



Testamentary Trusts, Beneficial Interests and Social Security Benefits

Issue 18 - 21 May 2009

Comprehensive Estate Planning involves not only transferring and managing wealth but preserving wealth including social security benefits to prevent the Estate from “shrinkage” in the event of a contingency such as death or disablement.

Unless Testamentary Discretionary Trusts are drafted and structured correctly potential beneficiaries may lose vital social security benefits. Thus the decision of the Full Federal Court in *Secretary, Department of Families, Housing, Communities and Indigenous Affairs v Elliott* [2009] FCAFC 37 (an appeal from a decision of Kenny J) (Elliott Decision) is of some interest in its consideration of what is meant by “beneficial interests” in the corpus or income of a trust.

In the Elliott Decision the question at issue was whether a Testamentary Discretionary Trust created by a Will was a “controlled private trust” within the meaning of s 1207V(1) of the *Social Security Act 1991* (SSA). There are a number of alternative tests in the SSA which, if satisfied, will mean that a trust is a controlled private trust. In the context of the particular facts, the trust would only be a controlled private trust if either of the appellants (Mr and Mrs Elliott (**the Elliotts**)) passed the “control test” as defined in the section. That

test (so far as is relevant for the facts) required that the aggregate of the beneficial interests in the corpus or income of the trust held by the individual and associates (whether directly or indirectly) was 50% or more in respect to s 1027V(2) (d) of SSA.

What follows is a review of the Elliott Decision in the context of preserving Social Security Benefits in respect to a Testamentary Discretionary Trust (DST).

The Facts

By his Will the deceased (Mr Elliott's father) created (by clause 5(b)) a “life discretionary trust” for the lifetime of the survivor of the Elliotts, the objects of which were the Elliotts, the deceased's grandchildren (of whom there was presently only one (Susan)) and the descendants of his grandchildren. By virtue of clause 5(c), on the death of her parents, Susan (if surviving her father and reaching 30 years of age) would become the primary beneficiary of a separate discretionary trust governed by clause 7 of the will. This second trust was not relevant to the present proceedings.

Pursuant to clause 5(b) of the Will, the trustees were empowered to apply the income and, if they saw fit, the capital of the trust for the “maintenance education advancement or benefit” of the



Elliotts or any other discretionary beneficiary "to the exclusion of the other or others and in such proportions as [the trustees] in their absolute discretion determine". Thus, the trustees' discretion as to which, if any, of the discretionary beneficiaries were to receive any payment of income or capital (and, if so, in what amounts) was "absolute" save that, in exercising their discretion, they were to have primary regard to the needs of Mr Elliott, and also to have regard to the impact of any payment or application on the social security entitlements of the Elliotts.

Clause 7 of the Will conferred power on the trustees to accumulate the income of the trust.

The case first came before the AAT which held that the trust was a controlled private trust and thus the recipients would not qualify for social security benefits. However on appeal, at first instance, Kenny J reversed the decision of the AAT. On further appeal, the Full Federal Court (Black CJ, Stone and Edmonds JJ) unanimously affirmed the decision of Kenny J.

The Full Court Decision

The Full Court, in a joint judgment, said that the issue of whether a person who is a beneficiary or object, whether as to income or capital or both under a discretionary trust, has an "interest" in that trust or the income thereof, invariably described as a "beneficial interest", has been addressed in a number of cases over the last 120 years in different statutory contexts. In every case, the answer or conclusion arrived at has depended on two matters:

- (1) the nature of the discretionary trust in relation to the beneficiary or object;

whether the trust is exhaustive with respect to the class of which the beneficiary or object is a member in the sense that the trustee is bound to distribute to one or more of the class or whether the trust is non-exhaustive by reason that the trustee has, in the case of income, a power to accumulate, or, in the case of corpus, there is a gift over in default of exercise of the discretion; and whether the relevant class is, at the relevant time, still open or closed; and

- (2) the statutory context in which the issue arises; in particular whether the mechanism of the statute cannot operate unless the precise extent of the interests can be identified.

In respect of the first matter (the nature of the discretionary trust in relation to the beneficiary or object) at least four kinds of trust have been identified:

- (1) exhaustive trust with a closed class of beneficiaries;
- (2) exhaustive trust with an open class of beneficiaries;
- (3) non-exhaustive trust with a closed class of beneficiaries; and
- (4) non-exhaustive trust with an open class of beneficiaries.

Provided there is, at or during the relevant point or period of measurement, more than one member of the class, it is impossible to measure the extent of an individual beneficiary's interest in the trust whether the trust is of a kind which falls within (1), (2), (3) or (4). On the other



hand, if the trust is of a kind that falls within (1) or (2), it will be possible, in relation to income, although perhaps not in relation to corpus in the case of trust (2), to measure the collective interests of all existing members of the class.

On the other hand, if the trust falls within (3), and certainly if it falls within (4), it will not be possible to measure the collective interests of all existing members of the class for the reason that the power to accumulate might be exercised. This is not to say that the members of the class have no rights, but those rights are not, in any relevant sense, capable of measurement. As to the second matter of statutory context, the Court said that an illustration of the different conclusions that flow from different statutory contexts is *Attorney - General v Heywood* (1887) 19 QBD 326 and *Attorney - General v Farrell* [1931] 1 KB 81 on the one hand and *Gartside v Inland Revenue Commissioners* [1968] AC 553 on the other. The Court also referred to the decision of the House of Lords in *Leedale v Lewis* [1982] 1 WLR 1319.

The Court concluded that, in the present case, the trusts as to both income and capital in clause 5(b) of the Will (together with clause 7(b)(i)) were non-exhaustive with an open class of beneficiaries. The beneficial interests of the

existing beneficiaries both individually and collectively were incapable of measurement, but that was the very thing which s 1207 V(2)(d) mandated before that "control test" requirement is satisfied. After referring to the following passage from the judgment of Kenny J:

"I accept that, as the Secretary submitted, the word 'aggregate' in par 1207V(2)(d) is used in its ordinary sense, signifying 'to gather into one whole or mass; to collect together, assemble; to mass': see Oxford English Dictionary. Paragraph (d) of subs 1207V(2) presupposes, however, that there are in fact 'beneficial interests in the corpus or income of the trust' that are capable of aggregation. If neither the individual nor his or her associates hold any such beneficial interests, then the paragraph cannot apply",

the Court said that the wide definition of "interest" contended for by the appellant inevitably failed in the face of the statutory requirement of aggregation. Hence on the basis of the specific circumstances the DST enabled the beneficiaries to receive social security entitlements.

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