Existing trusts as beneficiaries of wills

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Disadvantages of gifting assets by will to an existing trust (rather than to a trust established in the will) far outweigh the advantages of doing so.

That "a person may give his or her property by will to trustees of a pre-existing discretionary trust"[1] is a well-established principle, having been canvassed by judiciary and legislature in various Australian jurisdictions over the years,[2] with the issue arising before them in the context of whether such a gift would be a delegation of testamentary power, which, of course, is not permissible (subject to some narrow exceptions relating to charitable gifts).[3]

Gifting assets by will to a pre-existing or inter vivos trust is not a breach of the rule against delegation, so long as the trust is "sufficiently constituted according to the rules of certainty in trust law",[4] in particular, it can be determined with certainty whether "any given individual is or is not a member of the class" of beneficiaries of the trust.[5]

Any properly constituted existing trust, whether discretionary or fixed, may be a beneficiary under a will of a valid gift. A trust that is not yet in existence cannot be the recipient of a valid gift.[6]

In *Gregory v Hudson*,[7] the deceased left his entire estate of approximately $14m to the trustee of a family trust to hold on the terms of that trust for the benefit of his family (and a wider pool of beneficiaries). The deed of the trust was a typical discretionary trust deed with a wide class of beneficiaries. By disposing of his estate in this way, the deceased, who had terminal cancer, consolidated his wealth in one entity and appointed independent trustees to manage the wealth, clearly stipulating his wishes that his widow, former wife, adult sons from first marriage, his stepson and his grandchildren all benefit. It was intended that the independent trustees would preserve peace between all the various members of this acrimonious blended family and make distributions of income and capital according to the individual needs of each person. The deceased had put considerable thought into the memorandum of wishes which he left to the trustees and which the trustees undertook to follow faithfully.

The widow brought the proceeding to have the gift declared invalid on the grounds that it contravened the rule against delegation of testamentary power — in that the deceased did not make the gifts to his family himself, but vested the choice of who would benefit from his estate in the hands of the trustees of the trust. It was in her interests to have the gift set aside as the money would then pass on intestacy to her and to the deceased's children, which would be outright entitlements as compared to her having, for the rest of her life, to approach the trustees for payments of her expenses, which she resented. The widow was unsuccessful on this account and the gift was confirmed as valid by Young J.[8]

Advantages of leaving a gift to an established trust

The deceased's rationale for disposing of his estate in this way makes good commercial sense — instead of establishing a new trust under his will, he consolidated his wealth into one entity, thereby relying on a trust deed that had withstood the test of time and circumstances and reducing the administrative and management costs and trouble.

An existing trust holding a testamentary gift does not deprive the gift of the benefit of the concessions in s 102AG of the *Income Tax Assessment Act 1936* (Cth). Provided the trust deed permits the trustees to accept excepted trust property and to hold such property separately from the other trust assets, minors may receive distributions of income from the trust generated by the excepted trust property and be taxed at normal adult marginal tax rates on those distributions.

If there were concerns about the deceased's testamentary capacity or his ability to understand the complexities of a testamentary trust, then incorporating the inter vivos trust as a beneficiary may have overcome these concerns.

This estate planning technique is frequently proposed by willmaker clients and preferred by them over establishing a testamentary trust in the will. Despite the advantages of doing so, willmaker clients should be counselled against such a course in almost all circumstances.

Risks and disadvantages of leaving a gift to an established trust

The risks and disadvantages of leaving a gift to an established trust include the following (in order of significance).

(1) A careful review of the terms of the trust deed is required to ensure that:

(a) the intended person or entity controls or takes control of the trust on the death of the willmaker, for example, succession in the role of trustee or appointor or in the directors of the trustee company should be carefully considered by the willmaker and it should be maintained unchanged to the date of death to give effect to the intentions of the willmaker;

(b) the deed contains sufficient powers for the trustee to undertake what the willmaker envisages the trustee may need to do in the future; and

(c) the intended person or entities are eligible beneficiaries of the trust and this remains unchanged to the date of

death to give effect to the intentions of the willmaker (alternatively, the trustee has sufficient powers to add or exclude beneficiaries). This would include consideration of whether a family trust election has been made and a review of any resolutions made by the trustee previously, which may limit who can benefit from the trust.

If the careful review is not undertaken and appropriate paperwork is not prepared, the wishes of the willmaker may not be given effect to. This would cause not only upset and disappointment, but also expensive litigation to attempt to give effect to the wishes of the willmaker.

(2) In all Australian jurisdictions (other than South Australia), a trust can exist for up to 80 years. If the inter vivos trust is in existence for some time before it receives the testamentary gift or if the inter vivos trust is set to vest earlier than 80 years, the gift will not enjoy the trust environment for the full 80 years, only for the remaining life of the trust.

(3) Unless the will is prepared shortly before death:

(a) the trust may be wound up between the date of the will and the death of the willmaker. This could mean that the gift (as intended by the willmaker) fails altogether;

(b) the trust may cease being appropriate to receive the testamentary gift after the will is signed and before the date of death of the willmaker, such as by having exposed itself to risk, by the function it serves in the wealth structure of the willmaker, or by the liabilities and obligations it incurred;

(c) the control of the trust or the beneficiaries of the trust may be changed for an unrelated reason between the signing of the will and the date the trust receives the testamentary gift.

Changes which may defeat the intention of the willmaker could lead to the professional adviser (who made the later changes or who drafted the will) being exposed to an accusation of negligence.

(4) In order to take advantage of the s 102AG concessions:

(a) the trust deed must provide the trustee with the power to retain the testamentary gift (excepted trust property) as a separate fund;

(b) the trustee must keep the excepted trust property separate from other trust assets and be able to clearly identify the income derived from that property. There is a risk that the trustee may mix the testamentary gift with the other assets;

(c) the trustee must accurately account for the income derived from the investment of the testamentary gift.

It would be easy for the trustee to overlook or inadvertently mix capital or income. This would be difficult to undo or correct, and thereby the intentions of the willmaker could be defeated.

(5) The law treats the terms of the existing trust as being incorporated by reference into the will, so the trust must be clearly identified in the will and the terms that exist at the date of the will are the terms taken to be incorporated.[9]

Accordingly, if a change is made to the terms of the trust after the signing of the will, these changes will have no effect with respect to the testamentary gift, unless the changes were executed in accordance with the requirements for a valid will or the willmaker re-signed the will after the changes were made to the trust deed.

Practically, this could mean that a second trust would come into existence when the willmaker died (notwithstanding that the willmaker specifically tried to avoid that scenario). The first trust would be the existing trust with the terms as exist after the date of the signing of the will and the trust assets would be held on those terms. The second trust would be the trust with the terms that existed at the time the will was signed and the testamentary gift would be held on these terms.

(6) Extreme care must be taken not to fall foul of the anti-avoidance rules in s 102AG(3) and (4).

Conclusion

These risks and disadvantages would not be relevant to a trust drafted into the terms of the will as the terms would be drafted to complement the wishes of the willmaker and would not be inadvertently changed or overlooked. A trust drafted in the will and established by the will at death would be untainted by any history and, as such, is the preferred estate planning strategy.

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References

1 *Gregory v Hudson* [1997] NSWSC 140 per Young J.

2 For example, see Wills Acts in the ACT, Victoria, Queensland and the Northern Territory; *Lutheran Church of Australia South Australia District Inc v Farmers' Co-operative Executors & Trustees Ltd* [1970] HCA 12; *McCracken v Attorney-General (Vic)* [1995] VICSC 78.

3 *Gregory v Hudson* [1997] NSWSC 140; *Tatham v Huxtable* [1950] HCA 56.

4 *Gregory v Hudson* per Young J, quoting Mahoney JA in *Horan v James* [1982] 2 NSWLR 376: "A man must exercise and not delegate his testamentary power. This principle has been established by decisions of the High Court of Australia, the House of Lords and the Privy Council: … A testator does not exercise his testamentary power if, in effect, he empowers his executors or others to say what persons or objects are to be his beneficiaries: see *Tatham v Huxtable* [1950] HCA 56; (1950) 81 CLR 639 at p 653; and a delegation may, in my opinion, be unacceptable because it delegates the power to determine the quantum of the benefit which a selected beneficiary may take …".

5 *Re Gulbenkian's Settlements* [1970] AC 508; *McPhail v Doulton* [1970] UKHL 1.

6 *Re Jones* [1942] Ch 328.

7 [1997] NSWSC 140.

8 She succeeded in a claim for further and better provision under the NSW family provision legislation in effect at the time in *Gregory v Hudson (No. 2)* [1997] NSWSC 413.

9 *Re Edwards Will Trusts* [1948] Ch 440.