WILLS & ESTATES BULLETIN – ISSUE #14

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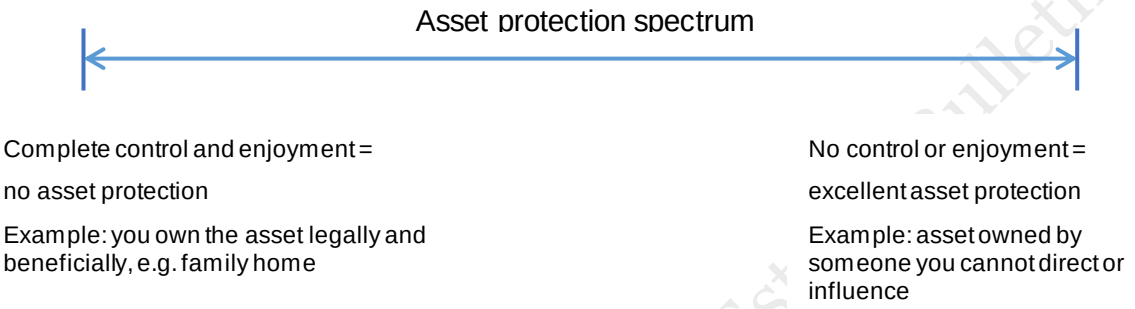
Bernard & Bernard – Testamentary trusts provide protection in the Family Court

Asset protection generally

1. All asset protection is a compromise between protecting assets and retaining control and enjoyment of those assets.



2. Each asset protection strategy sits somewhere on the spectrum from complete control, which means little-to-no asset protection, to the other end of the spectrum where we have excellent asset protection but limited control of the assets. Some asset protection strategies are so successful in removing control of the assets from those who paid for that asset, or inherited it, that there is no guarantee the person will ever be able to properly enjoy the asset and you begin to wonder whose asset it is.

3. It is a truism that the only certain asset protection in the Family Court arena is a binding financial agreement (**BFA**) made in careful compliance with the requirements of the *Family law Act 1975* (**Act**). Done properly, a BFA will remove the jurisdiction of the Family Court to make an order over the assets which are the subject of the BFA.[1]

4. Many clients come to us asking for an estate plan where the inheritance for their children can be protected, as much as is possible, from any relationship breakdown that their children may have in the future. In such situations we can provide testamentary trust wills which go some way to separating the child's inheritance from their other marital property. Note that this generally does not mean the assets are protected unless a BFA is used or the inheritance is almost completely removed from the control of the children to the extent that they can have no reasonable expectation of benefiting from it.

5. The recent Family Court decision of *Bernard*[2] sheds light on the Family Court's view as to when an inherited asset within a testamentary trust forms part of the matrimonial property of the parties.

6. Mr Bernard's parents had established 2 trusts in their wills; namely the Mr Bernard Trust and one for his sibling, the Ms Bernard Trust.

[1] Note that this assumes the circumstances at the time of making a BFA remain reasonably similar or at least as predicted by the parties when their BFA was entered into. If circumstances vary wildly, particularly if those circumstances involve children coming into the relationship, then the Court may have reason to examine whether the BFA remains just and equitable for the parties.
[2] *Bernard and Bernard* [2019] FamCA 421

7. The structure was as follows:

   (1) Mr Bernard was the primary beneficiary of the Mr Bernard Trust;

   (2) Mr Bernard was the appointor; and

   (3) the trustee was his sister, Ms Bernard.

8. The terms of Ms Bernard Trust were the mirror of those for Mr Bernard's trust. The 2 trusts were in partnership in a common property venture at the time of the case. Mr Bernard had been married for 24 years prior to his inheriting under the Mr Bernard Trust, but only remained married for 3 years after the inheritance.

9. Mr Bernard's wife, as his spouse, was a beneficiary of his trust (a potential beneficiary in the context of a discretionary trust).

10. On 2 July 2015 Ms C Bernard, as trustee of Mr Bernard's Trust, made a resolution to accumulate all future income for the purpose of renovations of trust property. The Court was satisfied this was an enduring resolution and there was no need for a fresh resolution to be provided each year for the income of those future years. We advise our clients to ensure they have a fresh resolution as to income each financial year. This is not just because from a tax and accounting perspective it is wise since you don't know what your income will be in future years and therefore there is significant uncertainty in trying to distribute it before it is earned; but also that trustee's discretion under trust law must always be maintained. A trustee cannot fetter their own discretion. Therefore a prudent practitioner assumes that a resolution as to future income would be such a fetter and may be void. However, this is not what was decided by the Family Court.

11. Mr Bernard's wife asserted that the assets of Mr Bernard's Trust were:

> "*in reality his, that he exercised control over the assets in the Mr Bernard Trust and it would therefore follow that the assets of the Ms C Bernard Trust are hers in reality and she exercised control over the assets of the Ms C Bernard Trust*"[3].

12. The Court had regard to the seminal case of *Spry*[4]. The Court helpfully sets out the differences between the circumstances of the Spry case (where the assets of the trust were deemed to be assets of the marriage) and the Bernard case:

   (1) Mr Bernard was not the settlor of his trust as Dr Spry was in his case.

   As with all testamentary trusts, the settlor of the Mr Bernard Trust was a parent of the primary beneficiary i.e. Mr Bernard's father.

   (2) Mr Bernard was not trustee of the trust unlike Dr Spry.

   This means that Mr Bernard did not have legal ownership of the trust assets. From a bankruptcy perspective, legal ownership of an asset is somewhat

[3] At paragraph 51
[4] *Kennon and Spry* [2008] HCA 56

immaterial in attempting to protect it because the *Bankruptcy Act* considers the beneficial owners. In family law however, legal ownership can be critical[5].

(3) Mr Bernard did not have power to appoint and dismiss trustees, as Dr Spry had[6].

The Court quoted the key principle from the *Spry* case:

"*Dr Spry's power as trustee to apply assets or income of the trust to Mrs Spry prior to the* ….[amendment] … *was, as pointed out by Gummow and Hayne JJ, able to be treated for the purposes of the Family Law Act as a species of property held by him as a party to the marriage, albeit subject to the fiduciary duty to consider all beneficiaries.*" (at paragraph 70)

Mr Bernard's situation was different:

"*The husband's interest was a beneficiary of the Mr Bernard Trust, and none other. He cannot apply assets or income of the trust to any person, himself or the wife. The wife has her own recourse and action as a beneficiary of that trust, as against the trustee who is her former sister-in-law*." (at paragraph 71)

13. Unsurprisingly, the wife asserted that because his trust was run in partnership with his sister's trust, and the trustee of his trust was his sister, that in reality he had actual control of the assets of the trust. I must confess it is not the realms of aluminium foil headwear to draw the inference that where siblings have otherwise identical mirror imaged testamentary trusts that they are each, in reality, controlling their own trust. This might be particularly the case where the trusts are in partnership in a common venture.

14. The Court was not so persuaded. The Court said the fact that the trusts were mirror images did not give either sibling power or control of their own respective trust. The Court rejected the comparison to another Family Court case where the Court had ruled that someone could exercise control over a trust which was formerly controlled by their parents. In that case there was apparently some evidence that their son, and party to the marriage, had been de facto controller of the commercial activities carried out by the trust.

15. However, in this case, the Court said there was no evidence that Mr Bernard had attempted to control his trust and instead it appeared that he and his sister had faithfully carried out their late father's testamentary wishes.

"*Miss C Bernard and Mr Bernard have been scrupulous in their company dealings, in their promulgation of resolutions, to ensure accumulation of funds to carry out renovations of the property, holding of meetings and the filing of tax returns and their distinct roles as trustee and beneficiary. I rarely see a family law matter where tax returns and disclosure is so up to date and thorough as has been in this matter*." (at paragraph 84)

[5] The trustee of a trust is the legal owner of all assets of the trust

[6] Mr Bernard was described as the appointor for his trust but still did not have power to hire and fire the trustee. This is unusual as typically the primary role of an appointor is to appoint and dismiss trustees. The terms of the trust i.e. the will, was not part of the judgment and we have not ben able to review it.

16. The Court even considered whether the 2 trusts might be a sham and rejected this outright. The Court said it was in fact the opposite of a sham trust.

17. The wife's application failed.

18. We must remember that the assets of the Mr Bernard Trust would not have been irrelevant when the property division was determined. Whilst the judgment does not consider the issue, we expect that the Court would have included those assets in Mr Bernard's financial resources, which may have altered the balance how the marital property was divided between them.

Estate planning lessons from *Bernard and Bernard*

19. This case[7] is an excellent exposition in careful estate planning and the utilisation of testamentary trusts. Mr Bernard's father was apparently able to successfully quarantine his wealth after he had died from being part of the marital property of his son and his daughter-in-law. The wealth in The Mr Bernard Trust was not dragged into the property division between Mr Bernard and his wife. That same wealth will be available for Mr Bernard and his descendants, perhaps for generations to come.

20. Careful estate planning provided a predictable trust law outcome in the Family Court arena – a laudable achievement.

21. Testamentary trusts can protect the inheritance you will provide to your children, from attack if your children separate.

Cameron Cowley

April 2020

[7] We will provide an update if the case is appealed but it does not appear to have been appealed at this stage.

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Breach of repair and maintenance obligations does not necessarily lead to the forfeiture of a life interest

***Nomchong -v- Vey-Cox*[8]**

1. In the recent case of *Nomchong -v- Vey-Cox* the Supreme Court considered whether a life interest was forfeited when the life tenant (i.e. the beneficiary of the life interest) failed to comply with their obligation to repair and maintain the property.

2. The will used reasonably common drafting in setting up a life interest and included that the interest was "*on the condition*" that the life tenant pay rates and other outgoings and keep and maintain the property in good repair.

3. There was some argument as to whether such drafting meant that they are conditions precedent or subsequent to the legal right or benefit obtained. Failure to meet such a condition would cause forfeiture of the benefit. The alternative was to find that instead it was not a condition, but a personal equitable obligation, meaning that whilst there may be rights to compensation if the obligations are not met, the interest is not forfeited.

4. In this case the property was in a poor state of repair and rates had not been paid. However the Court was reluctant to find that the life tenancy ended despite the use of the words "*on the condition*". The Court held the usual rule that the context of the entire will, and not just the relevant clause, must be considered to determine the meaning of the subject clause. When this was done, the Court found that it was not the intention of the testator that the defendant would lose her right to reside in the home if she failed to meet the repair obligation. The Court noted this would not be the case if there was an express provision in the will stating that failure to repair would result in the end of the life interest.

5. There was also discussion over whether a fund set up for expenses of the property could be used to pay the repairs and rates given that the repairs and rates were the obligation of the life tenant.

6. The Court found that the fund could not be used for this purpose given that it was not the trustee's obligation but instead the life tenant's obligation.

7. Lastly, of note was the Court's acceptance of case law relating to the interpretation of commercial leases as an appropriate standard by which to consider obligations under life interests. Many estate planners will find this helpful given that the case law on the obligations of trustees and life tenants mostly hails from the 19th Century and is quite alien to the current context.

[8] *Nomchong -v- Vey-Cox* [2019] NSW SC 1072

Lesson

8. The lesson from this case, as is the lesson from most construction cases, is that clarity in drafting provides certainty in application.

Cameron Cowley

April 2020

Section 63 Duties Act 1997 – Revenue Ruling DUT46

1. The Office of State Revenue (**OSR**) released Revenue Ruling DUT46 on 12 February. It explains the OSR's interpretation of section 63 of the Duties Act, which provides concessional duty for instruments made pursuant to a will.

2. The Ruling reflects current practice of the OSR and but some aspects may surprise practitioners. You can access the ruling here: https://www.revenue.nsw.gov.au/help-centre/resources-library/deceased-estates

3. We set out below a selection of the key parts of the ruling[9]:

Situation / dutiable event	Does the s63 concession apply?	Comment
Transfer of property in accordance with a specific gift, or a gift of residue	Concession applies. $50 duty	
Residue is gifted to 2 beneficiaries equally. By agreement the beneficiaries (e.g. a deed of family arrangement) between, one beneficiary takes all of the land, and the other takes shares.	Concession applies to 50% of the land transfer only (being the percentage of the land which is in conformity with the will).	The transfer is not in conformity with the will.
Residue is gifted to 2 beneficiaries equally. The executors exercise a power under the will or s46(5) of the Trustee Act 1925 to appropriate the land to one beneficiary and the shares to the other beneficiary. The value of the land and the shares is equal.	Concession applies pursuant to S63(2). $50 duty	The appropriation process must conform to the requirements of s46(5) of the Trustee Act 1925 or the power granted under the will. For example, the executors must obtain the consent of the beneficiary receiving the appropriated asset. Note the ruling also provides that executors cannot appropriate a property for beneficiary X if the property was specifically gifted to beneficiary Y.

[9] Please refer to the entire ruling for other examples and scenarios.

Residue is gifted to 2 beneficiaries equally. The executors exercise a power under the will or s46(5) of the Trustee Act 1925 to appropriate the land to one beneficiary and the shares to the other beneficiary. However the value of the land exceeds the value of the shares.	Concession applies only to 50% of the value of the land (not 50% of the value of their share of the residue as you may expect).	The ruling states this is because the beneficiary was only originally entitled to 50% of the land. This aspect of the ruling is inconsistent with the same situation if the land is valued equally to the shares – i.e. the beneficiary loses half of the duty concession.
Property is held on trust for sale by the executors. The parties agree to not to sell the land, but instead transfer the land to beneficiaries in the same proportions as they are entitled to the sale proceeds.	Concession applies $50 duty	
Property is transferred to beneficiaries pursuant to a family provision order of the Supreme Court.	Concession applies. $50 duty	The concession applies because section 72 of the Succession Act 2006 provides that a family provision order takes effect as a codicil to a will of the deceased.
Residue is gifted to 2 beneficiaries equally. Contract for sale/purchase between executors and a beneficiary for a property which forms part of the residue.	No concession – ad valorem duty.	If the transaction takes place as a transfer without a contract, pursuant to an agreement, then according to DUT46 a concession applies to the extent that the beneficiary would have received part of the property under the will.
Option to purchase granted in the will and a beneficiary takes it up.	Concession applies. $50 duty	The option terms must be strictly met. There must be no contract of sale
Testamentary trust – transfer to trustee from executor	Concession applies. $50 duty	

Testamentary trust – transfer to beneficiary from trustee	No concession - ad valorem duty.	Land comes into a testamentary trust at concessional duty, but full duty must be paid if land comes out of a testamentary trust. Note ruling G 010 version 2 in relation to Surcharge Duty provides that the same concession *may apply* to the surcharge. This potential discretion of the Commission of Revenue does not bring peace of mind!

5. The ruling encourages a particular transaction to be undertaken in a particular way, with the same commercial result, to get a different duty outcome. This feels contrived and is not common sense. For example, exercising an option to purchase land is free from duty, but not if a contract or any other written agreement is entered into. Another example is that if land is divided between beneficiaries by agreement then full duty will apply, but if done by an executor's power of appropriation will receive the duty concession.

6. This is unfortunate because it means that executors may not be able to ask a beneficiary to sign a contract – which we often recommend as it provides certain protections for the estate, and provide certainty for all parties in relation to issues such as warranties, timing, finance conditions and more.

Consequences for will drafting

7. Ignoring non-duty drafting considerations for a moment, this ruling encourages the following will drafting practices:

   (1) Use an option to purchase land if there is a chance one beneficiary may want to take it. There can be a alternative gift of the land if the grantee of the option does not take it up.

   (2) Have a broad power of appropriation to ensure the executors have power to appropriate land when dividing residue of the estate.

Partition

8. Section 30 of the Duties Act provides concessional duty for partitioning land. It may be that duty can be reduced if a transaction is achieved by partition, after administration of an estate, rather than a division of the land during the estate process. You would need to

consider CGT consequences of such partition. The partition ruling DUT 035v2 does not allow partitions to occur as part of the estate administration for duty purposes.

Advice

9. Duty is an area of law where a simple mistake can lead to an immediate and irrevocable debt to the Crown. For this reason we recommend that you do not undertake dutiable transactions without getting a specific advice on duty from an experienced practitioner. DIY duty calculations can be risky.

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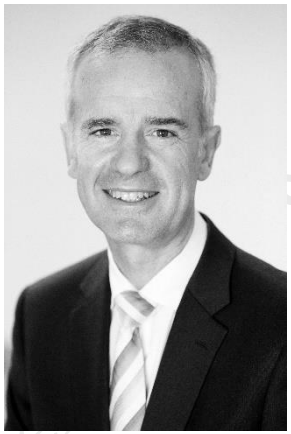
Our Estate Planning Team



Cameron Cowley

- Wills and Estate Planning
- Testamentary trusts
- Trusts
- Superannuation including SMSFs
- SMSF nominations
- Taxation issues of estate planning

Greg Moin

- Wills and Estate Planning
- Powers of Attorney
- Appointment of Enduring Guardians
- NCAT Reviews
- Farm succession
- Advanced Care Directives

Richard Morris

- Wills and Estate Planning
- Deceased Estates
- Family Provision Claims
- Complex Estates
- Foreign Wills
- Capacity claims

- Deeds of family arrangement
- Corporate succession

- Corporate succession
- Aged Care Law
- SMSF nominations

- Informal Will cases
- SMSF nominations
- Special Grants
- Probate/ Administration

We stand by all of the legal information in this bulletin. However it is important to understand that it is not legal advice for you. Advice must be tailored to your circumstances, and every client's circumstances are unique. If you try to apply the above information to your circumstances it may not lead to the outcome you seek. We would be most happy to provide tailored advice for you suited to your circumstances.