

Article Information

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Testamentary trusts- Keeping it in the family

Testamentary trusts have become increasingly attractive as an estate planning strategy to provide beneficiaries with flexibility and protection for inherited assets. The increasing personal wealth of this generation means they want certainty that the assets they pass to their children and grandchildren is done so in a tax effective environment while being protected from bankruptcy, divorce and other life events.

As a testamentary trust is separate to an individual's estate, it provides greater asset protection if the terms of the trust are clearly thought out at the time of the preparation of the will.

The recent Family Court of Australia decision of *Bernard & Bernard [2019] FAMCA 421* is a good example of how giving considered thought to your estate planning can give that protection. The case arose from the separation of the deceased's son from his wife.

Facts

The husband's father died in 2012 and by his will established a testamentary trust for each of the husband and the husband's sister. The husband was the primary beneficiary, and the class of other beneficiaries included his spouse, children, grandchildren and great-grandchildren. Despite being named as the primary beneficiary, the husband's sister was the sole trustee of the trust. The husband was not given a power of trustee appointment and he had no other legal title to the assets of the fund other than being a beneficiary.

The sister's trust mirrored that of the husband's in that the husband was the sole trustee of her trust. The two trusts operated a partnership which ran the family business of which the husband was the manager. The trusts also owned a commercial property which, the minutes prepared by the respective trustees of each trust in July 2015, recognised that the property needed significant renovations. This was to be funded by the respective trusts. To fund the renovations, the trustee of each trust resolved to accumulate the income of the trust after paying income tax instalments. The husband's son had previously received a distribution from the husband's trust but the husband had not.

The husband and his wife separated in 2015 after 28 years of marriage, being three years after the father's death. They subsequently divorced and the proceedings related to the division of their matrimonial property.

The wife argued that:

- the terms of the husband's trust required, on an annual basis, that if the trustee failed to distribute the income of the trust or made a decision not to do so, then that income must be distributed to the husband as the primary beneficiary, and was therefore income of the husband and matrimonial property; and
- as the trusts mirrored each other and the husband and his sister as trustees operated a partnership, they had the same legal obligations to each other and the the husband therefore had effective control of the assets of his trust.

The Court rejected the wife's claims and held that whilst the assets of the husband's trust were a financial resource it was not matrimonial property on the basis that:

- the husband had no control over his sister as the trustee;
- the husband could not direct the assets or income of the trust to any person;

- the trustee could apply the income of the trust for the benefit of other beneficiaries of the trust, and not just the husband;
- the mere fact that the husband's trust was identical to his sister's trust did not provide him with control of the assets of his trust;
- there were other classes of beneficiaries which included the wife but also the children, grandchildren and great grandchildren of the husband. It was acknowledged that the wife may have rights as a beneficiary, the value of which would be difficult to ascertain, and any recourse by the wife should be taken directly against the husband's sister as trustee; and
- the husband had not acquired the trust assets during the marriage but rather as an inheritance.

Lessons

If the husband had been the sole trustee of his trust then it is likely that the trust assets would have been matrimonial property. It is important to note that the father prepared his will at a time when the husband was still married to his wife, and one might assume, without any knowledge that they would subsequently divorce.

The circumstances demonstrate that discussing and developing an estate plan with expert advice will take these type of life events into account and provide the asset protection to beneficiaries a willmaker is seeking. A carefully structured testamentary trust can undoubtedly provide protection for your children in the event of a relationship breakdown.