The extent of the funding available will determine to what extent the estate planner's desired objectives can be achieved and to what extent they need to be modified or reconsidered.

It is often critical to look at ways of enhancing funding, both in terms of personal funding and in terms of eligibility for Government pensions and concessions (see below). While some estate planners will be unable or unwilling to enhance the level of personal funding they will be providing, others will be able to increase the level of available funding by:

- Wealth accumulation (if still possible) and retirement plans;
- Asset enhancement plans; eg ensuring that business assets will retain value on the death of a business principal; and
- Insurance cover for death, incapacity or for continuation of business.

Thus contingent funding of estate planning wishes can often be achieved for younger (and healthy) estate planners through life and other insurance or with careful longer term investment planning. For some older parents in particular no such opportunity may be available and the needs for retirement or of a surviving spouse may also compete with a wish to provide for a vulnerable beneficiary.

Where beneficiaries have suffered serious injury, compensation proceeds may need to be considered or claims may need to be initiated.

Exempt Assets & Next of Kin

Centrelink Exempt Assets

- # Own home (includes an interest in accommodation)
- # Pre retirement age super
- # Right of occupation or life interest
- # Special disability trust (note limits)
- # Assets owned by living parents (watch family companies & trusts)

Next of Kin (if no Will)

- # Spouse includes married or de facto; heterosexual or homosexual
- # Spouse & children share an inheritance
- # Parents inherit before sisters & brothers
- # Brothers & sisters need only one parent in common

Special Disability Trusts

The reason why there are likely to be many special disability trusts established in the future is because of the potential eligibility for income/assets means tested pension concessions for a principal beneficiary with a severe disability. As the concessions extend to eligible donors during their lifetime, these trusts may also be of significant benefit to those eligible donors; eg parents.

Under Australian procedures, Centrelink and Veteran Affairs concessions mean that the disadvantages of a special disability trust; eg its more limited scope and greater costs of administration, will be seen by many people as the price that has to be paid to gain the income and assets means tested pension concessions.

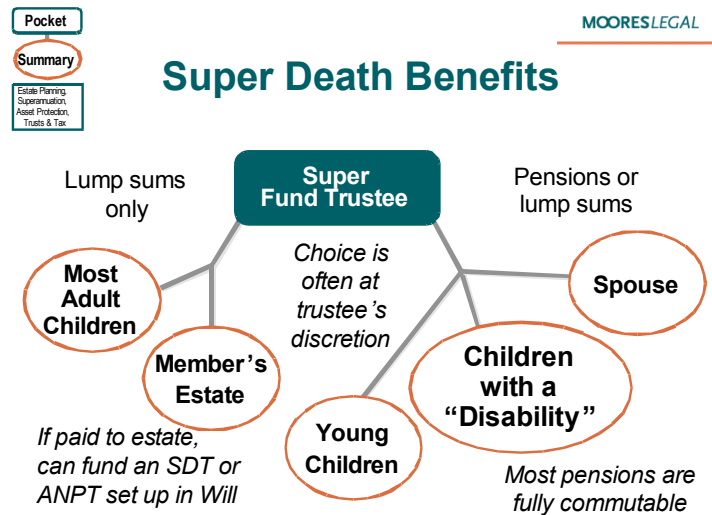
All Needs Protective Trusts

Two key reasons why an “all needs” protective trust may be an important option or alternative for a vulnerable family member are:

- Not all of the people who are significantly vulnerable to financial exploitation in our community will be classified by Centrelink/Veteran Affairs as having a severe disability and thus eligible for a special disability trust, eg many mental illnesses can render someone very vulnerable, but not necessarily eligible.
- In some cases, the amount of funds available to be placed on trust will either be too low to warrant being subject to the restrictions and costs of a special disability trust or be too high for the means tested concessions to apply.

Note: The 2 types of protective trusts can be run concurrently. For example, the 1st trust might hold a home and/or investments within the indexed exemption level (currently A\$551,750) to meet care and accommodation expenses. The 2nd trust (to meet other needs

and quality of life expenses) might start with funds sufficiently low to be within the principal beneficiary's Federal health card eligibility limit.



Paying Superannuation Death Benefits

As a consequence of the "sole purpose test" (see section 62 of the *Superannuation Industry (Supervision) Act* 1993 (Cth)), the choices as to payment of death benefits by the trustee of a superannuation fund are:

1. Lump Sum – Member's Estate or Dependants

A lump sum of all or part of the death benefits can be paid to the estate of the deceased. Alternatively, it can be paid directly to (or held on trust for) one or more "lump sum" dependants of the deceased; eg a surviving spouse, a child of any age or another person who was financially dependant on, or interdependent with, the deceased at the date of deceased's death).

Death benefits can be subject to income tax; eg most lump sum payments to an independent adult child.

2. Pension or Annuity – Income Stream Dependants

In addition to the rules relating to superannuation pensions generally, a pension commenced after the death of a fund member is only possible if the person was an "income stream" dependant of the deceased, eg a spouse, a child less than 18 years old, a financially dependant child who is aged less than 25 years old and children of any age that have a "disability".

A child death benefits pension needs to be cashed in at age 25 if the child does not have a disability.

Definition of “Disability” for Superannuation Death Benefit Purposes

- (a) is attributable to an intellectual, psychiatric, sensory or physical impairment or a combination of such impairments;
- (b) is permanent or likely to be permanent; and
- (c) results in:
 - (i) a substantially reduced capacity of the person for communication, learning or mobility; and
 - (ii) the need for ongoing support services.”

Katz v Grossman

- ✧ Key decision making role for 2nd (surviving) trustee/director (member or non-member)
- ✧ Able to solely choose who receives death benefits from sole member's super account
- ✧ Member's LPR not determined until probate of Will granted
- ✧ Member's wishes in Will or non-BDBN not binding on surviving trustee

Facts – Katz v Grossman [2005] NSWSC 934

A Self Managed Superannuation Fund (SMSF) was established on 25 March 1965. In May 1999, Ervin Katz appointed his daughter Linda Grossman as an additional trustee and became the sole member of the fund after the death benefits from the member's account of his wife Evelin were paid to his account.

In August 2003, Linda completed an application form for admission as a member of the fund. Ervin died in September 2003. In December 2003, Linda appointed her husband Peter as additional trustee of the fund. The appointment was made pursuant to section 6 of the *Trustee Act 1925* (NSW) rather than under the terms of the Trust Deed, as whilst the Deed permitted Ervin's estate to appoint an additional trustee, the estate was not functioning at this time as probate was not obtained until August 2004.

Linda and Peter refused to follow Ervin's non-binding death benefit nomination that his benefits in the fund be shared equally between his daughter and his son and determined to pay the death benefits of approximately A\$1m to Linda.

Daniel Katz challenged the appointment of Linda and Peter as trustees of the fund and also the appointment of Linda as a member of the fund on the basis that the appointments were defective. The Court however decided that Linda was able to exercise the power under the *Trustee Act 1925* (NSW) and therefore was able to appoint her husband as an additional trustee. Daniel however was successful in his challenge that Linda had not been validly admitted as a member.

The end result was that Daniel did not receive any of his father's superannuation benefits from the fund. Daniel could not have recourse to the Superannuation Complaints Tribunal as the tribunal does not have jurisdiction over a SMSF.

Preventing Katz v Grossman

- ✂ Binding death benefit nomination (may mean extra tax is payable on death benefit)
- ✂ Adjustment clause in Will (or family trust resolution) – need for sufficient assets
- ✂ Careful choice of fund membership & trustees/directors
- ✂ Careful choice of executors
- ✂ Special clauses in trust Deed

Lessons from Katz v Grossman

This case highlights the importance of having the right persons as trustees of an SMSF who are making the decision as to payment of the death benefits. Clearly, in this case, Ervin's intention was for both of his children to benefit from his superannuation as he provided for in his non-binding death benefit nomination.

Adjustment Clauses in Wills

One of the problems that Daniel Katz faced in the litigation was that the lawyer who drafted his mother's Will unfortunately did not appear to have included an adjustment or equalisation clause in her Will do deal with the possibility of unequal payment of the superannuation death benefits.

Binding Death Benefit Nominations

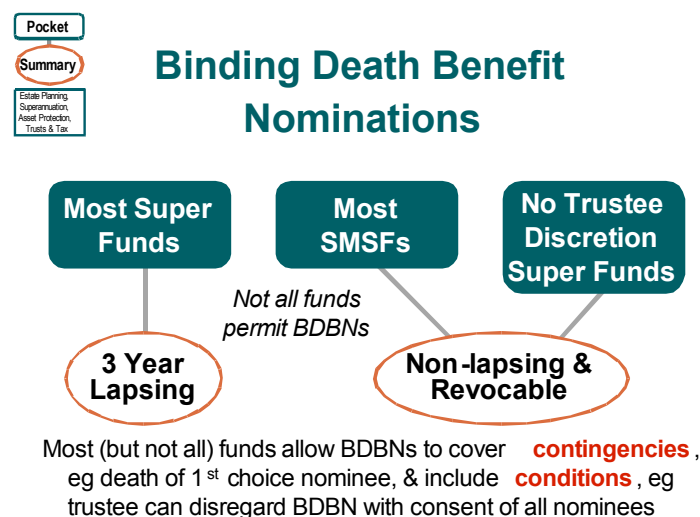
Had Ervin completed a binding death benefit nomination ("BDBN") nominating both of his children to receive the death benefit, the trustees would have been bound to pay the death

benefit in accordance with the BDBN, despite who was appointed as a replacement trustee after his death. It is believed the relevant Deed in this case did not permit members to make a BDBN.

Succession to the Role of Trustee

If a member dies, section 17A of the *Superannuation Industry (Supervision) Act 1993* provides that these rules must be complied with within 6 months of the fund failing to satisfy these rules. Should the Legal Personal Representative be appointed, their appointment runs from the time of the member's death until the death benefit commences to be paid.

Ensuring all potential beneficiaries of the superannuation are represented at the executor level is important if s17A(3)(a) of that Act is sought to be relied upon. The executors would therefore be responsible for making the decision as to whom to pay the deceased member's death benefit. Ensuring that the shares in any trustee company pass to the appropriate person or persons is also important.



Binding Death Benefit Nominations ("BDBNs")

One of the distinct features of the Australian superannuation régime is the power given to superannuation fund members (if the governing superannuation fund Deed permits) to provide the trustee of the fund with a nomination as to the payment of death benefits that the trustee usually has to follow.

The member's power to execute a nomination that is (in most cases) binding on the trustee of the superannuation fund is given to the member by the provisions of the *Superannuation Industry (Supervision) Act 1993* ("the SIS Act"), eg; section 59 for externally managed funds.

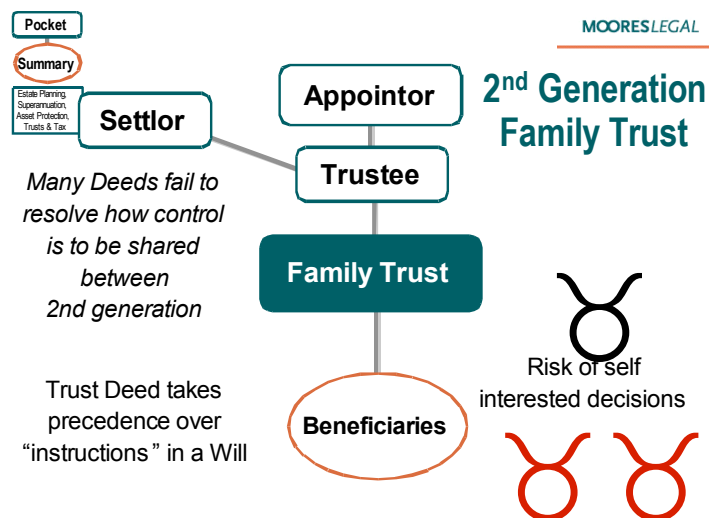
As with indicative (or non-binding) death benefit nominations, BDBNs can be made in favour of one or more of the fund member's "dependants", as defined for:

- Lump sum death benefits purposes – by subsection 10(1) of the SIS Act; and
- Income stream death benefits purposes – by sub-regulation 6.21(2A) of the Superannuation Industry (Supervision) Regulations 1994 (“SIS Regulations”).

BDBNs are quite separate from (and take precedence over) the fund member’s Will and are not automatically revoked when the fund member separates or divorces. A Will is, however, relevant if the BDBN requires all or part of the death benefits to be paid to the fund member’s legal personal representative (“LPR”).

Like Wills, BDBNs need to cover the possibility of a first^t or subsequent choice of nominee dying before the death benefit is able to be paid – reserve nominees should be included in the fund member’s nomination. Some, but not all, trustees allow conditional BDBNs (see later slide) and some accept a lapsing BDBN that expressly permits an enduring power of attorney or other LPR to confirm or re-confirm the nomination.

In the absence of a valid BDBN, the fund trustee, subject to the fund Deed, has the discretion to pay the member’s death benefits pursuant to section 62 of the SIS Act (ie to one of more dependants of the deceased or wholly or partly to the fund member’s LPR).



Control of a Family Trust

The trustee’s control of most family trusts is not absolute, because the trustee:

- Usually needs the consent of the appointor before major decisions can be made, eg the distribution of all or part of the capital;
- Can be removed as trustee by the appointor and another, replacement trustee can be appointed.

This means that the choice of the appointor of a family trust is often crucial, eg if the trustee has complete discretion to choose between any of the beneficiaries as to who receives the trust income and (unless it is reserved by the Deed) capital.

Control of a Family Trust – Second Generation

A critical estate planning issue for many people is who is to take over the power of appointment if the decision is taken to continue the trust into the second generation as a single trust. Usually, this issue is decided by the terms of the Trust Deed, with the terms of a Will only becoming relevant if and to the extent the Trust Deed so provides. Where the control is to pass to one person; eg an only child or just one child, this can usually be achieved by a simple nomination or amendment providing for the person to take over control on the death of the current appointor(s).

Where the control is to pass to more than one child, the issue is how that control is to be shared and what deadlock breaking and dispute resolution clauses are to apply.

Probable Need for Review

Frequently, a review of the Trust Deed is needed as many existing Deeds do not deal with the issue of second generation control. Care should be taken with the terms of any amendment in the light of the ATO's Statement of Principles on resettlement of a trust and the varying attitudes of different State and Territory Revenue Offices.



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Family Trusts – 2nd Generation Options

1. **Sole** Control
2. **Shared** control (adding dispute resolution clause may trigger CGT/duty)
3. **Neutral** control
4. Reduction of **net assets to nil** , eg distribution from asset revaluation reserve
5. **Cloning** or splitting (may trigger CGT/duty)
6. **Winding up** (may trigger CGT/duty)

Second Generation Control Options

For people with two or more children or other beneficiaries that they wish to benefit in the future from a family trust with assets that are likely to be retained past the current generation of control, there are six main options for passing that control. Notwithstanding the triggering of a Capital Gains Tax Event ("CGT Event") and possibly a dutiable transaction, winding up a trust can prove the most straightforward solution. Cloning or splitting a trust can now trigger a CGT Event and a dutiable transaction. The remaining four options are:

1. Sole Control

This is often the simplest solution, usually accompanied by an adjustment clause in a Will and/or a compensatory superannuation binding death benefit nomination. An amendment to the Trust Deed may be needed to facilitate this and the shares in the trustee company would be transferred via the Will as well.

2. Shared Control

Often this option occurs when the current appointors decide to trust the second generation not to behave unethically. Amending the Deed to provide a process for regulating disputes between the second generation; eg via mediation or arbitration, runs the considerable risk of a taxable CGT Event and possibly a dutiable transaction.

3. Neutral Control

The apparent cost of neutrality is often the reason why this option is not taken up. When the neutral administration option is utilised, it is critical that the neutral trustee is given clear guidelines as to how to administer an otherwise discretionary trust.

4. Reduction of Net Trust Assets to Nil

Creating asset revaluation reserves to fund capital distributions reducing the net trust assets to nil enables the size of the Willmaker's net estate assets to be increased. Income tax consequences need to be considered with this option, particularly if the trust has a "distributable surplus" in favour of a company beneficiary.



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Priorities for Protective Trusts

Established for vulnerable people, typically priorities (*in order*) will be:

- # Care and accommodation (the only expenditure priority permitted for "Special Disability " trusts)
- # Other essential needs, eg food, clothing, education
- # Quality of life benefits, eg entertainment, recreation

The needs of residual beneficiary not usually a priority, but the presence of a residual beneficiary provides asset protection

In most protective trusts, the vulnerable beneficiary has lifetime benefit of income and capital – usually the Willmaker or donor(s) stipulates who benefits after the vulnerable beneficiary dies

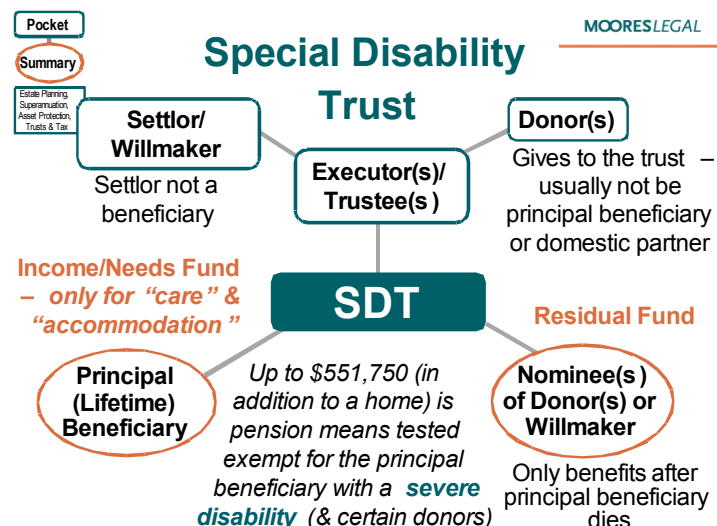
Priorities for Protective Trusts

The terms of trust for a protective trust for a vulnerable person are very different from a discretionary family trust. Instead they are usually relatively close to the default "prudent

person” rule that applies to all trusts to the extent that the terms of trust are not defined . (The "prudent person" rule usually applies to all enduring powers of attorney and to trusts where the State or Territory authority has appointed an administrator for a “represented” person.)

Where a special disability, all needs or other protective trust is being established by a Will or Deed, rather than just relying on the default statutory State or Territory prudent person rule, it is recommended that the following issues be specifically addressed in the terms of a protective trust:

- **Care, accommodation and support services** (finding suitable accommodation and carers can be a major difficulty, but can make an enormous difference to a vulnerable person’s quality of life; similarly care and support services can be a major on-going expense for many vulnerable people);
- (For protective trusts other than special disability trusts) **quality of life** (it is usual for the trustee to be given examples of what sort of quality of life expenditure can and should be incurred if surplus funds are available, eg recreation, holidays, travel);
- The **limited rights of residual beneficiaries** who usually only come into play on the death of the principal beneficiary, but in the absence of suitable priority provisions, can pressure or influence the trustee to manage the trust with their interests in mind. The presence of residual beneficiaries helps protect trust assets from challenge, eg by a spendthrift or gullible principal beneficiary.



Major Reasons for a Special Disability Trust

1. To provide in a single trust for the care and accommodation (but not other needs) of a child/other relative/friend with a severe disability (the “principal beneficiary”).

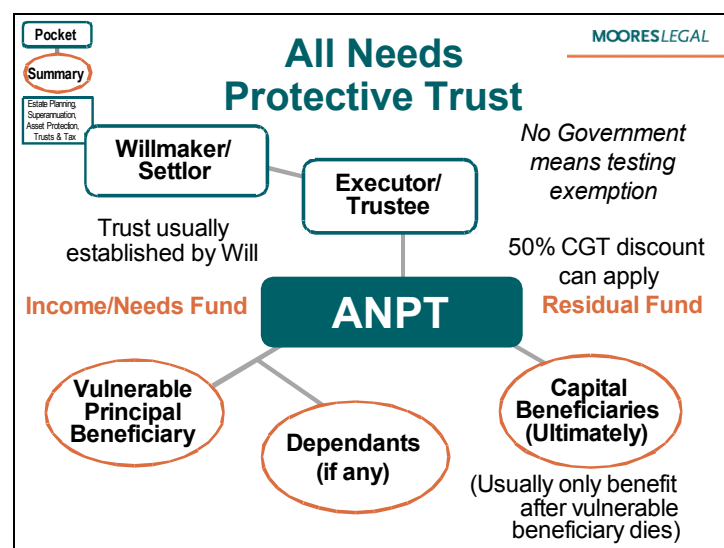
2. To have up to a threshold (currently A\$551,750) of assets and the income generated thereon being free of Centrelink and Veteran Affairs means testing for both the principal beneficiary and certain living donors.
3. Protection of trust assets from the principal beneficiary's possible creditors or unsuitable next-of-kin; eg an estranged natural father.

Trustees

The trustee must be either a professional trustee or at least 2 Australian resident individuals. The power to replace the trustee may be held by an appointor(s). The trust document's terms (Deed or Will) should be based on the Federal Government's model trust Deed.

Income, Capital Profits (Usually 50% CGT Discount) and Pension Benefits

While benefiting from a Centrelink/Veteran Affairs assets and income means testing threshold exemption, the principal beneficiary is taxed on trust income each year, with credit for any tax already paid; eg dividend franking credits. If the constraints of a special disability trust are an issue; eg the limitation of expenditure on care and accommodation, an all needs protective trust can be established instead or as well. If the trust owns the principal beneficiary's residence, the home will be exempt from CGT and probably from Land Tax, as well. If trust assets that were owned by a Willmaker pass via the trust to the Willmaker's nominee, no taxable CGT Event occurs until the residual beneficiary disposes of them. Other trust assets taxed as a capital gain on sale and for Deed trusts, (if not passing to the principal beneficiary's estate) on the death of the principal beneficiary.



Major Reasons for an All Needs Protective Trust

1. To protect (financially) a beneficiary who is vulnerable, but who has not been assessed by Centrelink/Veteran Affairs as having a severe disability.

2. To provide for paid care by relatives, food, clothing and recreation needs of a person who has been assessed as having a severe disability.
3. Establishment of a protective trust free of the constraints of a special disability trust; eg to support both the vulnerable beneficiary and any children.
4. Protection of trust assets from unsuitable next-of-kin; eg a child's estranged natural father.

Trustee (No Minimum Number Applies)

- Will – usually the trustee is the executor of the estate and is not usually subject to a power of appointment by a third party.
- Deed – the trustee is usually a family member, friend or a professional trustee.

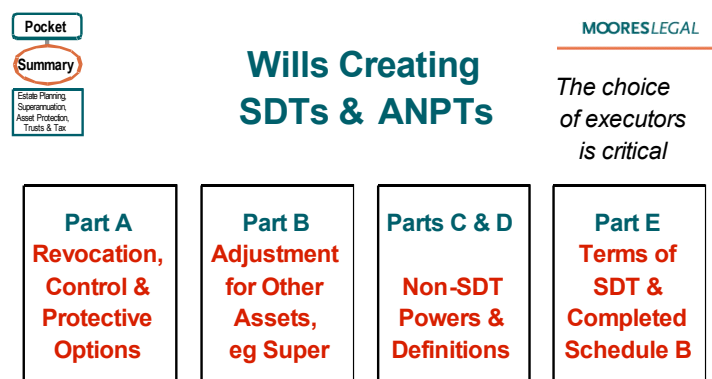
Income and Means Tested Pension Benefits

The vulnerable beneficiary is taxed on all trust income spent on or allocated or paid to or for the beneficiary, with credit for any tax already paid, eg dividend franking credits. Both income and capital are included in the vulnerable beneficiary's pension means test calculations.

Capital Profits (Usually Subject to a 50% Discount)

If trust assets that were owned by a Willmaker pass via the trust to the residual beneficiary, no taxable CGT Event occurs until the residual beneficiary disposes of them. Other trust assets taxed as a capital gain (for the vulnerable beneficiary, the vulnerable beneficiary's dependants or the residual beneficiaries) on sale or winding up of the trust.

WILLS CREATING SPECIAL DISABILITY TRUSTS and ALL NEEDS PROTECTIVE TRUSTS



In Part A the executors are usually given the power to choose between the SDT in the Will, any SDT that may have been established, an ANPT & contributing to super

Will Creating Protective Options

While the format of a Will creating protective options for a vulnerable person can vary, a typical format is set out as follows:

Part A

Among the clauses included in this Part of the Will are the:

- 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;
- Appointment of immediate and reserve executors, as well the nomination of any preferred advisors – given the vulnerability of the “protective” beneficiary, the choice of trustworthy and competent executors is critical;
- 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);
- Executor options for the protective arrangements for the vulnerable beneficiary;
- The terms of the All Needs Protective Trust; and
- Division of remaining estate provisions.

Parts B, C and D

Part B of the Will instructs the executor to adjust estate distributions to reflect benefits that the primary beneficiaries might receive from non-estate sources.

Part C sets out general administrative provisions for the estate.

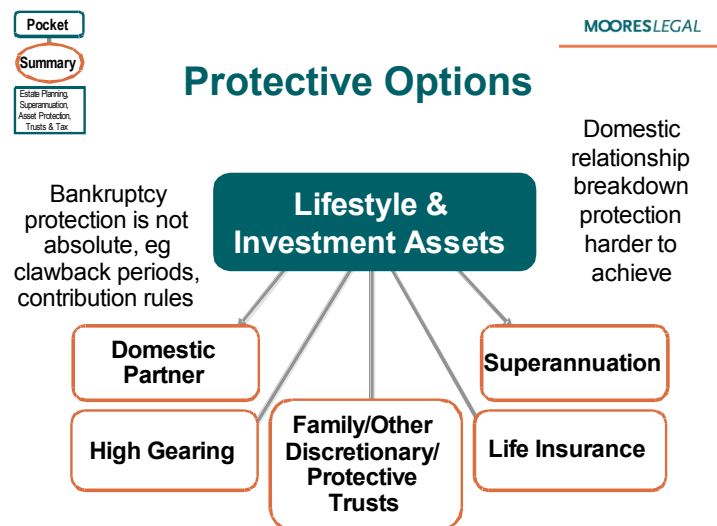
Part D sets out the definitions applying to particular words that are used in the Will, eg “child”.

Part E

Part E of the Will sets out the terms of the Special Disability Trust (which will need to be approved by Centrelink) and includes a completed Schedule B setting out who is to benefit when the principal beneficiary dies.

Appendix

Standard Protective Options – Family Law & Creditor Protection



Need for Asset Protection

The investment and lifestyle wealth that a person owns, controls or inherits may be in jeopardy for a variety of reasons; eg:

- Bankruptcy, whether because of personal transactions such as the calling in of a loan, liability associated with a profession or other occupation or the directorship or a senior executive role with a trading company;
- The enforcement of payment of a personal guarantee or indemnity given to a relative, friend or associated entity;
- The breakdown of a marriage or other domestic relationship.

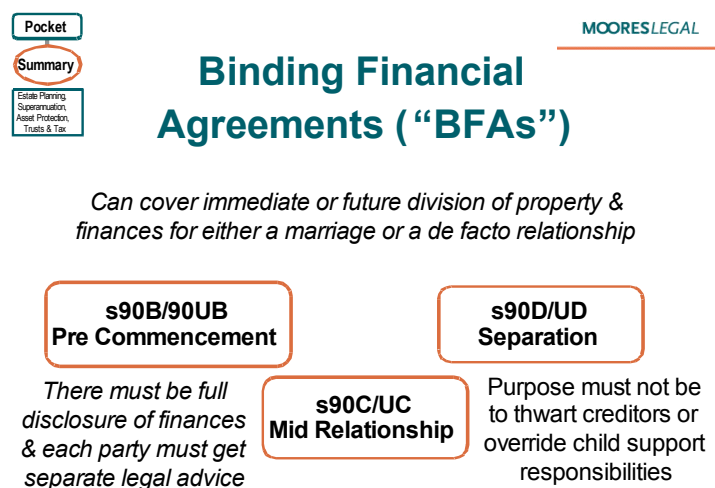
Financial Risk – Bankruptcy and Personal Guarantees/Indemnities

The right of the trustee in bankruptcy or the holder of a personal guarantee to recover all assets of the bankrupt or guarantor is significant, but does not extend to every asset

associated with the bankrupt or guarantor. Section 116 of the *Bankruptcy Act* 1966 (Cth) places some limitations on assets that can be recovered and, currently at least, the use that can be made of any trusteeship or power of appointment that a bankrupt may acquire when (pursuant to section 58) the assets of the bankrupt vested in the trustee in bankruptcy.

Domestic Risk (see also Binding Financial Agreements)

The laws relating to marriages and other domestic partner relationships are quite different from the bankruptcy laws and need careful consideration and independent legal advice for the respective parties. The rights of heterosexual partners (usually determined, or soon to be determined, by Federal family law) differ from the rights of homosexual partners (currently determined by the laws of the eight States and Territories). The Family Court of Australia has the power to split superannuation and make orders binding on the partners, their professional advisors and their relatives, friends and associates in respect of assets owned by individuals, trusts and companies.



Binding Financial Agreements – 3 Types for Marriages & De Facto Relationships

The three types of Binding Financial Agreements (BFAs) under the federal *Family Law Act* 1974 (Cth) are:

1. Section 90B or 90UB Agreement – can cover:

- How, in the event of the “breakdown” of the “marriage” or “domestic relationship”, any of the property or financial resources that either party had before divorce is to be dealt with;
- The maintenance of either of them during the marriage, after divorce; or

- both of the above.

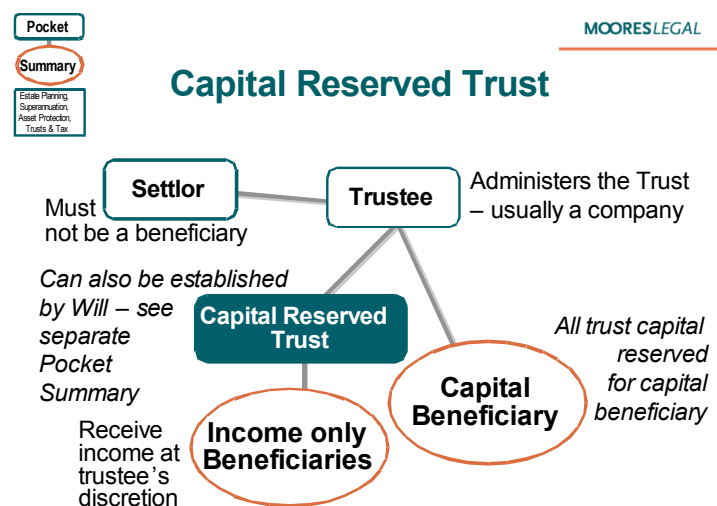
This type of BFA is made in contemplation of a marriage or domestic relationship and has no effect unless the parties in fact get married (because the Commonwealth does not have constitutional power at this time to make provision for unmarried couples).

2. Section 90C or 90UC Agreement – **must be**:

- Between parties to a marriage or domestic relationship;
- In respect of either or both of:
- How, if the marriage or relationship breaks down, any of the property or financial resources of either party had before divorce is to be dealt with; or
- The maintenance of either of them during the marriage, after divorce.

3. Section 90D or 90UD Agreement – **must be in respect of**:

- How any of the property or financial resources of either or both parties acquired during the marriage or domestic relationship is to be dealt with; or
- The maintenance of either of them.



Major Reasons for a “Fixed” Capital Reserved Trust (established by Deed)

1. Significant asset protection.

2. Family law and estate planning; eg to prevent a claim on the estate/notional estate of a surviving parent (or child) by a new partner – in New South Wales, for example, it may be necessary for the surviving parent to have relinquished any control.
3. Flexibility (income/benefits only) – each year the trustee can decide which family members or associated entities benefit.
4. Accumulation of income – 30% (rather than 46.5%) if “parked” with a corporate beneficiary.

Note: Income tax concessions apply to particular types of fully reserved trusts as to “accounting” capital, eg child support or estate proceeds trusts – and in each case separate confirmation of the position should be sought.

Trustee/Control

Frequently a person other than the capital beneficiary controls the trust for either an initial period or for the lifetime of the trust.

Income, Losses, Loans and Benefits

Income beneficiaries (similar to those of a fully discretionary trust) are taxed on all income spent on or allocated or paid to them, with credit for any tax already paid; eg dividend franking credits.

The trustee pays tax for beneficiaries under a legal disability; eg under 18, or who are non-residents.

Losses cannot be distributed and must be carried forward.

Loans from the trust may need to be on arm’s length rate terms and/or not exceed maximum terms.

As to benefits, Trust income/assets can be counted for Centrelink means tests purposes for non-excluded beneficiaries of the trust.

Capital Profits (usually subject to a 50% discount)

Taxable capital gains are generated on a sale of a trust asset, a distribution or on winding up; the trustee is usually given an express power to pay any CGT liability that might fall on a beneficiary.

A CGT Event may occur on winding up of the trust.

Parent to Child Loans

4 major reasons

- ✂ Purchase of a home for the child
- ✂ Payment of school fees for grandchildren
- ✂ Purchase of (or an injection of cashflow into) a child's business
- ✂ (By parents over 75) making of contributions into superannuation & the generation of income tax free income streams

Key considerations for loans can include enforceability, family law asset protection, estate planning & tax

Parent to Child Loans – Family Law Considerations

At present the rules governing the breakdown of domestic relationships are split between the Federal Family Court (for marriages) and State Courts (for heterosexual and same gender de facto relationships). A proposal to move the jurisdiction for de facto relationships to the Federal jurisdiction is awaiting enabling legislation by the Federal Parliament.

The Family Court in particular has the power to disregard the formalities of ownership or a contractual agreement when deciding on the division of assets. The Family Court can order third parties, such as a parent or professional advisor to deal with assets in particular way if the Court concludes that those assets are to be viewed as assets of the relationship.

All Courts, Federal and State, have the power to view assets not owned by a party to the relationship as a resource of one or other of the parties.

Generally, the more commercial in nature the terms of a loan, the more likely that the Court will be to view the loan as neither an asset of the relationship nor a financial resource of the child. For loans made to enable the child to acquire a non-superannuation income generating investment asset or a business asset, making the loan on commercial terms may prove to be a practical answer to threat of a Court disregarding a loan.

For loans made to fund a non-income generating asset or a child's contributions into superannuation, it is likely that the loan will have more chance of being accepted on its face by a Court if that loan and its terms are:

- In writing (securing a loan might also be helpful); and
- There has been written acknowledgement of those terms by the borrowing child and (if the child is in or about to commence a domestic relationship) the child's spouse or other domestic partner.

Further Reading

1. www.mooreslegal.com.au/services/epss/pocketsummaries
2. **Estate Planning Documents** – Allan Swan
(the source of the Pocket Summaries in this presentation)
3. **Australian Master Estate Planning & Succession Guide** – Allan Swan (scheduled for 2010)
4. **You Can't Take It With You** – Andrew Simpson
5. **Tax Issues in Family Law Property Settlements** –
The Difference Between Hacking & Carving – Peter Szabo

Review Exercise Answers: 1d, 2b, 3b, 4d, 5a, 6a, 7d, 8a, 9c

CCH Australian Master Estate Planning & Succession Guide (Parts 4-7)

This 7 part publication is scheduled to be available from CCH in 2010. The last four Parts (and their chapters) expand on the matters covered in this presentation and are:

Part 4 – Business Succession – Owner Controlled Businesses

Chapters: Business Succession – Internal or Family Succession; Business Succession – Involving Third Parties; Family Farm Succession; Small Business CGT Concessions; Business Succession – Other Tax Issues.

Part 5 – Transferring Wealth on Death

Chapters: Estate and Non-estate Assets – Control and Decisions re Death Benefits; Superannuation – Lump Sums v Death Benefit Income Streams; Binding Death Benefit Nominations; Second Generation Self Managed Superannuation Funds; Second Generation Family Trusts; Wills – Key Clauses; Wills – Key Clauses; Testamentary Trusts – An Overview; Beneficiary Controlled Testamentary Trusts; Ruling From the Grave; Life Interests and Rights of Occupation; Vulnerable Adult Beneficiaries; Special Disability Trusts; All Needs Protective Trusts; Philanthropic Trusts Established by Deed or Will.

Part 6 – Post Death Issues

Chapters: Child Death Benefit Pensions; Estate Administration; After the Event Trusts; Estate Litigation.

Part 7 – Review

Chapter: Reviewing Estate Planning.

* Allan Swan is a Melbourne lawyer and a partner in MOORESLEGAL

In compiling this presentation, Allan Swan referred to Pocket Summaries prepared by MOORESLEGAL: for further details visit www.mooreslegal.com.au/services/epss/pocketsummaries.