Family Trusts
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Summary
This initial summary is intended as a brief overview of what happens to your family trust if you die and a more detailed discussion follows.

The Key point with a Family Trust is that if the controller of the trust dies the assets of the trust still remain owned by the trust.

What changes is NOT the ownership of the assets but the person controlling the Trust.

The lawyer doing your estate planning must ensure that the following aspects are covered off:-

1. Is the trustee a natural person or a corporate trustee?
2. Who is the Appointor/Guardian/Nominator/Principal?
3. What does the Deed say about:-
   a. The replacement of a deceased trustee; and
   b. Who can exercise the Appointor power after the death of the current Appointor?
4. If the power of appointment defaults to the Executor, then careful choice of Executor is required as the Executor will now be in a position to allocate ALL of the trust to himself/herself to the exclusion of other beneficiaries.
5. If the client has the ability to transfer the Appointor power to another person via their Will, an appropriate person should be selected as replacement Appointor and the relevant clause included in the Will.
6. If it is intended that all of the client’s children share in the Trust, the trust deed should be examined to ensure that all of the children are actually named as beneficiaries in the trust deed.
7. The financial statements must be examined to ascertain if there are any beneficiary loan accounts and/or unpaid present entitlements and an approach formulated for dealing with these in the Will.
Some typical problems

I have seen cases where the Appointor power was held by the client’s former disgraced and out of favour accountant and in several other cases an ex-wife who had received a property settlement but the divorce lawyers had in each case overlooked having the Appointor power surrendered by the ex-wife.

Impact of your death upon your family trust - detailed discussion

What follows is a more detailed discussion of what happens to your family trust if you die.

The assets of your family trust do not form part of your estate upon your death, therefore those assets are unable to be gifted directly in your Will.

You can however specify who will control the trust after your death.

Be aware though that If the wrong person is in control of your trust then the trust’s income and capital may not benefit the people you intend in the proportions and manner you desire.

In order to determine who will control the trust upon your death, the trust deed should be examined as to the role of trustee, Appointor and guardian and the circumstances in which the trust ends. In your Will, or by an amendment to the trust deed, you may be able to nominate successors to these roles.

Role of trustee, appointor and guardian

The trustee of your trust owns the assets and determines the distribution of income and capital. Control of your trust will rest with whoever controls the trustee. The person (or persons) who has the power to “hire and fire” the trustee is usually termed the “Appointor” and this power is often referred to as the “power of appointment”. Often the trust will also have a “guardian” who is the person (or persons) appointed to monitor certain, usually more important, decisions of the trustee.

Diagram 1. at the bottom of the page, illustrates the traditional relationship of the Appointor and guardian to the trustee:

Appointor

In order to effectively transfer control of your trust upon your death, you generally should ensure:

1. Your replacement Appointor is either:
   i. those people you intend to benefit from the trust assets; or
   ii. an independent person (or persons) who is not a beneficiary of the trust and who you are confident will act in accordance with your intentions.

If the new Appointor is someone who is not independent and who is a beneficiary of the trust, then by selecting a favourable replacement trustee they may be able to stream the income and assets of the trust for their own benefit, to the exclusion of your other intended beneficiaries. While it may be appropriate for the survivor of you and your spouse to become the sole Appointor of the trust, when you are both deceased, it may be less appropriate for one of your children or more distant relatives to succeed to this position.

If your legal personal representative will succeed you as Appointor, care needs to be taken to ensure you do not inadvertently pass exclude any of your children from having a say in the control of your trust.

Further, the possibility of a child’s subsequent demise or disability must be considered and provided for by appropriate representation.
Legal requirements

2. Where you may have more than one successive Appointor:
   i. they act unanimously, to safeguard against a majority of Appointors voting to exclude the minority from benefit; and
   ii. the trust deed sets out procedures for resolving deadlocks.

3. A person or persons is appointed to represent the Appointor, in their best interests, where your Appointor:
   i. has not attained the age you think is appropriate for them to exercise the power of appointment, until they attain such age; or
   ii. lacks mental capacity.

The selection of Appointor is a very important decision when it comes to the ongoing management and distribution of your trust assets.

Debts you owe to your family trust

Where the family trust has loaned you money, upon your death you may not want the trust to be forced to demand repayment from your estate.

It is important to consider whether you wish the family trust to be able to forgive such a loan upon your death, and the tax consequences of this.

A debt forgiven by the entity may potentially:

- be deemed an unfranked dividend to you, resulting in a tax liability to your deceased estate;
- if you were also an employee of the company, FBT issues may arise; and
- if you used the loan money for income-producing purposes, then commercial debt forgiveness rules may also apply.

Your particular circumstances should be checked by your accountant or tax adviser for potential benefits or problems.

Debts owed to you by a company or trust

Debts owed to you from your family trust, will require repayment to your estate upon your death unless you make specific provision in your Will, or other relevant document, to forgive these debts.

However, there may be adverse tax consequences if your estate forgives such a loan. Therefore it may be advisable to consider incorporating into your Will, a clause which gives your executor the flexibility to:

- forgive the loan; or
- require repayment of the loan:
  i. immediately;
  ii. on the same terms as existed prior to your death; or
  iii. on such other terms as your executor thinks fit.

In this way your executor will be able to consider taxation rules and your beneficiaries’ interests before deciding whether to forgive or enforce a loan owing to your estate.

Unequal benefits to your children

You may have established “beneficiary accounts” for your children from your family trust.
Technically these amounts are debts that are owed to your children. If you cannot account for how these amounts have been spent for the benefit of your children, then your children may be entitled to call upon the amounts outstanding to their credit at any time in the future.

Where it is your intention to benefit your children equally on your death, your wishes may be be defeated if the family trust accounts reveal that the entitlements of your children are not equal.

You may wish to include a provision in your Will that your executor divide your estate, taking into account unequal loan accounts in existence in your family trust at your death, ensuring your children receive an overall equal distribution.

**Family trust elections**

It is important to be aware of family trust elections and whether one has been made in relation to your discretionary family trust.

A family trust election is a written election usually made to enable the trust to qualify for more favourable income tax treatment, and specifically, to permit the trust to receive franking credits where the assets of the trust are invested in shares.

Such an election requires you to nominate a “test individual” for the purpose of defining the “family group” of the trust. Regardless of the class of beneficiaries set out in the terms of your family trust deed, once a family trust election has been made the trust’s income and capital can only be distributed tax effectively to members of the family group, which may be a narrower group than the class of beneficiaries defined in your trust deed.

Distributions of income, capital or other benefits which are made to beneficiaries of your family trust who are outside the family group will be taxed at the highest marginal income tax rate.

Therefore where one of you is the test individual of a family trust election, then upon the death of the test individual, if the survivor of you remarries, or enters into a new relationship, then they will be excluded as a member of the family group and as such, any distribution of income and capital from your family trust to the survivor of you will be taxed at the highest marginal tax rate.

If you have made a family trust election, then we also suggest you consider the identity of the test individual and potential ramifications of this appointment on the death of the test individual, particularly if you are the spouse of the test individual. While a family trust election is irrevocable, it is important that you and your spouse are aware of the potential consequences of such an election in assessing its continuing viability from an estate planning perspective.

**Estate planning for your family trust**

Depending on the terms of your trust deed and your individual circumstances, some or all of the following may need to be implemented as part of the estate planning process, to ensure your wishes are fulfilled:

1. The terms of the deed may need to be amended, to change the way in which succession of control is provided for;
2. Provisions included in your Wills which will:
   - transfer control of the current corporate trustee of your trust;
   - transfer control of your trust for the benefit of the survivor of you and your spouse and in turn upon the death of both of you, your children;
   - provide your executor with flexibility to forgive or negotiate the repayment of any loan made by you to the trust;
   - address any allocations made by the trust to you and your children, including paid and unpaid allocations, if desired by you.
3. Ensure records are maintained as to how distributions of trust income are spent, as beneficiaries are able to demand payment of any income allocated to them, but not actually paid or applied for their benefit.
4. Prepare and sign a letter of wishes that upon both of your deaths the trustee manages trust assets in accordance with certain requests. This letter is not binding, however provides guidance to your trustees. treats your children equally having regard to your overall wealth, including your estate assets, superannuation and trust interests.
5. Consider, if you wish your trust to be wound up upon the death of your survivor, and the assets of the trust distributed:
   i. appointing a person or company as trustee who you would entrust to act in accordance with your intentions expressly setting these out in a letter of wishes; or
   ii. preparing and executing a Deed to vest the Trusts in an appropriate manner at that time.

Note: Capital gains tax may however be payable on a disposal of your trust assets in this manner.

iii. whether you wish the trust to be wound up on your death, keeping in mind the potential capital gains tax implications of such an action.

iv. the preparation of an irrevocable deed of resolution in which you, as trustee or director of the trustee company, resolve to vest the trust property upon your death and which sets out the manner in which the trust property is to vest.

If your executor (ie. your legal personal representative) will also become the Appointor or Guardian of the Family Trust on your death, pursuant to the terms of the trust deed, you should ensure that they are willing and able to accept this additional responsibility.