Law Society

Estate Planning Masterclass – 22 March 2017

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Estate Planning for Blended Families

Introduction

The statistics[1] show an increase in marriage, divorce, same sex relationships and children from various relationships. As solicitor's we must provide solutions to clients for these more complex circumstances. The estate planner's role is to offer advice which brings peace of mind about what happens if a client becomes incapacitated or dies.

The starting point is to prepare an estate plan that gives effect to the wishes of our clients based on their circumstances at that time.

If the clients are already in a blended family scenario they may wish to ensure that their children from previous relationships are provided for without leaving their current spouse destitute. They may have concerns about protecting their children's inheritance from the risk of the children going through a relationship breakdown.

Families with wealth accumulated and protected from generation to generation may want to ensure that only their lineal descendants benefit from the family treasures. The balance between control of the assets and maximising taxation savings become more relevant when clients have substantial wealth in family trusts and companies.

Other families who have not experienced death and divorce or attack on their fortunes may not have considered the possibility of same sex relationships or divorce in future generations or perhaps the death or disability of a child.

Regardless of the family dynamics, most clients want to avoid expensive litigation between family members after their death or an estate plan that will lead to disharmony in future generations.

It is further essential for the solicitor to have a thorough understanding of the client's asset structure and to work closely with other professional advisers including the client's other solicitors, financial adviser and accountant to ensure that the estate plan fits in with other advice that the client has received.

This paper will consider a few estate planning strategies for blended families and families with complex asset structures.

Wills – Necessary Considerations

Testamentary capacity

It is essential to record details of the discussion with a client about his wishes for the passing of his assets and interests after his death. The solicitor's consultation notes may be useful

[1] Australian Bureau of Statistics website: www.abs.gov.au

evidence if the court must make a decision about the validity of a will or determine disputes about the estate.

The test for testamentary capacity in Banks v Goodfellow[2] provides a useful roadmap for structuring the interview:

> According to the test, to have sufficient capacity a testator must:
> - Understand the nature and effect of a will;
> - Be aware of the extent of the property of which he is disposing;
> - Understand and appreciate the claims to which he ought to give effect;
> - Not suffer from a disorder of the mind or insane delusion that would result in an unwanted disposition.

The Law Society of WA has published on its website[3] a very useful and comprehensive guide to assist solicitors with the assessment of capacity in different scenario's, "When a client's capacity is in doubt. A practical guide for solicitors." It is worth noting the differences in the tests for capacity to perform acts of varying nature.

Statutory Wills

If a client who lacks capacity to make a Will, the provisions in Part XI of the Wills Act 1970 provide an estate planning tool which, if applied successfully, may avoid disputes about the estate after the testator's death.

The recent Supreme Court decision by Chaney J in the case of R v J[4] analyses the court's jurisdiction, contained in s40 of the Wills Act, to make a Will on behalf of a person who:

- lacks testamentary capacity,
- is alive; and
- has reached the age of 18 years.

The Will can relate to the whole or a part of the incapacitated person's estate.

The criteria for the court to consider are contained in s 42. The Court must refuse an application unless it is satisfied that:

- the person is incapable of making a valid Will;
- the Will is one which could be made by the person if he had testamentary capacity;
- the applicant is an appropriate person to make the application; and
- adequate steps were taken to allow persons with a legitimate interest in the application or with an expectation to benefit from the estate to be represented in the proceedings.

The court may refuse the application on other reasons than those listed in s 42.

S 41 provides guidance as to matters to be considered by the court. The applicant must provide the following evidence:

- a written statement of the nature and reasons for the application;
- an estimate of the nature and value of the assets and liabilities of the person;
- a suggested draft of the proposed Will;
- the wishes of the person;

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[2] (1870) LR 5 QB 549
[3] www.lawsocietywa.asn.au
[4] [2017] WASC 53

- the likelihood of the person regaining testamentary capacity;
- details of any Will (including an informal Will) of the person and of reasonable enquiries to locate the Will or details of the contents thereof;
- the interests of any person entitled under a previous Will or the intestate estate of the person;
- the likelihood of a family provision claim;
- the circumstances of any person for whom the person might reasonably be expected to make provision;
- a reference to any charitable or non-charitable gifts that the person might reasonably be expected to make by a Will;
- other facts relevant to the application.

After considering the s 42 threshold requirements of which the court must be satisfied and the guidance under s 41 as to matters to be considered by the court, Chaney J stated in paragraph 31 of his decision:

> "The task of the court is to make a will which in the court's judgment reflects an objectively proper disposition of the incapable person's estate giving weight to, but not being bound by, the wishes of the incapable person insofar as they can be reliably ascertained. The test thus involves both subjective elements and objective elements."

The court distinguished the Western Australian position relating to the making of statutory Wills from that in the other States by the absence of any reference in s 42 to the likely intentions of the incapable person or the reasonable likelihood of the person making the Will proposed by the applicant. In WA it is only required that the Will is one which the person could have made.

The case illustrates the importance of taking detailed and accurate notes during the interview with the testator. The application failed mainly because of the inconsistencies in the evidence provided and the lack of evidence to satisfy the court that the proposed Will is one which the deceased could have made.

The consent of the beneficiaries to the making of the proposed Will is not a determinative factor in favour of making the proposed Will. The court stated in paragraph 69 of the decision:

> "The object of s 40 is not to, in effect, confer will making power of an incapable person on the likely beneficiaries of that person's deceased estate. It is for the court to exercise its discretion, having regard to the information provided in accordance with s 41 of the Wills Act, as to whether a will in the terms proposed should be made."

Who should be provided for

Sally Bruce will be giving an overview of family provision case law. I will therefore only make the following brief comments:

Estate planning for blended families is often complex and clients may need to be educated about the competing claims that various persons may have against their estate.

Salmond J in In re Allen (deceased), Allen v Manchester[5] stated the basic principle of family provision legislation:

[5] [1922] NZLR 218

> "The provision which the Court may properly make in default of testamentary provision is that which a just and wise father would have thought it his moral duty to make in the interests of his widow and children had he been fully aware of all the relevant circumstances."

In the case of Luciano v Rosenblum[6] dealing with the claim of a widow against the estate of her husband, the court stated that a testator has a duty to his widow as far as his assets allow, to ensure that she is secure in her home, to ensure that she has an income sufficient to permit her to live in the style to which she is accustomed, and to provide her with a fund to enable her to meet any unforeseen contingencies.

The recent WASC decision in Mills v Piller[7] reflects the change in the way in which the claims of adult children are dealt with by the courts.

A central aspect of preparing an estate plan for a blended family is to minimise the potential for family provision claims after the testator's death. It is therefore necessary to ask those awkward questions to properly understand the family structure and relationships which may lead to disputes and undermine the wishes of the testator.

Asset ownership

A clear distinction must be made between assets owned personally and assets held by a separate entity.

The table shows a common ownership structure and passing of ownership or control of the asset types:

Jointly owned	**Individually owned**	**Trust or company**	**SMSF**
Residence	Bank account	Business	Cash
Bank account	Vehicles	Investment assets, eg residential / commercial properties	Share portfolio
Artwork and collectibles	Shares	Lifestyle assets, eg holiday home, hobby farm, etc	Commercial property
Passing ownership / control			
Survivorship	Provisions of Will or Administration Act in case of intestacy	- Appointment of Guardian/Appointor of Family Trust - Bequest of shares of company or units in unit trust under Will.	Lump sum / pension payments of death benefits.

Dealing with Joint Assets

It is essential to advise clients on the nature and effect of owning joint assets, as opposed to assets owned as tenants in common.

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[6] [1985] 2 NSWLR 65

[7] [2017] WASC 45

Assets held as joint tenants pass to the surviving joint tenant upon the death of the other. The deceased joint tenant's interest in the asset does not form part of his deceased estate.

A person's share of assets owned as tenants in common form part of the asset pool and can be dealt with in his Will.

It is quite common for spouses to own their residence as joint tenants. This means that the residence will pass to the surviving spouse and not form part of the deceased's spouse estate. This may protect the residence from family provision claims against the estate.

On the other hand, if a testator wants to ensure that his interest in assets held jointly with his second spouse will be available to provide for his children after the death of his spouse, a severance of the joint tenancy may be considered. Capital gains tax and duty implications must be considered before changing the tenancy of investment assets.

The relationship between a step-parent and children from a deceased's previous relationships often becomes less affectionate after the death of the parent. It should not be assumed that even well intending step-parents will not have a change of heart and a change of Will in later years.

Life interests

In the context of estate planning for a blended family, life interest provisions or capital reserved trusts are useful strategies to provide accommodation and income for the second spouse while retaining the capital for the children from the previous relationship.

"Crisp orders"[8] (flexible life interests) take the form of providing for ongoing maintenance and a home for the surviving spouse. The home can be sold at the request of the spouse to purchase more suitable accommodation as the spouse's circumstances change over time. In particular, the proceeds of sale can be used to fund the lump sum or periodic payments of a right of residence in an aged care or nursing home facility, whether or not the cost or part thereof can be recovered upon the spouse's death.

The client should obtain advice about the taxation implications of life interest provisions. If for instance a life interest is granted over the family home the CGT main residence exemption continues to apply. If the family home is replaced by a smaller unit to accommodate the spouse's changing needs, the CGT main residence exemption is lost.

Superannuation – Pensions and death benefits

While some clients are planning to sell the family home to fund their retirement, many clients do not realise the value of superannuation death benefits as part of their estate plan. This is especially important when life insurance is held within the client's super fund.

The Superannuation Industry (Supervision) Act 1993 (SIS Act) provides that a trustee must pay super death benefits to a member's dependants or legal personal representative.

The definition of the dependant of a member under s 10 of the SIS Act includes:

- Spouse
    - married/de facto including same sex couples. (No time threshold applies to determining a de facto relationship.)
    - living "on a genuine domestic basis in a relationship as a couple")
- Children

[8] 1979 NSW unreported decision of Holland J in Crisp v Burns Philp Trustee Company Limited

    - Natural / adopted,
    - step- or ex-nuptial children,
    - spouse's child and the child of person within the meaning of the Family Law Act 1975
- Persons in an interdependency relationship with the member. S 10A of the SIS Act provides that 2 persons, related or not, have an interdependency relationship if (subject to some qualifications):
    - They have a close personal relationship; and
    - Live together; and
    - One or each of them provides the other with financial support; and
    - One or each of them provides the other with domestic support and personal care.
    - The Superannuation Industry (Supervision) Regulations 1994[9] provides details of factors to be taken into account in determining the existence of an interdependency relationship.

The definition of death benefit dependants of a deceased person under s 302.195 of the Income Tax Assessment Act 1997 (ITAA 1997) includes:

- Spouse or former spouse
- Child **less than 18 years**
- Person in an interdependency relationship with the deceased
- Person who was a financial dependant of the deceased

Death benefit payments to death benefit dependants are tax free. However, independent adult children pay benefits tax of 15% on receipt of death benefits payments.

A more tax effective outcome is achieved when the death benefits are paid to the deceased member's estate and distributions made to adult children via a testamentary trust.

Testamentary trusts provide asset protection and taxation benefits by splitting income between beneficiaries.

If death benefits are paid to the deceased member's estate, the death benefits will pass in accordance with the provisions of the will. This is particularly relevant to blended families as the beneficiaries who may benefit from the assets of a deceased's estate are not limited by the definition of dependants contained in the SIS Act.

Because of the look through provisions of the taxation legislation, the taxation of death benefit payments via a deceased's will is the same as when the benefits are paid directly from the super fund.

Super death benefits can be quarantined in a separate testamentary trust for the benefit of death benefit dependants only. The age of the beneficiaries as at date of death of the member is determinative for the calculation of death benefits tax on payments to the trust, even if the beneficiaries at a future date no longer satisfy the definition of a death benefits dependants.

Clients may wish to equalise the inheritance of beneficiaries who will not receive death benefits by making greater provision for those beneficiaries in the Will, provided there are sufficient funds in the estate.

[9] Regulation 1.04AAAA of the SIS Regulations

The disadvantage of death benefits being paid to a deceased member's estate is the risk of disputes about the validity of the Will or family provision claims.

The member of a super fund may be able to nominate the beneficiaries of his death benefits. by way of a non-binding or binding death benefit nomination. Self managed super funds generally provide more flexibility in the making of beneficiary nominations.

A non-binding nomination leaves a discretion to the fund trustee to pay in accordance with the nomination or not. This is useful in the case of a bankrupt beneficiary or beneficiary at risk of a relationship breakdown.

On the other hand, binding nominations ensure that payments are made to the intended beneficiary. Binding death benefit nominations must be carefully worded to ensure that it is valid.

Beneficiary nominations must be reviewed as part of the estate planning process.

The choice of an enduring attorney and executor by the member of a self managed super fund is critical to avoid any risk of self-interested decisions by the person placed in control of the fund.

Assets owned by the Family trusts

Many clients do not realise that assets held by their family trust do not form part of their personal estate and cannot be dealt with under their Wills. This is a useful estate planning strategy where it is likely that a Will may be contested.

The ownership of assets held in a trust is not affected by the death of the controller of the trust. Trust assets are held by the trustee for the benefit of the trust beneficiaries in accordance with the terms of the trust deed.

It is imperative to review the trust deed and any amendments thereto. Note the vesting date of the trust and who the default beneficiaries are. In Western Australia under the perpetuity rules, trusts must vest within 80 years from commencement.

Consider the definitions relating to potential income and capital beneficiaries. The definitions of "spouse" and "children" are of particular importance in the context of estate planning for blended families. Any changes to the classes of beneficiaries must be approached with caution to avoid the risk of resettlement of the trust. It is advisable to obtain advice regarding the taxation consequences of any such changes.

Consider carefully who should succeed as the appointor and trustee of the trust. An appointor has power to dismiss the intended trustee. On the other hand the trustee has the power to make self-interested distributions unless the appointor is able to remove the trustee in time. Joint appointors or independent joint appointors may provide a mechanism for control to protect the interests of all beneficiaries.

Provisions for the succession of the controlling positions (trustee / appointor / guardian) can be included in the Will but amending the trust deed to address these issues may avoid delays caused by disputes about the validity of the Will.

Assets owned by Private Companies

Many clients use private companies as a vehicle to conduct a business or to hold investment assets. Often the assets of the company are viewed as part of the client's personal assets.

It is important for the client to be aware that because the company is a separate legal entity, the company owns the assets, even if the client is the only shareholder and sole director of the company. The shares form part of the estate of the client and will pass under the terms of his Will.

In some cases a company is used solely for the purpose of being the trustee of a family trust. In this case the directors of the company are the persons who will give effect to the terms of the trust deed.

The directors have the day to day control of the company. However, the shareholders have the power to remove and replace the directors. The majority shareholders therefore have effective control of the company.

If the family business is owned by the company, particular consideration should be given to the control of the company. It may be prudent to enter into a shareholders' agreement to regulate decision making by shareholders with regards to the company and the business.

It may also be prudent to enter into a buy-sell agreement to ensure that provision is made, by way of insurance, bank finance or otherwise, for the retirement, incapacity or death of a person involved with the company. In most cases, the remaining business "partners" prefer not to involve the personal representative or spouse of a deceased or incapacitated partner in decisions regarding the business.

On the flipside, it is often the case in farming families or family businesses that family members invest their time and money in building the business without investing sufficiently in superannuation or other insurances. It is important that an incapacitated business partner does not find himself in a position where he or his family do not have a sufficient income stream in unforeseen events.

Business structure: The succession of business interests depends on the structure in which the business is held.

The table contains some examples of common business structures and succession of these assets:

Sole Proprietor	**Partnership**	**Company / Unit Trusts**	**Trusts**
Assets owned personally by a sole proprietor passes under his will.	Assets owned personally by partners either jointly or as tenants in common: - Jointly owned assets pass by survivorship. - Assets owned as tenants in common pass under each partner's will.	Assets are owned by the company or trustee of the unit trust. Ownership is not affected by death of director. Shares or units pass under the shareholder / unitholder's will.	Assets owned by the trustee in the capacity as trustee. The appointor has power to appoint a new trustee upon the death of the trustee. The trust deed should contain succession provisions for the appointor. This may also be done by way of the will of the appointor. A corporate trustee is not affected by the death of a director /

			shareholder. Shares in a corporate trustee pass under the shareholder's will.
	A partnership agreement may deal with the succession of partnership assets in the event of divorce, incapacity, retirement or death. It is common for partners to enter into a business succession / buy-sell agreement supported by life insurance or personal / bank finance.	The Constitution of a company and Shareholders' agreements commonly deal with the management of a company on director and shareholder level. Unitholders agreements deal with management of unit trust at unitholder level. In the case of a corporate trustee, the directors of the company will be giving effect to the terms of the unit trust. A business succession / buy-sell agreement supported by life insurance or personal / bank finance deals with the succession of business interests in the event of divorce, incapacity, retirement or death.	Shareholder agreements commonly deal with the management of a corporate trustee / appointor on director and shareholder level. The directors of the company will give effect to the terms of the trust deed. A business succession / buy-sell agreement supported by life insurance or personal / bank finance deals with the succession of business interests in the event of divorce, incapacity, retirement or death.

Testamentary Trusts

Testamentary Trusts created under the terms of a Will provide significant benefits to the beneficiaries. It is a useful estate planning strategy to benefit future generations in a protective and tax effective environment.

The main benefits are:

(a) Asset protection: the assets are protected from bankruptcy. Testamentary trusts do not provide absolute protection in the event of a relationship breakdown because of the wide power of the Family Court to make orders binding third persons including the trustee of a trust.
(b) Taxation benefits: income splitting, exemptions for infant beneficiaries.

Leaving control of a testamentary trust in the hands of the executor, a trusted third party or joint controllers may add a further layer of protection to the trust assets.

The trustee of a discretionary testamentary trust has discretion as to distribution of income and capital. The beneficiaries obtain an interest in the trust assets only once a distribution is made.

The assets of a testamentary trust are not excluded from the Centrelink means tests. Consideration must be given to this issue by a testator intending to benefit a beneficiary receiving Centrelink benefits.

Special Disability Trusts provide asset protection and taxation benefits for severely disabled beneficiaries and donors to the trust. A SDT can be created during the lifetime of a donor or under his Will.

The main purpose of a SDT is to provide for the care and accommodation of a beneficiary who meets the requirements of the Social Security Act.[10]

The statutory provisions relating to SDT's are restrictive and may not necessarily be appropriate to a disabled beneficiary, even if he satisfies the eligibility requirements. For instance if a high net wealth client is intending to leave a significant portion of his estate to a disabled beneficiary who has no need to rely on Centrelink benefits, the option for less restrictive alternatives should be provided for in the Will.

All Needs Protective Trusts provide a useful alternative to a SDT. In cases where a beneficiary does not satisfy the requirements of a SDT, an ANPT may be a more appropriate option.

ANPT's are not subject to the strict requirements of a SDT allowing discretion to pay for needs other than the limited provisions allowed by a SDT, eg travelling, holidays and other activities to improve the disabled beneficiary's quality of life.

Clients should carefully select trustees who understand the specific needs of the disabled beneficiary and to apply the funds in an appropriate manner to satisfy those needs.

Enduring Powers of Attorney

An attorney has fiduciary duties to manage the financial and legal affairs of the donor in the interest of the donor.

Unless restrictions are placed by the donor, an enduring attorney has wide powers which do not lapse upon the donor losing mental capacity.

Examples:

- An attorney has power to act for the donor in Family Court property settlement negotiations. It is important to advice your client experiencing a relationship breakdown, to revoke his EPA if the spouse from whom he is now separated was appointed as the attorney.
- If the super fund trust deed permits, an attorney may act on behalf of the trustee of a self managed super fund. This creates a window of opportunity for the attorney to exercise the trustee's discretion to pay death benefits to himself to the exclusion of other dependants.

[10] Social Security Act (Cth) 1991 Part 3.18A Division 1, s 1209M

- An EPA may provide power to the attorney to confirm, amend or revoke a donor's super death benefit nominations. This is useful in the case of lapsing death benefit nominations.
- Make sure that an appropriate person is appointed by your client who is in a second relationship if he also has children from his first relationship. Appointing his spouse may sound practical at first but if the attorney is placed in a position to control distributions from the family trust, there may be few assets left to benefit the children.

The donor may specify that the EPA will only become effective upon a declaration of the donor's incapacity under the Guardianship and Administration Act.

Conclusion

Preparing an estate plan which reflects the client's wishes, meets the changing needs of beneficiaries and is robust enough to withstand attacks requires careful planning and creative strategies.

Adding a second spouse and adult children from the first relationship to the mix could be a recipe for disaster. As the solicitor you must be vigilant to ensure that your clients can have their cake and eat it!