

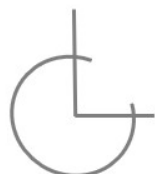
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# Succession Planning and Discretionary Trusts

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# Succession Planning and Discretionary Trusts

## 1 Introduction

- 1.1 It is expected that there will be over 1 million trusts in existence in Australia by 2022.<sup>1</sup> Whilst not all trusts will be discretionary in nature, a significant proportion (noting approximately 73.2% of trusts in existence in Australia in 2013/2014) are.<sup>2</sup>
- 1.2 With an Australian population as of June 2019 of 25,400,000,<sup>3</sup> there exists a trust for roughly every 25 individuals.
- 1.3 Given the high proportion of trusts in our society, and the continued rise in the recommendation of using discretionary trusts by tax and structuring professionals, the need for estate planning practitioners to understand how to deal with trust structures is of utmost importance.
- 1.4 This paper considers the following issues regarding discretionary trusts and succession planning:
  - (a) an overview on how to implement a succession plan for discretionary trusts;
  - (b) issues that may arise when dealing with multiple trust assets or multiple recipients for a single discretionary trust;
  - (c) issues that may arise when the discretionary trust succession plan fails; and
  - (d) options available in restructuring trust assets to fit the succession plan.
- 1.5 An overview of the tax issues in relation to discretionary trust succession planning will be provided as they arise throughout the paper.

## 2 Succession planning and discretionary trusts

### *Discretionary trust overview and rights of beneficiaries*

- 2.1 The popularity of discretionary trusts as wealth creation structures has seen a rise over the past decade due to three key advantages:
  - (a) tax planning opportunities;
  - (b) asset protection benefits; and
  - (c) succession planning opportunities.
- 2.2 With online providers offering discretionary trust establishments and deeds cheaper and faster than law firms; and tax and structuring professionals continuing to push the use of

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<sup>1</sup> The 2017 RMIT Report regarding 'Current issues with trusts and the tax system' at page 2 and <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-research/Current-issues-with-trusts-and-the-tax-system/>

<sup>2</sup> The 2017 RMIT Report regarding 'Current issues with trusts and the tax system' at page 20 provided statistics as to the breakdown of trusts in existence in Australia during the 2013-2014 financial year

<sup>3</sup> Australian Bureau of Statistics, 3101.0 - Australian Demographic Statistics, Jun 2019 – Released 19 December 2019 -

<https://www.abs.gov.au/ausstats/abs@.nsf/lookup/3101.0Media%20Release1Jun%202019#:~:text=Australia%27s%20population%20grew%20by%201.5%20per%20cent%20during%20the%20year,annual%20increase%20of%20381%2C600%20people.%22>

these structures, it's more likely than not that discretionary trusts will become a common consideration for client's estate plans.

- 2.3 Unfortunately, due to the ease of accessing what are complex creations of equity, clients and tax advisors alike can often misunderstand the complexities attaching to discretionary trusts, particularly when it comes to planning their succession.
- 2.4 The most common misunderstanding is that assets of discretionary trusts are dealt with under a client's Will automatically. Unfortunately, the answer is not so simple with a wide variety of factors influencing how a trust's succession can be undertaken.
- 2.5 Broadly, a trust is a legal relationship where there is:
- a a legal owner of property (the '**trustee**'), who;
  - b holds the property ('trust property');
  - c for the benefit of others (the '**beneficiaries**'); and
- pursuant to certain terms or rules ('**trust deed**').
- 2.6 Unlike companies and sole traders, a trust is not a separate legal entity. Instead, the trustee looks after the property and manages the trust (i.e. the management position). Any benefits generated from the trustee's management are then distributed to the beneficiaries (i.e. the owners).
- 2.7 It is the fact that a trust is a relationship that prevents the trust property being dealt with under either the legal owner (the trustee) or beneficial owner's (beneficiary's) respective Wills. Trustees cannot deal with trust property under their Wills as it is not an asset in which they are beneficially entitled; whilst beneficiaries cannot deal with trust property under their Wills as they do not legally hold title to such asset.
- 2.8 The complexity that a discretionary trust adds is the fact that there is a broad **discretion** of the trustee to decide who can benefit from the trust.
- 2.9 Whilst other trusts may fix who can benefit (and thereby there can be a clear ownership percentage), a discretionary trust blurs this ownership percentage by allowing the trustee to decide (at the trustee's discretion) who can benefit from the trust (considered the 'discretionary beneficiaries'), whilst being able to change this discretion on a yearly basis.
- 2.10 It is generally accepted that the only rights that such discretionary beneficiaries are entitled to, is the right to compel a trustee to administer the trust. *Gartside v Inland Revenue Commissioners* (1986) AC 553 at 606 is often quoted to support this notion in relation to discretionary beneficiaries of the trust:
- "[n]o object of a discretionary trust has, as such, any legal right to or in the capital. His sole interest, if it be an "interest" within the scope of these provisions is with regard to the income: he can require the trustee to exercise, in bona fide, their discretion as to how it shall be distributed, and he can take and enjoy whatever part of the income the trustee choose to give him"*
- 2.11 Although this statement is often referred in older cases, Australian law has adopted the conclusions:
- (a) Per Owen J in *R and I Bank of Western Australia Ltd v Anchorage Investments Pty Ltd* [1992] 10 WAR 59 at 79:  
  
*The trustee has a duty to administer the trust bona fide having regard to the purpose for which it was established. This is a duty which the court will enforce at the behest*

*of the beneficiary. In this way, the remedy defines the nature of the interest of an individual beneficiary.*

- (b) Per French J in *Richstar Enterprises Pty Ltd and Others; Australian Securities and Investments Commission v Carey (No 6)* (2006) 153 FCR 509 at 29:

*... in my opinion, in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of "property"....*

- (c) More recently in *Kestenberg v Kestenberg* [2020] VSC 84 at 7:

*[A] discretionary beneficiary has no proprietary interest, vested or contingent, in the assets of a trust but only an expectation...a discretionary beneficiary, is not entitled as of right to disclosure of that which could be properly described as 'trust document'*

- 2.12 The above cases reinforce the law that beneficiaries of a discretionary trust have no direct interest in the income and capital of the trust, and that the trustee has the absolutely discretion to determine how such income and capital of the trust is to be distributed.
- 2.13 Further, Courts will generally not question the merits of a discretionary decision taken by a trustee as they seek to abide by a 'principle of non-interference'<sup>4</sup>. This is generally due to Courts being reluctant in overturning the valid choice of persons to utilise such a discretionary structure – *[I]t is to discretion of the trustees that execution of the trust is confided...[However, the discretion must be exercised] within an entire absence of indirect motive, with honesty of intention, and with fair consideration.*<sup>5</sup>
- 2.14 Where the trustee fails to exercise their discretion to determine who benefits from the trust, the trust deed will often state which beneficiaries will benefit from the trust (colloquially known as the 'default beneficiaries').
- 2.15 In contrast to the limited rights of discretionary beneficiaries, *Ramsden v FCT* [2005] FCAFC 39 at [37] considered that default beneficiaries, being a 'taker in default of appointment is ordinarily regarded as having a vested interest in the property to be taken, though liable to be divested by an exercise of the trustee's power to appoint elsewhere: *Hardingham & Baxt Discretionary Trust* (2<sup>nd</sup> Ed). *The interest although vested, is defeasible*'.
- 2.16 That is, although a default beneficiary may have an interest in the trust fund, that interest is **defeasible** by a prior exercise of a trustee's power.
- 2.17 Due to the lack of a guaranteed right to the income and assets of the trust, the beneficial owners (i.e. the beneficiaries) of a discretionary trust are therefore more reliant on the decision-making of the trustee and absent any other role, are often named or involved at the trustee level.
- 2.18 That other role referred relates to a role who can have the ability to change the Trustee. This role is often called the 'appointor' or 'principal' role (referred to as the **appointor** throughout this paper) and can even go by other terms such as 'guardian' or 'father'.
- 2.19 A benefit of such a role is that the underlying owners of a discretionary trust can exert a form of influence over the trustee to make decisions in the best interest of the owners, else they be replaced with someone more complying.

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<sup>4</sup> See G Thomas, *Thomas on Power* (1<sup>st</sup> edn), Sweet & Maxwell, London, 1998, at [6-204]

<sup>5</sup> *Re Beloved Wilkes Charity* (1851) 3 Mac & G 440; 45 ER 330 at 333

- 2.20 It is noted, however, that not all discretionary trusts hold an appointor role, and a review of the trust deed is required to confirm the existence of such a role.

***Succession planning considerations***

- 2.21 Practically, from a succession planning perspective for a discretionary trust, it is crucial to understand who takes over the trustee and/or appointor role in the event key persons are deceased or have lost capacity.
- 2.22 The trust deed will usually outline a default position on who takes control on the passing of individuals in those roles as well as provide general powers allowing for successors to be nominated. However, each trust deed must be reviewed to confirm this position as each trust deed providers draft their documents differently. Where a trust deed fails to outline the default position in relation to the death of key persons, each States' respective Trusts Acts will require reviewing.
- 2.23 A checklist of succession planning questions to be considered in relation to a trustee role is summarised below:
- (a) Can the trustee retire and appoint their own successor?
  - (b) Is there an explicit power to appoint a successor trustee by Will?
  - (c) Is there flexibility to outline the conditions on appointing a successor trustee?
  - (d) Are there any conditions before a trustee can retire and appoint their successor?
  - (e) Are certain persons excluded from being the trustee?
  - (f) Can the trustee explicitly be a sole individual or corporation?
  - (g) Are there other restrictions on how the trustee can appoint their own successor?
  - (h) Is the trustee automatically retired on certain events occurring?
  - (i) Who replaces the trustee if they are automatically removed? If any trustee are still able to act, do they continue to act in their own right?
  - (j) Are there any restrictions on how a trustee may retire (e.g. other consent required, or there needs to be a minimum of at least two individual trustees)?
  - (k) Can separate trustees be appointed over particular assets of the trust?
- 2.24 The succession of the appointor role will also need to be considered (if the trust contains such a role) much in the same manner as the trustee succession considerations above.
- 2.25 Where a company is utilised (whether as a trustee or appointor of the trust), then questions will need to be considered in relation to directorships and shareholdings of the company much in the same way of the above.
- 2.26 Often when advising on the succession plan of a discretionary trust for a client, the question will be who takes control of the trustee and appointor role of the trust if no steps are taken.
- 2.27 If such persons do not align with the client's succession planning intentions, then steps will need to be taken to ensure appropriate documentation are put in place to ensure the control of the discretionary trust passes as intended:
- (a) in the circumstances where there is no appointor role:
    - (i) a deed of change of trustee can be prepared to change or dilute the trustee role while the current controller is alive. This can either by way of

appointing multiple individual trustees or appointing a company trustee with multiple directors. This can allow the intended family member to take control of the discretionary trust immediately on their own or jointly with the current owner; or

(ii) a deed of appointment of successor trustee can be prepared to automatically change the trustee on certain events occurring to the current trustee (such as death or loss of capacity). The comprehensiveness and ability for this document to be prepared will depend on how the above questions have been answered; and

(b) in the circumstances where there is an appointor role, much of the same documents mentioned above can be prepared specifically for those involved at the appointor level. There will, however, be more flexibility when there is an appointor role, as separate persons can be appointed into the trustee and appointor role (for example, the management of the discretionary trust can pass to the intended successors by way of the change of trustee, while the current controllers can continue to retain control of the appointor role).

2.28 Where the existing terms of the trust deed do not allow for the relevant documents to be prepared, then steps can be taken by preparing a deed of variation, amending the terms of the trust deed to either:

- (a) allow for the proposed successor nominations/documentation to be made; or
- (b) hardwire automatic appointments/changes to the trustee and/or appointor role directly.

2.29 In the event where the trust already has a company as trustee or appointor, steps could just be taken to change the directorship and shareholding in that company accordingly. In such a circumstance, steps can be taken to put in place appropriate documentation passing ownership, namely:

- (a) on the death of the current controller:
  - (i) where the shares in the company are held by the controller individually, this means ensuring the current controller's Will is drafted in a manner that makes the shares (whether by way of a specific gift, or due to the overall structure of the beneficiaries under the Will) pass to the intended family members who are intended to control the company. Where it is not appropriate to have the shares pass via an individual's Will (due to a potential estate challenge as mentioned above), documents such as a shareholders agreement or call option agreement may be suitable in providing certainty for the intended family members to obtain the relevant shares on the death of the current controller;
  - (ii) where the shares are held by a trust, this means reviewing the succession of the trust on death and ensuring control and/or ownership in the trust passes to the intended family member (much like considering the above issues for consideration);
- (b) on the loss of capacity of the current controller:
  - (i) where the shares are held by an individual, this means ensuring an appropriate enduring power of attorney document is prepared to allow the intended family members to make decisions on behalf of the current controller, as shareholder of the company (please note that the ability to

make director decisions are not usually transferrable under an enduring power of attorney document);

- (ii) where the shares are held by a trust, this means reviewing the succession of the trust on loss of capacity of the key person and ensuring control and/or ownership in the trust passes to the intended family member (again, much like considering the above issues for consideration).

2.30 Thought should also be made in relation to any loans and/or unpaid present entitlements (UPEs) owed to and from the discretionary trust, and whether any existing loans/UPEs inadvertently shifts value away from intended persons. For example, a discretionary trust conducting a business, owing a large sum to the deceased whereby certain children will take control of the discretionary trust (as they were involved with the running of the business), whilst all other children will benefit equally under a deceased's Will. In such a situation, the children benefiting under the Will may end up with a windfall benefit at the expense of the children succeeding control in the discretionary trust.

### **Case study examples**

2.31 Whilst the succession planning issues to consider in relation to discretionary trusts may appear to logical and straight-forward; in practice, most trust deeds do not cater or adequately consider each issue.

2.32 Below are examples of the trustee and/or appointor successor clauses from reviewed trust deeds as well as potential issues to consider.

#### **Example 1**

**4.4(b)** *The power of appointing a new Trustee is Vested in the Principal.*

**4.4(c)** *Subject to Clause 4.4(d), the Principal may at any time and from time to time without the consent of any person by deed or instrument in writing remove any Trustee from the office of Trustee any may also at any time and from time to time and without the consent of any person by deed or instrument in writing appoint any person or Corporation to be a Trustee either alone or jointly with any continuing Trustee. A purported exercise of the Principal's power under Clauses 4.4(b) and 4.4(c) is ineffective and void if the Principal purports to:*

- (i) *appoint the Settlor as a Trustee; or*
- (ii) *remove a sole Trustee or all the Trustees without appointing a replacement Trustee or Trustees.*

**4.4(d)** *If the Principal becomes bankrupt or makes any arrangement or composition with the Principal's creditors in accordance with the applicable Bankruptcy or Corporations legislation:*

- (i) *in the case where there is a sole Principal – the Bankrupt Principal will by deed appoint any person or Corporation to be a replacement Principal; or*
- (ii) *in the case where two or more persons are named or nominated in accordance with Clause 4.3 as the Principal – the Bankrupt Principal need not appoint a replacement Principal and the office and powers of the Bankrupt Principal will vest in the remaining Principal(s).*

**Definition for Principal means:**

- (a) *the person or persons jointly or successively named in the Schedule and the person or persons nominated by the person so named in the Schedule and acting as Principal for the time being in writing inter vivos or (in the case of the sole or last surviving such person) by will to succeed the person named in the Schedule during his lifetime*

*(and from the date so nominated) or upon his death as the Principal; or*

- (b) the entity or entities jointly or successively named in the Schedule and the entity or entities nominated by the entity so named in the Schedule and acting as Principal for the time being in writing to succeed the entity named in the Schedule during its existence (and from the date so nominated) or upon its liquidation as the Principal; or*
- (c) in the case of two or more persons named or nominated as the Principal, no power or authority or direction by the Principal shall be valid or effective unless the same is jointly exercised by such persons unless otherwise specified in the Schedule or in such nomination.*

**Schedule definition for Principal**

*John Smith and any other person who may be appointed by a written instrument but in the absence of any other appointment or nomination then on his or her death, Jane Smith and or any other person appointed by a written instrument but in the event of a failure of such appointment or nomination and on his or her death the legal personal representative of the survivor of them.*

2.33 In relation to Example 1, the following should be noted:

- (a) The provisions in relation to the Principal role of the trust contemplates a successor Principal if a Principal die.
- (b) Failing any document, the legal personal representative of the last named Principal will be the Principal of the trust on the death of all named Principals.
- (c) The definition of Principal allows a successor Principal to be nominated '*in writing inter vivos or... by will*'. Not all trust deeds provides the ability to nominate a successor by Will.
- (d) Thought is also had in the event a Principal is bankrupted (in that the Principal is able to nominated a replacement Principal).
- (e) An issue, however, is the fact that the trust deed does not have a default position in the event the Principal loses capacity.
- (f) In such a circumstance occurring, provided no separate nomination has been made, the Principal continues in its role (without having the capacity to exercise their discretion to change the trustee). The trustee role in this scenario would be of utmost importance.
- (g) Curiously, the trust deed contemplates '*The office of a Trustee...[being]...ipso facto be determined and vacated if the Trustee being an individual dies or is found to be of unsound mind or a person whose personal estate is liable to be dealt with in any way under the law relating to mental health...'*.

**Example 2**

**9.3(i)** *The power of appointing a new Trustee shall vest in the Principal or should he die in his legal personal representatives PROVIDED THAT neither the Principal nor any person in whom this power shall vest may appoint himself or a Beneficiary to be a Trustee hereof.*

**9.3(ii)** *The Principal may at any time and from time to time without the consent of any person by Deed remove any Trustee from its office and may also at any time and from time to time and without the consent of any person by Deed appoint any person company or corporation to be a Trustee hereof either alone or jointly with any continuing Trustee. Upon the death of the Principal this power of removal and appointment may be exercised by the*



*legal personal representatives of the Principal PROVIDED THAT neither the Principal nor any person in whom this power shall vest may appoint himself or the Settlor or a Beneficiary to be a Trustee hereof.*

**9.3(iii)** *If more than one person shall be named Principal in the Schedule hereto then the powers conferred upon such persons pursuant to the terms hereof shall be exercised by them jointly during their lifetimes and by the survivor or survivors of them on the death or deaths of any of such persons and upon the death of the survivor of all persons appointed as Principal pursuant to the terms hereof by the legal personal representatives of the last of such persons to die.*

**Principal defined in the Schedule** *to be John Smith.*

2.34 In contrast with the Example 1, the succession provisions of Example 2 are lacking. Specifically:

- (a) The only succession planning potential the trust deed for Example 2 offers is the ability to link the successor Principal of the trust with the legal personal representative of the Principal on death.
- (b) There is no ability to nominate a successor Principal on the loss of capacity of the Principal; nor does a Principal's legal personal representative replace an incapacitated Principal on loss of capacity.
- (c) At least in the case of Example 1, a nomination could be made in contemplation for such a scenario.
- (d) Subject to the terms of any variation power, it would be recommended that the terms of the trust deed in Example 2 be varied to allow for a more flexible and comprehensive succession planning terms to be included in the trust deed.

### **Example 3**

#### **16.2 – POWER TO REMOVE AND/OR APPOINT APPOINTOR**

- (a) *The Appointor may appoint a person as an additional or replacement Appointor. The Appointor may do so by deed.*
- (b) *If the Appointor exercises the power under clause 16.2(a), the Appointor may remove the additional Appointor at any time by deed.*
- (c) *The Appointor may appoint a person as a replacement by Will. The Will is effective unless the Appointor has revoked the power to appoint an Appointor.*

#### **16.5 – IF SOLE INDIVIDUAL APPOINTOR**

*If a sole individual Appointor*

- (a) *Dies and has not appointed a replacement by deed or by Will and has not revoked the power to appoint an Appointor, then the Appointor's legal personal representative becomes Appointor on the Appointor's death until all of the children of the Appointor attain the age of twenty-five years when they, together or with an independent person would become Appointor; and*
- (b) *If any children referred to in clause 16.5(a) died leaving children, those children would have the right themselves or through their guardian to nominate one person to be Appointor in place of their deceased parent; or*
- (c) *Becomes mentally or physically incapable of fulfilling the role of Appointor, the Appointor's legal personal representative becomes Appointor for so long as that incapacity continues; or*
- (d) *Becomes insolvent under administration then the Appointor's legal personal*

*representative becomes Appointor until all of the children of the Appointor attain the age of twenty-five years when they, together or with an independent person would become Appointor.*

For completeness, the Appointor is defined to be John Smith, who is married to Jane Smith who he has had a child with (aged 5 years old).

- 2.35 Example 3 offers substantial improvements compared to the succession provisions of Examples 1 and 2.
- (a) Under Example 3, it is clear that the Appointor has the ability to nominate a successor by deed or Will.
  - (b) Further, the Appointor retains the ability to remove an additional Appointor if they so choose.
  - (c) Importantly, there is some form of consistency in terms of having default positions for persons to adopt the Appointor role in the event an Appointor dies or loses capacity.
  - (d) Despite being much clearer, issues could arise where the children of the Appointor attains the age of 25 in which different persons may assume the Appointor role of the trust in different circumstances.
  - (e) For example, the Appointor's spouse may assume the Appointor role on loss of capacity, whilst the children assume the Appointor role on the death of the Appointor (due to the trust deed naming different persons in the default successor Appointor roles).

#### ***Varying the terms of a trust deed***

- 2.36 Where the existing terms of the trust deed are not suitable, steps can be taken to amend the terms of a trust deed.
- 2.37 Whilst much of whether the variation is possible will depend on the wording of variation power, care should be appreciated in distinguishing between a **trust power** and a **mere power** when dealing a variation power of a trust deed.
- 2.38 The difference between the two powers was described in *Farwell on Powers*<sup>6</sup> by referencing Lord Eldon's judgment in *Brown v Higgs*<sup>7</sup>:
- 'Where there is a mere power of disposing and it is not executed, the court cannot execute it; but wherever a trust is created and the execution of that trust fails by the death of the trustee or by accident, the court will execute the trust. But there are not only a mere trust and a mere power, but there is also known to the court a power which the party to whom it is given is intrusted and required to execute; and with regard to that species of power, the court considers it as partaking so much of the nature and qualities of a trust, that if the person who has that duty imposed on him does not discharge it, the court will to a certain extent discharge the duty in his room and place.'*
- 2.39 The above judgment can be summarised in that mere powers may or may not be exercised, whilst a trust power must be exercised if not by the trustee then by the court, or a trustee appointed by the court.
- 2.40 In the context of a discretionary trust, the 'trust power' relates to the distribution of income or capital of a trust fund to the 'default beneficiaries' insofar that where the trustee fails to

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<sup>6</sup> 3rd edition (1916)

<sup>7</sup> 8 Ves.Jr. 561

exercise its discretion to either distribution or accumulate the relevant amount, the default beneficiaries will be deemed to be entitled to such amount, which will be enforceable by the courts.

- 2.41 In its application in varying a trust deed's terms, care must be taken in ensuring a trust's variation power allows for sufficient variation of both a mere power and trust power.

**Example 1**

An example of a variation power restricting the power to vary a trust and power is as follows:

*18 The Trustee for the time being may at any time and from time to time by deeds revoke add to or vary all or any of the trusts hereinbefore provided or the trusts provided by any variation or alteration or addition made thereto from time to time and may be the same or any other deed or deeds declare any new or other trusts or powers concerning the Trust Fund or any part or parts hereof the trusts whereof shall have been so revoked added to or varied...*

- 2.42 In the above Example 1, the variation power seems to limit any revoking, adding to or varying of a trust in a trust deed to the trusts listed before clause 18.
- 2.43 The variation power is then explicit in flagging that the powers of the trust fund can only be added to and not varied.
- 2.44 This may troublesome if any of the powers in the trust deed require amending or deleting, however, it can equally be suggested that the trustee then choose not to exercise the particular power in question or merely insert an 'amended' power.

**Example 2**

A slight variation to Example 1 is as follows:

*9.2 The Trustee may by Deed revoke add or release or vary all or any of the trusts or powers hereinbefore declared or any trusts or powers declared by variation, alteration or addition made hereto from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund or part or parts thereof provided...*

- 2.45 Regarding Example 2, while the trust and power may be amended, revoked or added to, any variation to the trust deed can only be made to the trusts and powers before clause 9.2.
- 2.46 Note the slight expansion of the ability to vary the terms of the trust deed through the addition of the word 'powers'.
- 2.47 Whilst not as much of a problem in more recent trust deeds, this issue will commonly arise when reviewing older trust deeds (and as will be highlighted in the *Mercanti* cases discussed below).

### **3 Multiple trust assets, multiple recipients, single discretionary trust**

- 3.1 In addition to the broad foundations in relation to the succession planning of discretionary trusts set out in the above section, additional complexities arise when passing control of a discretionary trust holding multiple assets to multiple recipients.
- 3.2 Such a scenario is not uncommon given the vast amount discretionary trusts holding multiple assets, regardless if a discretionary trust holds:
- (a) two or more investment properties;
  - (b) an investment property and share portfolio; or

- (c) a substantive share portfolio.
- 3.3 Where there are two or more intended recipients, the succession planning concerns for the discretionary trust relates to:
- (a) how decisions can be made and what can be done to break 'deadlocks';
  - (b) how can the appointor exercise its discretion to remove and appoint a trustee where trustees are unable to agree; and
  - (c) who benefits from the discretionary trust where the trustee is unable to agree on how to exercise its discretion to distribute income and the appointor is unable to exercise their ability to change the trustee.
- 3.4 Where the terms of the trust deed are such that trustees and appointors must make decisions unanimously, then risks may arise where the successor recipients cannot agree on how the assets of the trust should be invested moving forward.
- 3.5 In such circumstances, the default beneficiaries of the trust become crucial in determining if the right people end up benefiting from the trust deed.

**Example 1**

Steps were taken by the parents to ensure control in a discretionary trust (Smith Family Trust) passed to their two sons – Adam and Bob as equal trustee and appointor.

Time has since passed and Adam is married with children; whilst Bob is engaged to his girlfriend.

As Bob is to be married soon, he considers it an appropriate time to review his estate planning arrangements, including his interest in the Smith Family Trust, and to ensure his soon-to-be wife (Blair) can benefit from the trust in the event Bob predeceases her.

Known to Bob and Blair, Adam never got along with Blair.

As such, Bob took steps to ensure Blair replaces him in any trustee and appointor role of the trust.

Unfortunately, the trust deed contains the following terms:

**12.7 – Several Trustees to Act Jointly**

*If at any time there is more than one Trustee of this Deed they shall act jointly.*

**14.6 – Several Appointors to Act Jointly**

*Subject to sub-clause 14.7 if, at any time, there is more than one Appointor appointed pursuant to this Deed they shall act jointly.*

**14.7 – Specified Appointors**

*If at any time there are two or more Specified Appointors –*

- (a) *Any one of the Specified Appointors may remove a Trustee pursuant to sub-clause 12.2;*
- (b) *The written consent of each of the Specified Appointors is required to appoint a new or additional Trustee; and*
- (c) *Where the Deed requires the written consent of the Appointor, that consent shall only be effective upon the giving of the written consent by each Specified Appointor.*

**Specified Appointors defined to be** *Specified Beneficiaries who is holding office as an Appointor or any other entity appointed by a specified beneficiary.*

**Specified Beneficiaries defined to be** *Adam and Bob.*

**6.2 Distribution in Default of Appointment**

*In default of and subject to any appointment pursuant to Sub-Clause 6.1, the Trustee shall on and after the Distribution Date stand possessed of the Trust Fund and the net income thereafter to arise including any income arising or derived therefrom –*

- (a) UPON TRUST for such of the Specified Beneficiaries who are not Excluded Persons and if more than one as tenants in common in equal shares;*
- (b) Insofar as any part of the Trust Fund or the said net income thereof or any category of the net income is not effectively or validly disposed of by the operation of this Clause then UPON TRUST for such charitable objects or purposes as the Trustee may determine.*

- 3.6 In the above Example 1, issues will arise for Bob's succession planning intentions in relation to 'his share' of the discretionary trust.
- (a) Notwithstanding the fact that Bob may have exercised all the necessary powers to appoint Blair as his successor trustee and appointor, there would have been the risk for Adam declines to act jointly with Bob.
  - (b) Provided Adam wishes not to cause friction with his relationship with Bob during Bob's lifetime, Adam could have had the option to decline in acting jointly with Blair as joint trustees and appointors following Bob's passing.
  - (c) In doing so, Adam could rely on the mechanisms of clause 6.2 of the trust deed to ensure any income generated from the trust be distributed to himself as a default beneficiary of the trust.
- 3.7 Bob would therefore need to take additional steps in addition to merely ensuring his successor is validly appointed, which could include varying the underlying default beneficiaries of the trust or fixing the trust interests to be split equally between two family groups. Care must be taken if such a step is taken as adverse revenue consequences may arise.

***When will stamp duty be payable on the amendment of a discretionary trust?***

- 3.8 Please note for the purposes of this paper, the stamp duty consequences of Queensland will be considered (governed under *Duties Act 2001 (Qld) (QLD Duties Act)*). If a discretionary trust holds assets in other States/Territories, then a separate analysis of that jurisdiction's stamp duty legislation is required.
- 3.9 For Queensland stamp duty purposes, section 8 of Qld Duties Act states that duty is imposed on dutiable transactions.
- 3.10 Section 9 of Qld Duties Act provides that a dutiable transaction includes any of the following (summarised to include the transactions most commonly seen):
- (a) there has been a transfer or an agreement for the transfer of dutiable property;
  - (b) there is a creation or termination of a trust of dutiable property; or
  - (c) there is a trust acquisition or trust surrender.
- 3.11 These transactions are only relevant from a Queensland stamp duty perspective where they relate over dutiable property.
- 3.12 Dutiable property is defined in section 10 Qld Duties Act to include (but not limited to):
- (a) land in Queensland;
  - (b) Queensland business assets;

- (c) chattels in Queensland; and
- (d) potentially indirect interests in the above.<sup>8</sup>

3.13 It should be appreciated, that in Queensland, stamp duty may be triggered where a dutiable transaction occurs in relation to a discretionary trust operating a Queensland business.

3.14 If the discretionary trust does not hold dutiable property, then no stamp duty should apply to any amendment made to the trust (as there is nothing taxable from a stamp duty perspective) that triggers a dutiable transaction.

3.15 If the discretionary trust does, then it is important that the changes do not trigger stamp duty.

***Transfer or an agreement for the transfer of dutiable property***

3.16 Transfer should take on its ordinary meaning in that it applies where dutiable property goes from a legal entity to another legal entity.

3.17 Transfer is also defined in Schedule 6 of Qld Duties Act to include an assignment and exchange.

3.18 In the context of discretionary trusts, the only entity that legally holds the trust property is the trustee.

3.19 Therefore, where trust property goes from the trustee to another person/entity, a dutiable transaction will arise. Simplistically, it there is a transfer if there is a change in the legal owner of the dutiable property.

3.20 It should also be noted that where a trust has multiple trustees, the trustees are taken to be a single person.<sup>9</sup>

3.21 Practically, this means that if John and Jane are trustees of a trust and treated as a single person, John and Kate as trustees for the trust (even as trustee for the same trust) will be treated as a separate person.

***Creation or termination of a trust over dutiable property***

3.22 A creation of a trust occurs when a person who does not hold dutiable property on trust, starts to hold the property as trustee.<sup>10</sup>

3.23 A trust may also be created where a person holds dutiable property as trustee for one trust, and then starts to hold the same dutiable property as trustee for another trust where either:

- (a) The persons with trust interests in the two trusts are different/ or
- (b) The same persons have a trust interest in both trusts, but their percentages are different between the two trusts.<sup>11</sup>

3.24 A termination of a trust occurs when a person holding dutiable property as trustee, starts to hold the property in their own capacity.<sup>12</sup>

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<sup>8</sup> Indirect interests can include a security interest, a partner's interest in a partnership, a trust interest and the interest of a discretionary object of a trust that holds property mentioned above – section 10(2) of Qld Duties Act.

<sup>9</sup> Section 50 of Qld Duties Act

<sup>10</sup> Section 53(1) of Qld Duties Act

<sup>11</sup> Section 53(2) of Qld Duties Act

<sup>12</sup> Section 54 of Qld Duties Act

3.25 While the transfer head of duty considers the change in legal ownership over dutiable property, the creation or termination of a trust considers if a trust has been created or terminated.<sup>13</sup> That is, the legal owner of the dutiable property may be the same, the question is whether there has been a change in the legal owner's capacity over the dutiable property.

***Trust acquisition or trust surrender over dutiable property***

3.26 Like the above heads of duty, this head of duty will only apply to discretionary trusts holding dutiable property.

3.27 There are also specific provisions imposing a 'look-through' approach for indirect interests in dutiable property (i.e. through later trust interests or partnership interests).<sup>14</sup>

3.28 A trust acquisition occurs when a person acquires a trust interest in a trust,<sup>15</sup> while a trust surrender occurs when a person surrenders a trust interest.<sup>16</sup>

3.29 A trust interest means a person's interest as a beneficiary of a trust, other than a life interest. Specifically, in relation to discretionary trust, the taker in default (or the default beneficiary) has the trust interest.<sup>17</sup>

3.30 A taker in default's proportionate interest in the trust is calculated under section 60 of Qld Duties Act to be:

- (a) The percentage of the trust income or trust property the beneficiary would receive in default of appointment by the trustee; or
- (b) If the beneficiary would receive both trust income and trust property in default of appointment by the trustee, the greater percentage of the trust income or trust property the beneficiary would receive.

3.31 It is noted that there are provisions to avoid a double-up in duty payable on a trust acquisition or trust surrender. Specifically, if duty is paid on a trust surrender, then no duty is paid on a trust acquisition as a result of the trust surrender.<sup>18</sup>

3.32 The dutiable value of a trust acquisition or surrender will be based on the greater of the following:

- (a) The consideration for the acquisition or surrender so far as the consideration relates to dutiable property, or an indirect interest in dutiable property, held by the trust; or
- (b) The value of the acquisition or surrender worked out under section 63 of Qld Duties Act.<sup>19</sup>

3.33 In contrast with the above two heads of duty relating to changes of legal ownership or the changing of capacity to hold dutiable property as trustee – the dutiable transaction relating to trust acquisitions and surrenders considers change to the underlying beneficial ownership.

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<sup>13</sup> Similar to CGT event E1 under the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) legislation

<sup>14</sup> Section 58 of Qld Duties Act.

<sup>15</sup> Section 55 of Qld Duties Act.

<sup>16</sup> Section 56 of Qld Duties Act.

<sup>17</sup> Section 57 of Qld Duties Act.

<sup>18</sup> Section 58 of Qld Duties Act.

<sup>19</sup> Section 63 of Qld Duties Act looks at the unencumbered value of the underlying dutiable property held in the discretionary trust.

### **Summary**

- 3.34 The heads of duties affecting discretionary trusts can be summarised as follows:
- (a) duty payable on a change of legal ownership;
  - (b) duty payable when legal ownership remains the same, but trusts are created or terminated; and
  - (c) duty payable when beneficial ownership changes.

### **When will capital gains tax be payable on the amendment of a discretionary trust?**

- 3.35 Capital gains tax (CGT) events can be triggered when varying a trust. Specifically CGT events E1 and E2 may apply.
- 3.36 CGT event E1 arises if a trust is created over a CGT asset and CGT event E2 occurs where an asset is transferred to a trust.
- 3.37 Usually, the amendment to trustee, appointor or beneficiary roles do not seek to create a trust over a CGT asset (as a trust is already in existence), nor does it seek to transfer an asset to a trust.
- 3.38 However, it is commonly said that if a variation triggers a 'resettlement', then either CGT event E1 or CGT event E2 may be triggered.
- 3.39 In particular, the consequences of a resettlement include:
- (a) all assets are treated as having been disposed of by the original trust and settled on the new trust (i.e. CGT event E1 occurs); and
  - (b) any losses in the trust are trapped and cannot be carried forward to offset income in the 'new' trust.
- 3.40 Historically, the ATO in its Statement of Principles (SOP) provided an outline of what may give rise to a resettlement of a trust. The guidance provided by the SOP indicates that a resettlement will arise where there has been an alteration to a trust sufficient to constitute a new trust relationship.
- 3.41 However, the ATO withdrew its SOP following the decision of the Full Court of the Federal Court of Australia in *Commissioner of Taxation v Clark (Clark)* [2011] FCAFC 5. In that case, the trust in question was a unit trust which had been substantially changed over several years by changing the trustee, the beneficiaries and the trust property.
- 3.42 In rejecting the Commissioner's argument that these amendments had amounted to a resettlement of the trust, the Court held that the three factors to consider in determining whether there has been a continuum of the trust are:
- (a) the terms of the trust deed;
  - (b) the trust property; and
  - (c) the membership of the trust.
- 3.43 Further, the Court confirmed that where the changes are within the scope of the variation power in the relevant trust deed, changes over time to the trust property and beneficiaries should not trigger a resettlement, provided that they can be identified at all times and there has not been a severance which would lead to the termination of the trust.<sup>20</sup>

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<sup>20</sup> *Commissioner of Taxation v Clark (Clark)* [2011] FCAFC 5 at [87]  
Succession planning and Discretionary Trusts Page 16 of 35



- 3.44 Following the withdrawal of its SOP, the ATO released Tax Determination 2012/21. This determination states the ATO's position formerly set out in its SOP was largely unsustainable following the Court's decision in Clark and that neither CGT event E1 nor CGT event E2 happens unless:
- (a) the change causes the existing trust to terminate and a new trust to arise for trust law purposes; or
  - (b) the effect of the change is such as to lead to a particular asset being subject to a separate charter of rights and obligations such as to give rise to the conclusion that that asset has been settled on the terms of a different trust.

3.45 Paragraph 24 of TD 2012/21 specifically states that:

*“Relevantly, the principals established by those cases are also relevant to the question of the circumstances in which CGT event E1 or E2 may happen as a result of changes being made to the terms of an existing trust pursuant to a valid exercise of a power in the deed (including a power to amend). In light of those principles, **the ATO accepts that a change in the terms of the trust pursuant to exercise of an existing power (including an amendment to the deed of a trust), or court approved variation, will not result in a termination of the trust and, therefore, subject to the observation in paragraph 27 [which relates to when trust property are held under a new charter of obligations] will not result in CGT event E1 happening.**”*

3.46 Therefore, provided the terms of the respective trust provides sufficient power to allow for a certain amendment to be made in relation to the trust, there will be no adverse income tax consequences for such an amendment being made.

3.47 As such, often the key concern for trust amendments relates to the potential dutiable transactions being triggered upon amendments being made.

***Summary in relation to when amendments may trigger a dutiable transaction***

3.48 No stamp duty consequences arise in relation to any documents changing either the appointor (regardless of whether effected during an appointor's lifetime or via Will or nomination by deed) or discretionary beneficiaries.

3.49 Adverse stamp duty consequences, in the context of amending a discretionary trust, will commonly arise when:

- (a) there has been a change of legal ownership – usually when a change of trustee occurs; and
- (b) there has been a change of beneficial ownership, which in the context of Qld Duties Act is a change in the takers in default, or the default beneficiaries – usually when default beneficiaries are being amended.

3.50 Where a change of trustee is to be effected following the death or lose of capacity of an existing trustee, such stamp duty consequences will be delayed until such event occurring.

3.51 In both circumstances above, there are exemptions available, which may allow an amendment to proceed without triggering adverse stamp duty consequences.

***Exemption – change of trustee***

3.52 As outlined above, stamp duty is payable where there has been a change of legal ownership over dutiable property.

3.53 This includes circumstances when the trustee of a trust is changed, and even if there is a remaining trustee.

- 3.54 Section 117 of Qld Duties states that stamp duty will not be imposed *“for the sole purpose of giving effect to a change of a trustee if:*
- (a) *The transaction is not part of an arrangement:*
    - (A) *Involving a change in the rights or interest of a beneficiary of the trust; or*
    - (B) *Terminating the trust; and*
  - (b) *Transfer duty has been paid on all trust acquisitions or trust surrenders for which transfer duty is imposed for the trust before the transaction.”*
- 3.55 Commonly, a change of trustee is not often coupled with a changing of a beneficiary’s interest in the trust, and as such they will comply with the necessary requirements for the exemption.
- 3.56 The exemption can be claimed through completing an appropriately worded statutory declaration and submitting such declaration when lodging the change of trustee for stamping.
- 3.57 Where the change of trustee is part of a broader transaction that involves beneficiaries of the trust being changed, then care will need to be taken to ensure that the requirements at section 117(2) Qld Duties Act are met, specifically:
- (a) *“Transfer duty has been paid on all trust acquisitions or trust surrenders:*
    - (i) *Of trust interests in the trust made under the arrangement; and*
    - (ii) *For which transfer duty is imposed; and*
  - (b) *Transfer duty has been paid on all trust acquisitions or trust surrenders for which transfer duty is imposed for the trust before the transaction; and*
  - (c) *The change of trustee is not part of an arrangement to avoid the imposition of duty.”*
- 3.58 In such a circumstance, provided stamp duty is paid on the change of beneficiary aspect of the transaction, the general change of trustee exemption may still be available.

***Exemption – trust acquisition or surrender in family trust***

- 3.59 Section 118 of Qld Duties Act allows a change of taker in default in a discretionary trust to be exempt from stamp duty provided it relates to a family unit.
- 3.60 Specifically:
- Transfer duty is not imposed on a dutiable transaction that is a trust acquisition or trust surrender of a trust interest if:*
- (a) *The trust is established and maintained as a discretionary trust primarily for the benefit of the members of a particular family or a family company; and*
  - (b) *The person acquiring or surrendering the trust interest is a member of the family who, or is a family company that, does not benefit in the capacity of trustee.<sup>21</sup>*
- 3.61 A discretionary trust is established and maintained primarily for the benefit of the members of a particular family or a family company if:
- (a) *“The primary beneficiaries of the trust consist only of members of the family or the family company; and*

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<sup>21</sup> Section 118(1) of Qld Duties Act

(b) *The takers in default of an appointment for capital by the trustee of the trust consist only of members of the family or the family company.*<sup>22</sup>

3.62 The requirements can therefore be summarised as follows:

- (a) The primary beneficiaries of a trust must only consist of members of a family or the family company;
- (b) The capital default beneficiaries of a trust must only consist of members of a family or the family company; and
- (c) Changes to the default beneficiaries must only be between members of a family or the family company.

3.63 It is therefore important to appreciate, who is a member of a family (as well as what a family company is).

3.64 A person is a member of a particular family of another person if they are spouses or any of the following in relation to the first person or the spouse:

- (a) child, stepchild or adopted child;
- (b) grandchild or great grandchild;
- (c) brother, sister, aunt, uncle or cousin;
- (d) parent, step-parent, adoptive parent, grandparent or great grandparent.<sup>23</sup>

3.65 A family company is defined to be a corporation in which all its directors and shareholders are members of the relevant family for which the trust is established and maintained for.<sup>24</sup>

3.66 Therefore, changes to the default beneficiaries between the above persons/entities, may be exempt provided the other requirements are satisfied.

3.67 It should also be noted that section 118(2) of Qld Duties Act considers trust acquisitions or surrenders being triggered due to the death or birth of family members, and allows for an exemption to be made.

## **4 Issues that may arise as part of a discretionary trust succession plan**

### ***Mercanti v Mercanti***

#### ***Background***

4.1 The Mercanti Case involved a relationship breakdown between a father (Michael Mercanti) and son (Tyrone Mercanti) and the validity of deeds of variation of two trusts changing the appointor role and the subsequent change of trustee effected by the new appointor.

4.2 Michael commenced a shoe repair business in the 1960s which grew into a successful business, resulting in the establishment of two discretionary trusts to be utilised as part of the trading business:

- (a) the Michael Mercanti Family Trust (**MMF Trust**), which Slondia Nominees Pty Ltd (**Slondia**) acted as corporate trustee; and

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<sup>22</sup> Section 118(3) of Qld Duties Act

<sup>23</sup> Section 118(6) of Qld Duties Act.

<sup>24</sup> Section 118(7) of Qld Duties Act

- (b) the Footwear Wholesale Trust (**FW Trust**), in which Citycourt Pty Ltd acted as corporate trustee.
- 4.3 The directors and shareholders of the corporate trustees were Michael and his wife, Yvonne; with Michael being named as the Appointor of the MMF Trust and FW Trust.
- 4.4 Over time, Michael's youngest son, Tyrone became involved in the business (upon leaving school at the age of 18), ultimately being made a director of the corporate trustees in 2001.
- 4.5 Steps were subsequently taken in 2004 (as part of effecting Michael and Yvonne's estate planning intentions) to pass the appointor role to Tyrone and deeds of variations were subsequently executed.
- 4.6 By late 2012, the relationship between Tyrone and his parents broke down. Disputes arose as Michael wished to receive more income from the businesses, and have certain expense paid from the business; in which Tyrone disagreed.
- 4.7 Additional disputes and disagreements continued to arise until July 2013, whilst Tyrone was away on holiday; Michael and Yvonne (as shareholders of the corporate trustees) removed Tyrone as a director.
- 4.8 Tyrone subsequently, as appointor, executed documentation changing the corporate trustees of the MMF Trust and FW Trust.
- 4.9 Michael subsequently disputed the original 2004 deeds of variations appointing Tyrone as an Appointor of the MMF Trust and FW Trust.

***First instance***

- 4.10 The relevant variation powers for the MMF Trust and FW Trust are set out below.

**Variation power for MMF Trust**

*28 Subject to clause 10 hereof the Trustees for the time being may at any time and from time to time by deeds revocable or irrevocable revoke add to or vary all or any of the trusts terms and conditions hereinbefore contained or the trusts terms and conditions contained in any variation or alteration or addition made thereto from time to time and may in like manner declare any new or other trusts terms and conditions concerning the Trust Fund or any part or parts thereof the trusts whereof shall have been so revoked added to or varied provided that the rule known as the Rule against Perpetuities is not thereby infringed and provided that such new or other trust powers discretion alterations or variations -*

- (1) insofar as the beneficial interests created by this Deed are revoked added to or varied shall be for the benefit of all or any one or more of the General Beneficiaries or any one or more persons born or unborn being lineal descendants of whatever degree (or the spouse of any lineal descendant) of any grandparent of any General Beneficiary; but*
- (2) shall not be in favour of or result in any benefit to any member of the excluded class;*
- (3) shall not affect the beneficial entitlement to any amount set aside for any beneficiary prior to the date of the variation alteration or addition; and*
- (4) shall not (save as provided in paragraph (1) of this clause) enlarge the number of persons capable of falling within the description 'beneficiary' hereinbefore contained.*

*Save as provided in this clause these presents shall not be capable of being revoked added to or varied.*

**Variation power for FW Trust**

- 14.1 The Trustee may at any time and from time to time (but whilst there shall be an*

*Appointor only after having given not less than 30 days written notice to the Appointor of his intention so to do) by deeds revoke add to or vary all or any of the trusts hereinbefore provided or the trusts provided by any variation alteration or addition made thereto from time to time and may by the same or any other deed declare any new or other trusts or powers concerning the Trust Fund or any part thereof the trusts whereof shall have been so revoked added to or varied.*

*14.2 The powers specified in clause 13.1 shall not be exercised so that:*

*14.2.1 any interest under the trusts as so revoked added to or varied may vest after the expiry of the perpetuity period;*

*14.2.2 any member of the Excluded Class is becomes or may become entitled to any interest or benefit under the trusts as so revoked added to or varied; or*

*14.2.3 the beneficial entitlement to any amount set aside for any Beneficiary prior to the date of the variation alteration or addition is affected.*

*14.3 Save as provided in clauses 14.1 and 14.2 these presents shall not be capable of being revoked added to or varied.*

4.11 In determining whether the above variation powers were broad enough to enable a variation to the appointor role, the Le Miere J considered the following:

- (a) that it is the 'court's primary task in construction is to discover the intention of, relevantly, the settlor from the words used in the instrument read as a whole. Where an instrument is capable of more than one meaning the interpretation which avoids consequences which are, in the circumstances, capricious or unreasonable will be preferred. That meaning may not necessarily be the most obvious or most grammatically correct: *Scaffidi v Montevento Holdings Pty Ltd [2011] WASCA 146 [65], [66], [154]*';<sup>25</sup>
- (b) that a 'power of amendment in a trust deed will be construed according to its natural meaning. In *Kearns v Hill (1990) 21 NSWLR 107* the New South Wales Court of Appeal rejected any narrow or strict construction of a power of amendment in a trust deed';<sup>26</sup>
- (c) that 'a power of amendment is not likely to be held to extend to varying the trust in a way which would destroy its 'substratum': *Re Dyer [1935] VLR 273*';<sup>27</sup> and
- (d) in '*Jenkins v Ellett [2007] QSC 154* Douglas J held that a power to vary 'all or any of the trusts' of a trust deed did not include a power to discharge the principal of the trust deed, who had power to remove and appoint trustees. Douglas J reached that view after considering the text of the provision conferring the power of amendment. Douglas J also had regard to the nature of the proposed amendment:

*The power to appoint a new trustee available to the Principal under clause 12 does not seem to me to be one that requires easy amendment to add to any desirable flexibility in managing the fund: cf Meagher JA in *Kearns v Hill (1990) 21 NSWLR 107 107 - 109*. Clause 12's purpose of allowing the removal of a trustee is also inconsistent with the possibility that the trustee could negate the operation of the power by amending the schedule to the deed to change the identity of the Principal ...*

*The Principal's ability to remove and replace a trustee seems to me to be one of the fundamental features of the structure of this deed, one setting up the family discretionary trust. The maintenance of that power is obviously designed to ensure*

<sup>25</sup> *Mercanti v Mercanti [2015] WASC 297* at 74

<sup>26</sup> *Ibid* at 75

<sup>27</sup> *Ibid* at 76

*that the control of the trust will remain with the significant intended beneficiary, here George Jenkins, and after him his spouse or his executor, as follows from the definition of 'The Principal' in the schedule. To allow the power in clause 12 to be subverted by the trustee it was designed to supervise purporting to use clause 11's powers to amend the deed rather than the trusts declared by the deed is not, in my view, permissible. It is akin to destroying the substratum of the deed [18] - [19].<sup>28</sup>*

4.12 Le Miere J held that the variation to the MMF Trust was valid and that *'the natural and ordinary meaning of the words of cl 28 are that the trustees may amend the provisions of the trust deed, including the items in the Schedule naming or describing the Appointor and the Guardian. In my opinion there is nothing in the remaining provisions of the trust deed that necessarily imply that the trustees cannot amend the deed by removing the Appointor or Guardian and replacing them'*.

4.13 In contrast, his Honour determined that the variation to the FW Trust was invalid as:

- (a) the wording of the variation only allowed variations to clauses prior to the variation power (in which the appointor powers were not present):

*'The crucial words of cl 14.1 are 'the Trustee may ... vary ... the trusts hereinbefore provided'. In my opinion the 'trusts hereinbefore provided are the trusts provided for in the earlier provisions of the trust deed. Clause 2 (Declaration of Trust) declares that the trustee shall stand possessed of the Trust Fund and the income thereof upon the trusts and with and subject to the powers and provisions hereinafter expressed. The trusts and powers expressed are found in cl 2 (Declaration of Trust), 4 (Profits of the Trust), 5 (Vesting of Trust), 6 (Benefits in Addition), 7 (Trustee Powers), 8 (Trustee's General Powers). The identity of the Appointor is not 'any of the trusts hereinbefore provided ...',<sup>29</sup> and*

- (b) regardless, the variation of an appointor's role did not relate to the underlying trusts of the FW Trust:

*'In my opinion the natural and ordinary meaning of the words 'the Trustee may ... vary ... the trusts hereinbefore provided' does not extend to varying the terms and conditions of the trust deed dealing with the office of Appointor as distinct from the trusts created by the trust deed.'<sup>30</sup>*

#### ***On appeal***

4.14 Michael appealed the decision in relation to the findings for the MMF Trust (in which the change of Appointor was held to be valid) to the Court of Appeal<sup>31</sup> on the following grounds:

- (a) **Ground 1:** The MMF Trust Deed does not empower the Trustee to do so on construction of the variation power.
- (b) **Ground 2:** Alternatively, the variation power did not allow the Schedule the MMF Trust Deed to be varied so as to remove the appointor and appoint a new appointor in his place.
- (c) **Ground 3:** The MMF Trust Deed of Variation is not binding upon Slondia (the corporate trustee) because the instrument was not executed by Slondia pursuant to the lawful authority of Slondia's directors or shareholders.

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<sup>28</sup> Ibid at 77

<sup>29</sup> Ibid at 100

<sup>30</sup> Ibid at 101

<sup>31</sup> *Mercanti v Mercanti* [2016] WASCA 206

- (d) **Ground 4:** The MMF Trust Deed of Variation constituted a fraud on the power to amend the MMF Trust Deed and thus a breach of Slondia's fiduciary duty as Trustee of the MMF Trust.
  - (e) **Ground 5:** Michael's agreement to and execution of the MMF Trust Deed of Variation was as a result of the equitable fraud by, further or alternatively the undue influence of, Tyrone.
  - (f) **Ground 6:** The appointment of a new trustee by Tyrone for the MMF Trust amounted to a fraud on the power of the appointor and was a breach of duty.
  - (g) **Ground 7:** That the appointment of Tyrone as appointor was void but in the alternative, that Tyrone held such powers on constructive trust for Michael.
- 4.15 In rejecting Michael's arguments relating to **Grounds 1 and 2**, the Court accepted that notwithstanding the variation power related to variations '*hereinbefore*' declared and the MMF Trust deed of variation varied the Schedule (being situated after the variation power), on construction:
- (a) *'the attachment of the Schedule as a convenient drafting technique in the context of a trust deed that was obviously intended for use as a standard form document;*
  - (b) *the status of the definition of 'the Appointor' as, in part, a definition in the strict sense and, in part, an operative provision; and*
  - (c) *the express references in the definition of 'the Appointor' to the relevant provision of the Schedule,*
  - (d) *require, in combination, that the relevant provision of the Schedule be read and construed as if it were, in substance, embodied in and part of the definition.*
- Also, in my opinion, the definition of 'the Appointor', with the relevant provision of the Schedule read and construed as if it were, in substance, embodied in and part of the definition, must be read and construed with the operative provision with respect to the Appointor in cl 21.<sup>32</sup>*
- 4.16 The Court also made note to distinguish between the words 'the trusts' (in which the Schedule would not be apart of) and the 'terms and conditions' (of which the Schedule relates to).
- 4.17 In rejecting **Ground 3**, reference was made to the file note of lawyers present at a meeting between Tyrone, Michael and Yvonne, in which they were instructed to change the Appointor of the trust to Tyrone.
- 4.18 This, along with other contemporaneous evidence, was sufficient in documenting that there 'was a meeting of minds' as to the execution of the deed of variation, notwithstanding the lack of formal procedures being met.
- 4.19 **Ground 4** was rejected on the basis that it was accepted that the trustee's duties conferred in exercising the variation power were:
- (a) *'to act honestly and in good faith; and*
  - (b) *to exercise the power for the purpose for which it was conferred and not for any extraneous or ulterior purpose.,<sup>33</sup>*

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<sup>32</sup> Ibid at 140 and 141

<sup>33</sup> Ibid at 250

and that *'the power of variation in cl 28 of the MMF Trust Deed may be exercised to achieve or promote, relevantly, any of the purposes for which the MMF Trust was created'*.<sup>34</sup>

4.20 Such purpose could be inferred to include:

- (a) *'conferring benefits from time to time on one or more of the Beneficiaries for the time being of the MMF Trust, as determined from time to time by the Trustee for the time being (at all material times, Slondia), subject to the provisions of the MMF Trust Deed, including any consent required from the Guardian for the time being (at all material times, Michael Mercanti) pursuant to cl 10 of the MMF Trust Deed; and*
- (b) *ensuring, in the context of a trust which may not vest until the Vesting Day (namely, 30 June 2055) and the existing provisions with respect to the effective control of the MMF Trust, that the provisions of the MMF Trust Deed with respect to the offices of Guardian and Appointor remain appropriate.*<sup>35</sup>

4.21 Therefore, the exercising of the variation power to 'advance Tyrone's inheritance' would not render the deed of variation *'improper or liable to be set aside in equity'*.<sup>36</sup>

4.22 The Court also accepted that the substratum of the trust was not varied by the changing of the appointor under the deed of variation. Relevantly *'the substratum of the MMF Trust was the conferral of benefits from time to time on one or more of the Beneficiaries for the time being of the MMF Trust, as determined from time to time by the Trustee for the time being, subject to the provisions of the MMF Trust Deed, including any consent required from the Guardian for the time being pursuant to cl 10 of the MMF Trust Deed. The substratum was not, in my view, to be ascertained or defined by reference to the identity of the persons or entities who, at the date of execution of the MMF Trust Deed, held the offices of Trustee, Guardian or Appointor'*.<sup>37</sup>

4.23 The Court also separately noted the independent legal advice obtained by Michael and Yvonne from Brett Davies Lawyers.<sup>38</sup>

4.24 In rejecting **Ground 5** regarding Michael's execution of the deed of variation for the MMF Trust being due to equitable fraud, the Court did not accept Michael's evidence that he did not give instructions to make Tyrone the appointor of the MMF Trust.<sup>39</sup>

4.25 Rather, weight was placed on evidence from advisors at the time claiming that Michael was properly advised of the effect of the change and that the change of appointor was being made to allow Michael to 'step back' from the business.<sup>40</sup>

4.26 **Ground 6** was rejected on the basis that not all roles in a trust deed attached fiduciary duties on them.

4.27 Where the role:

- (a) prevents the exercise of a power in favour of the yielder, then fiduciary duties may arise;
- (b) otherwise, if the yielder of a power is entitled to exercise the power for his or her own benefit, then the power will be person as distinct from fiduciary.<sup>41</sup>

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<sup>34</sup> Ibid at 261

<sup>35</sup> Ibid at 262

<sup>36</sup> Ibid at 264

<sup>37</sup> Ibid at 265

<sup>38</sup> Ibid at 267

<sup>39</sup> Ibid at 295 and 296

<sup>40</sup> Ibid at 298 and 299



4.28 The Court held that the ‘effect of Tyrone Mercanti exercising his power as Appointor to remove Slondia and appoint Parradele as Trustee was consistent with the purpose of the MMF Trust, as revealed by the MMF Trust Deed of Variation. The effect of executing the MMF Trust Deed of Variation in 2004 was to transfer effective control of the MMF Trust and its business to Tyrone Mercanti immediately. Tyrone Mercanti’s action in preserving the status quo was not improper. He was not acting dishonestly or in bad faith or for any extraneous or ulterior purpose’.<sup>42</sup>

4.29 **Ground 7** was dismissed without consideration.

#### **Takeaways**

4.30 From disputing the validity of decisions and documents signed (whether be due to a lack of power or improper procedures followed) to challenging the exercising of such powers in ‘bad faith’, the *Mercanti* cases provide a text-book example on how to challenge a discretionary trust’s succession plan.

4.31 One might question, however, whether the case would have made it this far if Michael had prepared a nomination appointing Tyrone as the successor appointor following the death and loss of capacity of Michael and Yvonne, rather than making the change to the appointor role during Michael and Yvonne’s lifetime.

#### ***Hoh v Ying Mui Pty Ltd***<sup>43</sup>

4.32 Another family feud, such to the degree that the Court observed the tragic nature:

‘3 *Hoh Senior passed away on 21 April 1988. Before his death, Hoh Senior delivered instructions for his will which included the following prayer:*

*These are my last instructions to my children, grand-children and their descendants and it is my sincere wish that they will be faithfully carried out.*

...

*It is my deepest and dearest wishes that my children and descendants will continue to love and help each other when I am gone. Take heed of the old saying “Harmony within the Family promotes prosperity”. The way to achieve such harmony as taught by ancient sages is to cultivate the virtues of filial piety and brotherly love.*

4 *It is tragic for the Hoh family that these wishes of Hoh Senior have not to date been fulfilled, culminating in the present litigation of Wagnerian proportions and cost – not only in financial terms, but also in exacerbating the strains within the family which have driven it to this point.*<sup>44</sup>

4.33 This case related to a bitter family dispute between two factions of the Hoh family:

- (a) the George faction – based in Malaysia; and
- (b) the Frank faction – based in Australia.

4.34 The dispute related to the actions of the Frank faction regarding multiple discretionary trusts (the Ying Mui Trust, The Amore Trust and FRG Investments Trust, collectively the **Trusts**) owning significant Australian assets (accumulated by Hoh Senior during his lifetime), whereby the Frank faction greatly benefited.

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<sup>41</sup> Ibid at 320

<sup>42</sup> Ibid at 326

<sup>43</sup> [2019] VSCA 203

<sup>44</sup> *Ying Mui Pty Ltd v Hoh* (Ruling No 1) [2016] VSC 519 at 3-4

- 4.35 Such actions included:
- (a) selling assets held by the Ying Mui Trust to associated persons of the Frank faction;<sup>45</sup>
  - (b) deliberately misleading the George faction as to the assets and distribution holding of the trust;<sup>46</sup>
  - (c) arranging for net income of the Ying Mui Trust to be distributed to associated persons of the Frank faction; and<sup>47</sup>
  - (d) entering into management fee agreements in favour of associated persons of the Frank faction.<sup>48</sup>
- 4.36 Such was the degree of abuse of power, the trial Courts ordered:<sup>49</sup>
- (a) a new trustee be appointed to each of the trusts and the trust assets be transferred to the new trustee;
  - (b) associated persons of the Frank faction pay equitable compensation to the new trustee in respect of management fees and trust distributions made; and
  - (c) the sales of properties from Ying Mui Trust be set aside and the properties retransferred to the Ying Mui Trust.
- 4.37 Much of the decision was made on the basis that the Frank faction breached their fiduciary or statutory duties for the Trusts by entering into management fee arrangements and making trust distribution payments; and such determinations were questioned on appeal.
- 4.38 For the purposes of this paper, the following was noted by the Court in determining that duties were breached by the Frank faction (which can be contrasted with the claim of breach of trusts or duties in the *Mercanti* cases).
- 4.39 The Court held that the Frank faction were in a position of clear conflict of interest in addition to utilising their position as director of various corporate trustees to benefit their associated entities to the detriment of the corporate trustees, by entering into management fee agreements.<sup>50</sup>
- 4.40 Regarding the receipt of trust distributions as breaches of trust, it was noted that:
- (a) distributions should have been taken as having been motivated by the Frank faction's *'improper purpose of obtaining a 'fighting fund' to be used by the Frank faction against the George faction in anticipated litigation concerning the administration and control of the Ying Mui trust'*;<sup>51</sup>
  - (b) members of the Frank faction *'did not give any genuine consideration to how the discretion of appointment ought to have been exercised, or whether the 2012–2014 Distribution Payments were in the best interests of the present and future beneficiaries of the Ying Mui Trust and the Amore Trust'*.<sup>52</sup>

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<sup>45</sup> *Hoh v Ying Mui Pty Ltd* [2019] VSCA 203 at 41

<sup>46</sup> *Ibid* at 42

<sup>47</sup> *Ibid* at 51

<sup>48</sup> *Ibid* at 41

<sup>49</sup> *Ibid* at 55

<sup>50</sup> *Ibid* at 265

<sup>51</sup> *Ibid* at 280

<sup>52</sup> *Ibid* at 281

- 4.41 In addition, the trial judge (with the Court of Appeal) held that:<sup>53</sup>
- (a) any argument that the distributions were for the benevolent purpose of protecting the Trust funds from the George faction could not be relied upon as no such purpose existed on construction of the trust deeds;
  - (b) in exercising the trustee discretion to distribute, members of the Frank faction exercised their powers in bad faith and in a dishonest fashion by concealing actions from the George faction, as well as for an improper purpose of establishing a fighting fund.
- 4.42 In reconciling the difference between the treatment of the *Ying Mui* case and *Mercanti* cases, one would note the wider approach the Courts adopted in considering the broader purposes of the Trusts (i.e. to benefit the extended family, rather than one family unit as was the case in *Mercanti*).
- 4.43 Differences in relation to the cases are, however, present:
- (a) the *Mercanti* cases effectively related to the passing of the family business to a son whilst the father and mother were living;
  - (b) in contrast the *Ying Mui* case considered the ongoing management of discretionary trusts following the passing of the heads of the family (which can be distinguished in that the discretionary trusts were not passed or set aside for a particular family unit).
- 4.44 Given there was no formal ‘transferring’ of the Trusts in the *Ying Mui* case to a particular family unit, differences can arise in that those responsible for managing the Trusts would need to exercise their discretion having genuine consideration of all the beneficiaries at large.
- 4.45 Certainly the existence of letters from the Frank faction to the George faction of the following effect, would cause concern as to the ability for those in the Frank faction making decisions relating to the Trusts to make such decisions with proper consideration as required under trust law:
- By letter dated 31 July 2010, she rejected the proposed meeting and stated that the dispute was ‘past the point of discussion’ because: ‘MY DAD HAS MADE HIS DECISION — in his words, he wants “out” of all business associations with the extended Hoh family’.*
- Lynn said in her letter that her proposal: ‘was a “cleaner” solution to my dad’s initial intentions to effectively wind up all these businesses with a view to distributing the proceeds to relevant parties’, [24] and continued: ‘[t]he only decision that needs to be made here is by you and uncle George — whether you want to accept my proposal as set out in my letter, or take your chances with what my dad will do if you reject my proposal’. [25] She set a deadline of 6 August 2010 for acceptance of her proposal and, on Frank’s instructions, threatened that he would ‘do it his way’ if the proposal was not accepted by that time.’<sup>54</sup>*
- 4.46 Further, the Court noted that “George’s statements are consistent with him working for the whole family (including Derek and Richard) on behalf of SYM and with Frank acting for the narrower family (excluding Derek and Richard) on behalf of Ying Mui”.<sup>55</sup>

***Callus v KB Investments***<sup>56</sup>

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<sup>53</sup> Ibid at 282

<sup>54</sup> Ibid at 38

<sup>55</sup> Ibid at 140

<sup>56</sup> [2020] VCC 135

- 4.47 In contrast to the *Ying Mui* case, the recent Victorian case of *Callus v KB Investments* [2020] VCC 135 is example where by a disgruntled beneficiary could not establish the fact that the trustee '*was not in a position to give real and genuine consideration to the interests of the beneficiaries, or that it did not give real and genuine consideration of those interests*'.
- 4.48 This was notwithstanding that the trustee of the trust in that case transferred a property to one of the beneficiaries over another and left no written reasons or record for making such a decision.
- 4.49 In that case, a disgruntled family member challenged the trustee's discretion to transfer trust property to one of four named beneficiaries in a discretionary trust deed.
- 4.50 The Court undertook to consider, not whether the final outcome was fair, but rather whether the trustee at the time had proper consideration as part of the process of making a decision.

***What is 'real and genuine consideration'***

- 4.51 The case provides a detailed summary of the relevant legal principles by referencing McMillan J in *Re Marsella; Marsella v Wareham (No. 2)* [2019] VSC 65.<sup>57</sup>
- 4.52 The key principles can be summarised as follows:
- (a) In accepting to be a trustee, the trustee is bound by duties to exercise their power in the best interest of beneficiaries.
  - (b) Where a trustee is provided 'unfettered discretion', such discretion must be exercised in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.
  - (c) In determining whether such discretion was exercised appropriately, a Court may look at the inquiries the trustee made, the information they had, and their reasons for, and manner of, exercising their discretion.
  - (d) It is not the Court's role to determine the weight of such matters in the trustee exercising its discretion.
  - (e) A lack of good faith can include the taking account of irrelevant considerations and a refusal to take into account relevant considerations.
  - (f) The trustee must inform themselves of the relevant matters to exercise the discretion. Where the consideration is not properly informed, then it is not genuine.
  - (g) Finally, the purpose for which a power is conferred on the trustee must be inferred from the trust deed.
  - (h) Whether a trustee exercised a power for a proper purpose is a question of fact to be decided on the evidence. A trustee is not bound to disclose her or his reasons in reaching a particular decision, and a negative inference cannot be drawn from the non-disclosure by a trustee of the reasons for his or her decision.
- 4.53 In this case, the Court held that there was no proof that the trustee did not act honestly and in good faith. The Court considered the following:
- (a) the trustee exercised their discretion pursuant to the terms of the discretionary trust (including not being required to retain records of the decision or not being required to seek the guidance of the Guardians);<sup>58</sup>

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<sup>57</sup> *Ibid* at 141

- (b) the trustee exercised their discretion per an oral recollection from the prior decision-maker of the trust (being the father of those managing the trustee);<sup>59</sup>
- (c) there was no hostility between the trustee and disgruntled beneficiary at the time of the transfer (such hostility arising at a later point in time);<sup>60</sup> and
- (d) there was sufficient evidence that on the balance of probabilities, the trustee obtained appropriate legal advice regarding the deed prior to exercising its discretion.<sup>61</sup>

## 5 Restructuring trust assets to fit the succession plan

- 5.1 For some clients, the ensuring that the trustee, appointor and beneficiary roles of a trust pass to the intended recipients, will not be enough to ensure their succession planning intentions are achieved (consider the above case of *Ying Mui*).
- 5.2 Various reasons for this can include:
  - (a) the fact that a discretionary trust may conduct a business, and business succession mechanisms are intended to be included to ensure a smooth transition; or
  - (b) the fact that the controllers of the trust know from the outset that the multiple recipients of a single discretionary trust will not get along (whether it be due to differences in their investment appetite, or differences in their family and personal objectives), or for the potential abuse of by those family members sitting in control roles of a discretionary trust.
- 5.3 In such circumstances, additional steps can be taken to either:
  - (a) separate trust assets so that control over separate trust assets can pass to separate recipients; and/or
  - (b) ensure guidelines or frameworks are considered and implemented.

### ***Separating trust assets into separately distributable 'siloes'***

- 5.4 Families may choose to separate trust assets into different entities and ensure the succession of control of each respective entity passes to the intended family members.
- 5.5 There are revenue issues to consider when doing so, namely CGT and stamp duty.
- 5.6 However, successfully doing so can significantly reduce the ability for recipients to dispute, as they would not be making decisions with each other given that their asset was given to them in separate structures (or separately controllable structures).

### ***Trust cloning (or transferring trust assets into separate structures)***

- 5.7 Trust cloning is a strategy used to transfer Queensland dutiable property from one trust to another.

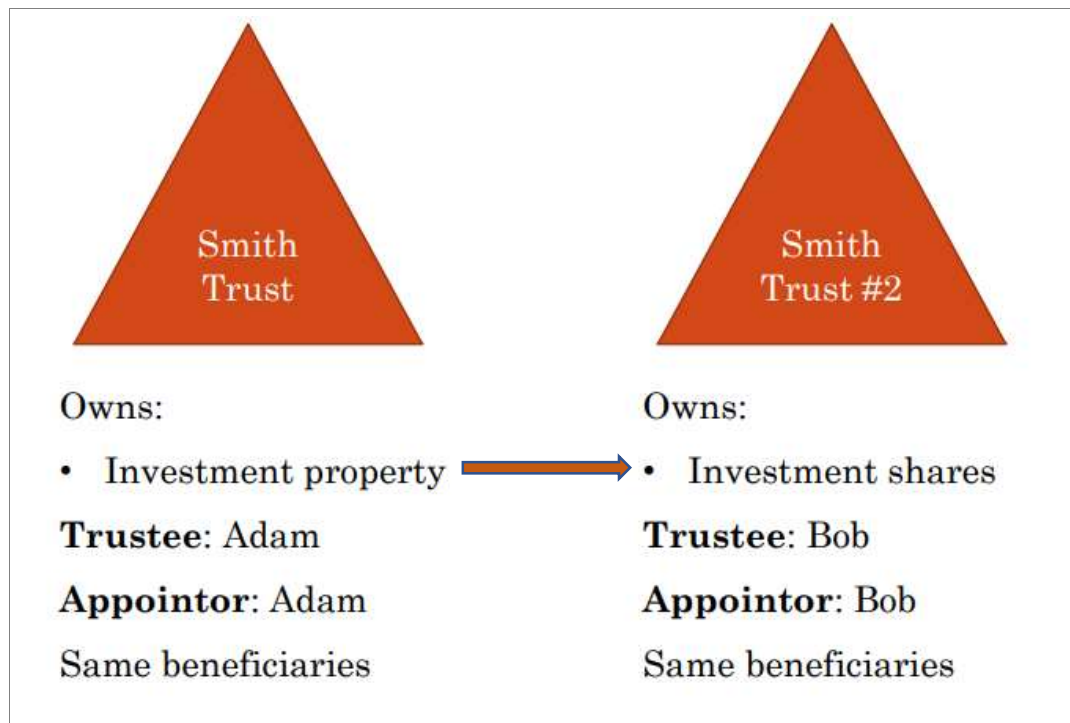
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<sup>58</sup> Ibid at 145 and 148

<sup>59</sup> Ibid at 149 and 150

<sup>60</sup> Ibid at 152

<sup>61</sup> Ibid at 153

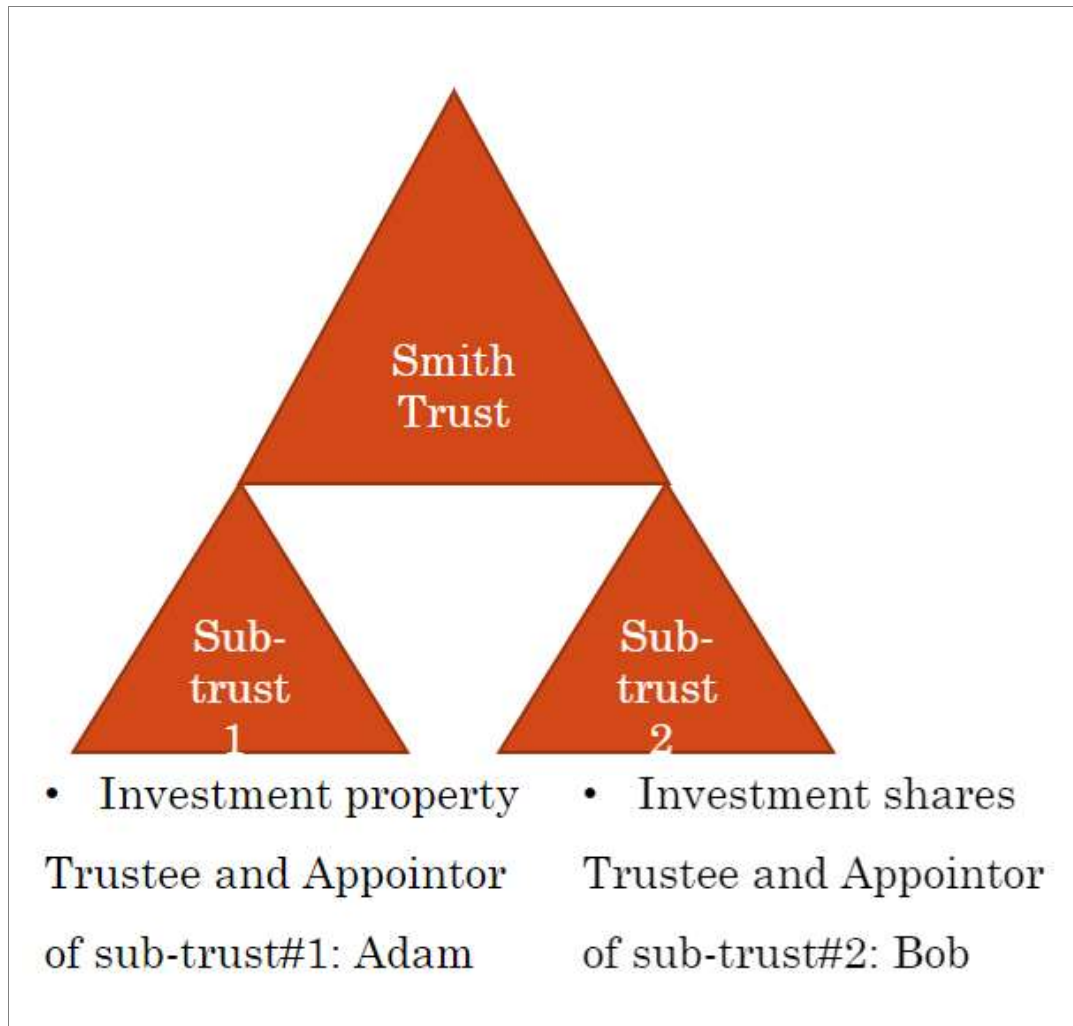


- 5.8 It works by effectively ‘cloning’ a second trust on substantially similar terms as the initial trust to ensure that no dutiable transaction is triggered for Queensland stamp duty purposes.
- 5.9 If successful, it allows assets to be transferred into separate discretionary trusts, and separate succession plans implemented for each respective trust.
- 5.10 While historically, there was a CGT exemption applied to trust cloning arrangements under section 104-55(b) and 104-60(b) ITAA 1997; such exemptions have been abolished since 2008.
- 5.11 It should be noted that although there is no explicit CGT exemption for trust cloning, there are tax legislation provisions available that can assist in managing the CGT consequences of transferring assets from one trust to another such as the small business capital gains tax concessions and small business restructure rollover.
- 5.12 The use of the trust cloning arrangement is as a tool to manage adverse stamp duty consequences of moving dutiable property from one trust to another.
- 5.13 In dealing with the relevant stamp duty heads of duty under Queensland stamp duty law, trust cloning obtains an exemption by:
- (a) ensuring persons with the relevant trust interests in the original and cloned trust are identical and with the same percentages in the trust interests;
  - (b) ensuring assets are not suddenly held or ceased to be held on trust by the trustee; and
  - (c) ensuring there is no change in the legal owner of the asset.
- 5.14 Where assets of the trust are not dutiable, no particular phrase will apply to such arrangement; rather, CGT consequences will need to be managed – much in the same way as it would have been had a trust clone occurred.

***Trust splitting***

- 5.15 A downside of a trust cloning arrangement is the fact CGT consequences must be managed.

- 5.16 Where the CGT consequences of transferring an asset from one trust to another cannot be managed, trust splitting provides the potential ability to allow control over separate assets to pass to different recipients.
- 5.17 Trust splitting effectively involves the creation of separate sub-trusts over assets of a trust.
- 5.18 Following the establishment of a separate sub-trust, steps are then taken to change either the trustee and appointor of the sub-trust, or the successor trustee and appointor of the sub-trust.



- 5.19 Unlike trust cloning, no transfer of assets out of the original trust is required. Rather, there may be a change of trustee, in which case, change of trustee exemptions are available for stamp duty and CGT purposes.
- 5.20 Whilst potentially useful in allowing control over separate assets to pass to different recipients, trust splitting does not solve the issue of having multiple recipients manage a single discretionary trust.
- 5.21 This is because notwithstanding different persons may be managing separate sub-trusts, persons will still need to be appointed to act as trustee and appointor for the head trust.
- 5.22 In such circumstances where the control between the sub-trusts and head trust does not align, the controllers at the head trust level may potentially cause concern for those at the sub-trust levels.

- 5.23 Practitioners have sought to mitigate such arrangement by varying the terms of trust deeds to further 'remove' the sub-trust from head trust interference. This could be achieved by:
- (a) varying the terms of the trust deed such that a separate appointor can be appointed for each sub-trust;
  - (b) ensuring (through variation) that the trustee and appointor of a sub-trust can appoint their own successor);
  - (c) limiting the beneficiaries of a sub-trust to a family group; and
  - (d) limiting the ability for trustees of parallel sub-trusts from claiming trustee indemnities against the other sub-trusts.
- 5.24 Whilst able to solve the practical commercial concerns with having control over a head trust differing from the sub-trusts, such additional steps brought cause for concern from the Australian Taxation Office (**ATO**) via Tax Determination TD 2019/4.
- 5.25 Where complex trust splitting arrangement as identified in TD 2019/4 were effected, the ATO has adopted a view that adverse CGT consequences could arise.
- 5.26 Where the trust splitting arrangements are limited to the simpler arrangement of merely changing the trustee over an asset held on sub-trust – no adverse CGT consequences would arise. However, in such a scenario, the trust split would not properly achieve a client's succession planning intention in ensuring multiple recipients would not need to work with each other.

***Ensuring guidelines or frameworks are considered and implemented***

- 5.27 Sometimes, families are still able to work together following the passing or incapacity of the heads of the family.
- 5.28 Where such circumstances exist, it may be the case that the recipients require either formal or informal guidance, as well as a framework to assist families in ensuring decisions can be made in a 'fair' and 'balanced manner'.

***Companies and family constitutions***

- 5.29 For those families requiring formal procedures to be adopted, the use of companies as trustees and appointors offers an additional layer of governance.
- 5.30 Without the use of corporate entities into the trustee and appointor roles, the ability to dictate how decisions are made can be quite limited (particularly in light of the lack of trust deeds containing comprehensive provisions in relation to the decision making ability of such roles).
- 5.31 By introducing and changing trustees and appointors of the trust into corporate entities, opportunities arise where documents relating to corporate entities (such as family constitutions and/or shareholders agreements) can be drafted outlining:
- (a) any named successor directors;
  - (b) a requirement that key persons to be involved in advising successor directors as independent directors of the company, including:
    - (i) where the discretionary trust conducts a business - key employees involved in the business who can assist with advising on the operational aspects of the business;



- (ii) also - independent advisors who can provide unbiased recommendations in the interest of the discretionary trust;

cases have noted the '*advantages of the appointment of an independent trustee...An independent trustee, not being, or being associated with any, beneficiary, would have the benefit of neutrality, and impartiality, and the beneficiaries will be provided with some comfort that the trustee is independent and impartial. The facility of an independent trustee would more than likely ensure that the trusts are properly administered according to law and without conflict. In this way, the risk of further disputation and the potential for further adversarial litigation, would be minimised. This would be of undoubted benefit to the trusts and the beneficiaries*'.<sup>62</sup> Whilst this quote arises in relation to trusts, the same benefits could be said of including independent directors for a corporate trustee.

- (c) the process to appoint successor directors which could:
  - (i) require the independent directors being in the majority in any appointments;
  - (ii) require such persons being of suitable qualification;
- (d) the process on how decisions must be made including:
  - (i) the voting power of directors;
  - (ii) any threshold percentage for decisions to be made (which can often be difficult tailor given that there can only be a maximum of four trustees of a trust);
  - (iii) requiring certain persons to be in the majority for decisions or holding casting votes;
- (e) limiting the ability for shareholders to override the decisions of the directors.

5.32 Additional documents would also potentially be required to ensure the above framework cannot be overridden. For example, by ensuring any appointor role in a trust is structured in a manner consistent with any trustee role which can include:

- (a) amending the terms of the trust deed by replacing the appointor terms; and/or
- (b) changing the appointor role to align with the trustee role including through the use of a company appointor (whether the company is the same company acting as trustee or a new company with the same constitution terms).

5.33 Where such a strategy is utilised, concern may arise relating to the fettering of a corporate trustee's future exercise of powers.

5.34 In this regard, the drafting of the company documentation must be precise to ensure that the decisions of the trustee company are not so limited such that it '*binds himself as to the manner in which he will exercise a discretion in the future*'.<sup>63</sup>

5.35 In so far that the company documentation governs who are able to be appointed as a director (and shareholder) of the company, such provisions would not normally extend to dictating how the trustee will exercise its future discretions.

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<sup>62</sup> Ying Mui & Ors v Frank Kiang Ngan Hoh & Ors (No 6) [2017] VSC 730 at 597

<sup>63</sup> Professor Finn: Fiduciary Obligations at p51

- 5.36 That said, the case of *Dagenmont* [2007] QSC 272 has provided authority whereby the entering of a trustee of a trust into an agreement to ‘pay-out’ a retiring founder of a business \$150,000 for life did not constitute a fettering of the trustee’s discretion.
- 5.37 Generally, the provisions of a company constitution and/or shareholders agreement of a corporate trustee, would not go to such degrees in ‘locking’ a corporate trustee into making agreed future payouts.

***Memo of directions***

- 5.38 Where a less formal framework is appropriate for clients, it has been accepted that a trustee may take into account a ‘memorandum of wishes’ in relation to a trust controlled by the deceased with the Courts accepting that the *‘Trustee is entitled to take into account this memorandum of wishes in exercising its discretions conferred under the Trust Deed, just as the Trustee is entitled to take into account the views of beneficiaries’*.<sup>64</sup>
- 5.39 The statement will not bind your trustees in making certain decisions, but will form part of the matters the trustee must give consideration to when exercising their discretions.
- 5.40 In the case of *Monaghan v Monaghan* [2016] NSWSC 1316, the deceased left the following wording in a ‘Memorandum of Wishes’ in relation to the Monaghan Discretionary Trust:
- 5.41 *“This Memorandum of Wishes has been prepared by me in connection with Monaghan Discretionary TRUST, being a Trust established by Deed of Settlement dated 27.02.03 between ACIS Settlements Pty Ltd as Settlor and Peter M. Monaghan Pty Ltd as Trustee as amended from time to time (‘the Trust’) to convey to the Trustee of the Trust my wishes in respect of the distribution of the capital and income of the Trust following my death.*
- 5.42 *It is my wish that following my death the capital and income of the Trust should be applied by the Trustee as if that capital and income formed part of my estate and accordingly was subject to distribution in accordance with my Will, to the intent that, the Trustee of the Trust should notionally add the capital and income of the Trust to the assets of my estate and deal with the capital and income of the Trust as if the capital and income of the Trust formed part of my estate for distribution along with the assets of my estate in accordance with my Will.*
- I declare that the contents of this direction are provided to the Trustee on a confidential basis and the terms are not to be communicated to any potential beneficiary.”*<sup>65</sup>
- 5.43 The Court noted, referencing *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, that the trustee is entitled to take into account the memorandum of wishes in determining how to deal with the assets of the Monaghan Discretionary Trust.
- 5.44 Further, they noted:

*“[62] But as Campbell JA said speaking extra-judicially, **established principles of trust law would appear not to require the application of rules of natural justice to the decisions of discretionary trustees**: see JC Campbell “Exercise by Superannuation Trustees of Discretionary Powers” [2009] 83 ALJ 159, at 175. As Campbell JA said, the private law context in which trustees make their decisions usually does not give rise to an obligation to adhere to the rules of natural justice but this is really as a matter of construction of the constitutive documents of the trust. **But his Honour also pointed out that the well-known obligation of trustees to give “genuine consideration” to the exercise of a discretion will sometimes mean the trustee will be required to gather information the trustee does not then hold and that such a procedure, though not identical to affording rights of natural justice or***

<sup>64</sup> *Monaghan v Monaghan* [2016] NSWSC 1316 at [49]

<sup>65</sup> *Ibid* at [48]

*procedural fairness, covers at least some of the same ground. But Campbell JA also observed in the common case of a family discretionary trust the trustee will frequently already know enough about the circumstances in life of the various potential objects of the power of appointment to be able to make an appointment without gathering extra information.”<sup>66</sup>*

- 5.45 In this regard, the Court reiterated that “*the Trustee’s obligations in this area are well established: Karger v Paul [1984] VR 161 at 164, 166 and 178. It can be assumed that the Trustee will follow established law in respect of the degree of inquiries the Trustee has to make in order to give “genuine consideration” to the exercise of its discretion to reach the decision that the Trustee contemplates*”.<sup>67</sup>

## **6 Conclusion**

- 6.1 Ensuring a discretionary trust passes in a manner consistent with an estate plan is complex and rarely straight forward.
- 6.2 It requires a detailed analysis of the terms of the trust deed, and where such default position is inappropriate, changes are to be made in a careful manner.
- 6.3 Additional complexities can arise when dealing with discretionary trusts holding multiple assets intended for multiple recipients. In such circumstances, worst-case scenarios must be considered, advised and (if appropriate) planned for accordingly.

## **7 Disclaimer**

- 7.1 This paper covers legal and technical issues in a general way. It is not designed to express opinions on specific cases. It is intended for information purposes only and should not be regarded as legal advice. Further advice should be obtained before taking action on any issue dealt with in this paper.

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<sup>66</sup> Ibid 62

<sup>67</sup> Ibid 63