

Vulnerable Beneficiaries – 10 Page Overview

For adult vulnerable beneficiaries without significant personal exertion income, estate planning funding is likely to come from:

Means
Tested
Pensions

Living
Relatives

Inheritances

Super
Pensions

Cashflow – Funding Estate Plans

While unlimited funding would usually mean a range of possibilities for supporting a vulnerable beneficiary, the reality for most people is that the options open to them are limited by funding constraints and the fact that there are often other intended beneficiaries to consider, eg other children. The extent of the funding available will determine to what extent the estate planner's desired objectives can be achieved and to what extent they need to be modified or reconsidered.

It is often critical to look at ways of enhancing funding, both in terms of personal funding and in terms of eligibility for Government pensions and concessions (see below). While some estate planners will be unable or unwilling to enhance the level of personal funding they will be providing, others will be able to increase the level of available funding by:

- Wealth accumulation (if still possible) and retirement plans;
- Asset enhancement plans, eg ensuring that business assets will retain value on the death of a business principal; and
- Insurance cover for death, incapacity or for continuation of business.

Thus contingent funding of estate planning wishes can often be achieved for younger (and healthy) estate planners through life and other insurance or with careful longer term investment planning. For some older parents in particular no such opportunity may be available and the needs for retirement or of a surviving spouse may also compete with a wish to provide for a vulnerable beneficiary.

Where beneficiaries have suffered serious injury, compensation proceeds may need to be considered or claims may need to be initiated.

Exempt Assets & Next of Kin

Centrelink Exempt Assets

- # Own home (includes an interest in accommodation)
- # Pre retirement age super
- # Right of occupation or life interest
- # Special disability trust (note limits)
- # Assets owned by living parents (watch family companies & trusts)

Next of Kin (if no Will)

- # Spouse includes married or de facto; heterosexual or homosexual
- # Spouse & children share an inheritance
- # Parents inherit before sisters & brothers
- # Brothers & sisters need only one parent in common

Special Disability Trusts

The reason why there are likely to be many special disability trusts established in the future is because of the potential eligibility for income/assets means tested pension concessions for a principal beneficiary with a severe disability. As the concessions extend to eligible donors during their lifetime, these trusts may also be of significant benefit to those eligible donors, eg parents.

The Centrelink and Veteran Affairs concessions mean that the disadvantages of a special disability trust, eg its more limited scope and greater costs of administration, will be seen by many people as the price that has to be paid to gain the income and assets means tested pension concessions.

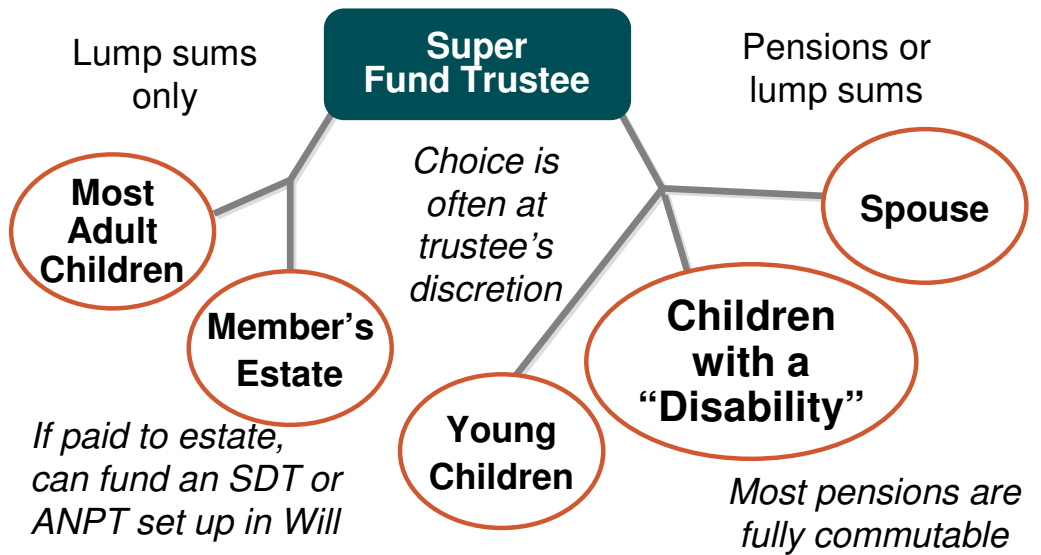
All Needs Protective Trusts

Two key reasons why an "all needs" protective trust may be an important option or alternative for a vulnerable family member are:

- Not all of the people who are significantly vulnerable to financial exploitation in our community will be classified by Centrelink/Veteran Affairs as having a severe disability and thus eligible for a special disability trust, eg many mental illnesses can render someone very vulnerable, but not necessarily eligible.
- In some cases, the amount of funds available to be placed on trust will either be too low to warrant being subject to the restrictions and costs of a special disability trust or be too high for the means tested concessions to apply.

Note: The 2 types of protective trusts can be run concurrently. For example, the 1st trust might hold a home and/or investments within the indexed exemption level (currently \$532,000) to meet care and accommodation expenses. The 2nd trust (to meet other needs and quality of life expenses) might start with funds sufficiently low to be within the principal beneficiary's Federal health card eligibility limit.

Super Death Benefits



Paying Superannuation Death Benefits

As a consequence of the sole purpose test (see section 62 of the SIS Act), the choices as to payment of death benefits by the trustee of a superannuation fund are:

1. Lump Sum – Member's Estate or Dependants

A lump sum of all or part of the death benefits can be paid to the estate of the deceased. Alternatively, it can be paid directly to (or held on trust for) one or more "lump sum" dependants of the deceased, eg a surviving spouse, a child of any age or another person who was financially dependant on, or interdependent with, the deceased at the date of deceased's death). Death benefits can be subject to income tax, eg most lump sum payments to an independent adult child.

2. Pension or Annuity – Income Stream Dependants

In addition to the rules relating to superannuation pensions generally, a pension commenced after the death of a fund member is only possible if the person was an "income stream" dependant of the deceased, eg a spouse, a child less than 18 years old, a financially dependant child less than 25 years old and children of any age that have a "disability". A child death benefits pension (see separate Pocket Summary) needs to be cashed in at age 25 if the child does not have a disability.

Definition of "Disability" for Superannuation Death Benefit Purposes

"(a) is attributable to an intellectual, psychiatric, sensory or physical impairment or a combination of such impairments;

(b) is permanent or likely to be permanent; and

(c) results in:

(i) a substantially reduced capacity of the person for communication, learning or mobility; and

(ii) the need for ongoing support services."

Priorities for Protective Trusts

Established for vulnerable people, typically priorities (*in order*) will be:

- # Care and accommodation (the only expenditure priority permitted for “Special Disability” trusts)
- # Other essential needs, eg food, clothing, education
- # Quality of life benefits, eg entertainment, recreation

The needs of residual beneficiary not usually a priority, but the presence of a residual beneficiary provides asset protection

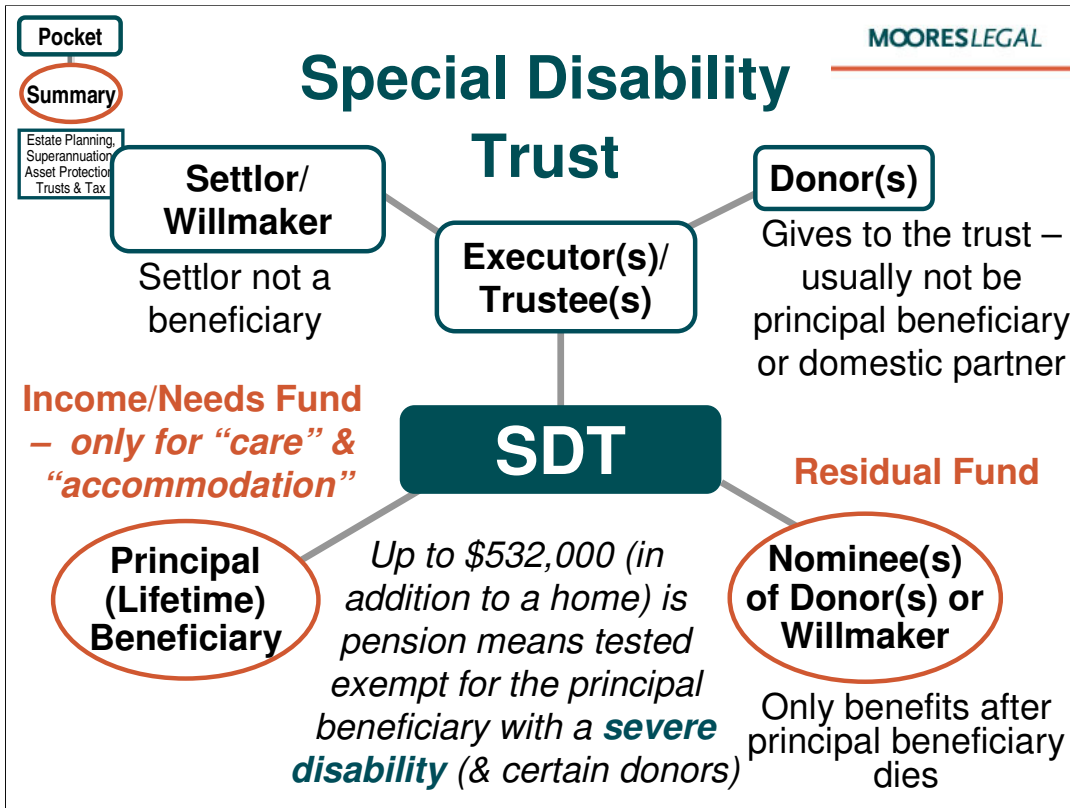
In most protective trusts, the vulnerable beneficiary has lifetime benefit of income and capital – usually the Willmaker or donor(s) stipulates who benefits after the vulnerable beneficiary dies

Priorities for Protective Trusts

The terms of trust for a protective trust for a vulnerable person are very different from a discretionary family trust. Instead they are usually relatively close to the default “prudent person” rule that applies to all trusts to the extent that the terms of trust are not defined. (The prudent person rule usually applies to all enduring powers of attorney and to trusts where the State or Territory authority has appointed an administrator for a “represented” person.)

Where a special disability, all needs or other protective trust is being established by a Will or Deed, rather than just relying on the default statutory State or Territory prudent person rule, it is recommended that the following issues be specifically addressed in the terms of a protective trust:

- **Care, accommodation and support services** (finding suitable accommodation and carers can be a major difficulty, but can make an enormous difference to a vulnerable person’s quality of life; similarly care and support services can be a major on-going expense for many vulnerable people);
- (For protective trusts other than special disability trusts) **quality of life** (it is usual for the trustee to be given examples of what sort of quality of life expenditure can and should be incurred if surplus funds are available, eg recreation, holidays, travel);
- The **limited rights of residual beneficiaries** who usually only come into play on the death of the principal beneficiary, but in the absence of suitable priority provisions, can pressure or influence the trustee to manage the trust with their interests in mind. The presence of residual beneficiaries helps protect trust assets from challenge, eg by a spendthrift or gullible principal beneficiary.



Major Reasons for a Special Disability Trust

To provide in a single trust for the care and accommodation (but not other needs) of a child/other relative/friend with a severe disability (the “principal beneficiary”). # To have up to a threshold (currently \$516,500) of assets and the income generated thereon being free of Centrelink and Veteran Affairs means testing for both the principal beneficiary and certain living donors. # Protection of trust assets from the principal beneficiary’s possible creditors or unsuitable next-of-kin, eg an estranged natural father.

Trustees

The trustee must be either a professional trustee or at least 2 Australian resident individuals. The power to replace the trustee may be held by an appointor(s). The trust document’s terms (Deed or Will) should be based on the Federal Government’s model trust Deed.

Income, Capital Profits (Usually 50% CGT Discount) and Pension Benefits

While benefiting from a Centrelink/Veteran Affairs assets and income means testing threshold exemption, the principal beneficiary is taxed on trust income spent on permitted care and accommodation, with credit for any tax already paid, eg dividend franking credits. If the constraints of a special disability trust are an issue, eg the taxing of surplus accumulated income at 46.5% (including standard Medicare Levy), an all needs protective trust can be established instead or as well. If trust assets that were owned by a Willmaker pass via the trust to the Willmaker’s nominee, no taxable CGT event occurs until the residual beneficiary disposes of them. Other trust assets taxed as a capital gain on sale and for Deed trusts, (if not passing to the principal beneficiary’s estate) on the death of the principal beneficiary.

SDT Donors

Donors to SDT	Eligibility Rules
Living parent , guardian, grandparent, sister & brother	Donor concessions apply for first \$500,000 (not indexed) of gifts; CGT & State duty may apply
Principal beneficiary & domestic partner/any entities they control	No donor concessions; can only gift out of bequests/super death benefits received in past 3 years
Other living donors & donors via Wills & superannuation death benefits	No donor concessions, but no restrictions on gifts; no CGT or State duty payable if transfer via Will

Donors – Special Disability Trusts

There are 2 types of donors (making unconditional gifts) to a special disability trust, ie:

- People who have died and funded the donation to the special disability trust by way of a bequest or the payment of a superannuation death benefit; and
- Living donors.

It is likely that the most frequent donor to a special disability trust will be the former and that the person donating will be wanting to provide for a surviving family member such as a child, grandchild, niece, nephew, brother or sister. The donations will be often funded from a family home or from the capital (such as superannuation) used to provide the donor with an income stream during the donor's lifetime.

To encourage living people to donate, there are means testing concessions for certain living donors to a special disability trust (up to a total of \$500,000). Living donors eligible for these concessions (free of any usual deprivation period for gifting of assets) are parents, guardians, grandparents and siblings of the Principal Beneficiary.

The assets a donor can contribute to a special disability trust (by way of unconditional gift) can include cash, listed securities or real estate, eg the home in which the Principal Beneficiary already resides or is to reside.

The only contribution to a special disability trust permitted by the Principal Beneficiary or a domestic partner of the Principal Beneficiary is all or part of the proceeds of an inheritance or a superannuation death benefit received (other than from the domestic partner) within 3 preceding years.

SDT Investments

SDT Investments	Restrictions
Residence of principal beneficiary, eg house, right of residence, accommodation bond	Cannot be bought from (or sold to) related parties, but can be gifted to trust; land tax & CGT exemptions should be considered
Listed securities , eg shares	Can be bought at market prices from (or sold to) anyone
Residential or business investment property & other assets	Cannot be bought from (or sold to) related parties, but can be gifted to trust

Prohibitions – Special Disability Trusts

There are a number of key restrictions on how a special disability trust is to be administered and on its dealings with related parties (the definition of “related party” in the model trust Deed at www.facsia.gov.au includes all parties associated with the Deed [other than a professional trustee], together with relatives of the Principal Beneficiary and related entities). These include **prohibitions** on:

- Making payments to a related party for undertaking care of the Principal Beneficiary or for repairs and maintenance of accommodation. (Income that is not spent on either care or accommodation must be accumulated. The standard income tax rate for trust accumulations is 46.5% [including Medicare Levy]. It is possible that the Australian Taxation Office may decide to exercise its discretion and allow a reduced rate of tax for special disability trusts under section 99 of the Income Tax Assessment Act 1936).
- Accepting donations (including compensation payments) from the Principal Beneficiary or the domestic partner of a Principal Beneficiary (other than unconditional donations funded by a bequest or superannuation death benefit received not more than 3 years before the transfer).
- Purchasing assets (including accommodation, but excluding listed securities purchased at market prices) from the Principal Beneficiary or a related party.
- Borrowing from any source whatsoever.
- Lending or providing other forms of financial assistance, eg guarantees, to the Principal Beneficiary or a related party.

SDTs – Other Issues

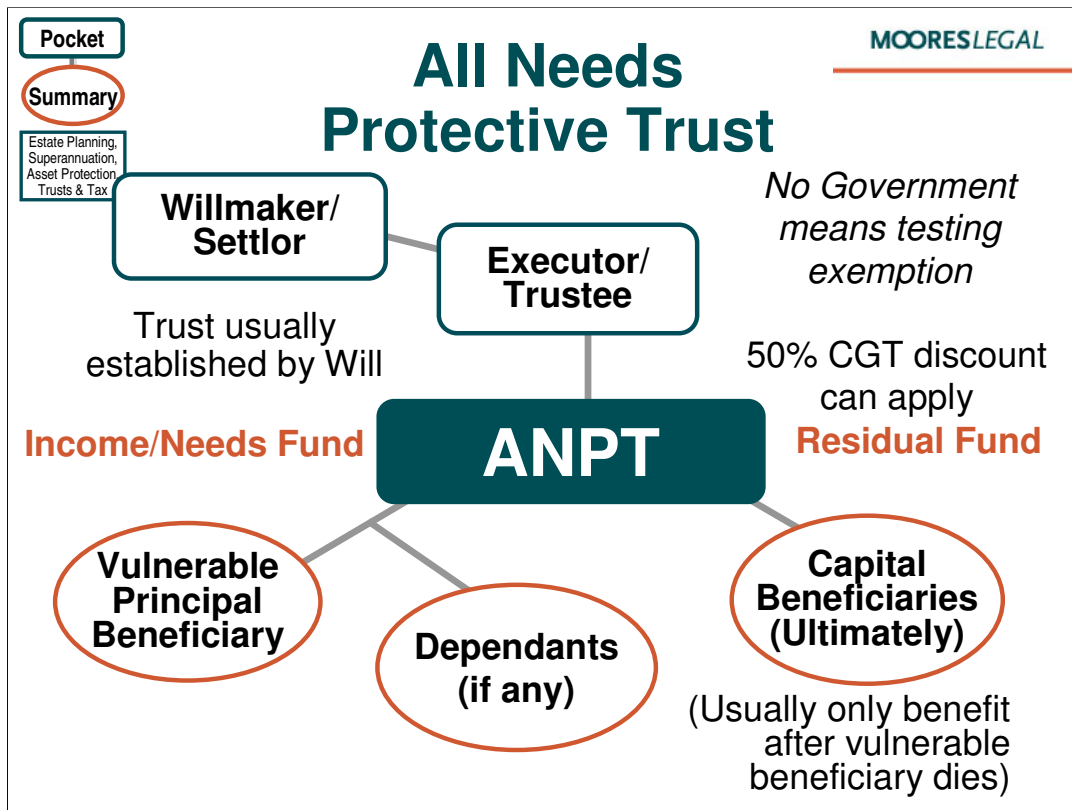
- # 1 trust limit – problem for separated parents
- # Can have 2 or more donors (eg an individual & a family trust), each can nominate different residual beneficiaries
- # Tax (46.5%?) on “accounting” income not spent on principal beneficiary’s care & accommodation by financial year end
- # Trustees must be “clean history” Aust residents
- # Trust must end when principal beneficiary dies

Willmaker should give executor several choices, ie use existing/new special disability trust and/or all needs protective trust, set up super pension or contribute to super

Attributes of a Special Disability Trust

There is a model trust Deed for a special disability trust available at www.facsia.com.au. Centrelink (or, if applicable, Veteran Affairs) require the inclusion of the key terms of this model Deed (with adaptations in the case of a trust established by Will) in the terms of any trust that they approve as being a special disability trust. Key attributes of the model trust Deed include:

- A living settlor (the Willmaker has this role in a Will), who is not able to be a residual beneficiary, pays a nominal sum to start the trust.
- Either a professional trustee (ie a professional trustee company or an Australian legal practitioner) or 2 or more acceptable individuals act as trustee of the trust.
- A principal (sole lifetime) beneficiary with a “**severe**” **disability as defined** by the relevant Act, ie if under 16 years is “profoundly disabled” or (if over 16 years):
 1. Has an impairment which would entitle them to a Disability Support Pension;
 2. Because of their disability, is not working, and is not likely to work, at relevant minimum wages; and
 3. Either lives in an institution, hostel or group home that provides care for people with disability and for which funding is provided (wholly or partly) under [a Government agreement] or has a disability that would, if the person had a sole carer, qualify the carer to receive a Carer Payment or Carer Allowance.
- Provision for one or more donors to be able to give (unconditionally) money, property or listed securities to the trust and for the donors to be able to nominate who receives the balance of their donated funds when the principal beneficiary dies.
- Restrictions on how the trust is to be administered and on its dealings with related parties, eg prohibitions on making payments to a relative of the principal beneficiary for care or other services provided.
- Administrative provisions including the possibility of audits and the preparation of an investment strategy.



Major Reasons for an All Needs Protective Trust

To protect (financially) a beneficiary who is vulnerable, but who has not been assessed by Centrelink/Veteran Affairs as having a severe disability. # To provide for paid care by relatives, food, clothing and recreation needs of a person who has been assessed as having a severe disability. # Establishment of a protective trust free of the constraints of a special disability trust, eg to support both the vulnerable beneficiary and any children. # Protection of trust assets from unsuitable next-of-kin, eg a child's estranged natural father.

Trustee (No Minimum Number Applies)

- Will – usually the trustee is the executor of the estate and is not usually subject to a power of appointment by a third party.
- Deed – the trustee is usually a family member, friend or a professional trustee.

Income and Pension Benefits

The vulnerable beneficiary is taxed on all trust income spent on or allocated or paid to or for the beneficiary, with credit for any tax already paid, eg dividend franking credits. Both income and capital are included in the vulnerable beneficiary's pension means test calculations.

Capital Profits (Usually Subject to a 50% Discount)

If trust assets that were owned by a Willmaker pass via the trust to the residual beneficiary, no taxable CGT event occurs until the residual beneficiary disposes of them. Other trust assets taxed as a capital gain (for the vulnerable beneficiary, the vulnerable beneficiary's dependants or the residual beneficiaries) on sale or winding up of the trust.

Wills Creating SDTs & ANPTs

*The choice
of executors
is critical*

Part A
**Revocation,
Control &
Protective
Options**

Part B
**Adjustment
for Other
Assets,
eg Super**

Parts C & D
**Non-SDT
Powers &
Definitions**

Part E
**Terms of
SDT &
Completed
Schedule B**

In Part A the executors are usually given the power to choose between the SDT in the Will, any SDT that may have been established, an ANPT & contributing to super

Will Creating Protective Options

While the format of a Will creating protective options for a vulnerable person can vary in format, a typical format is set out as follows:

Part A

Among the clauses included in this Part of the Will are the:

- Introduction to the Will identifying the Willmaker and dating the Will;
- Revocation of previous Wills and codicils and the setting out of limitations, eg limiting the Will to Australian assets or excluding assets in a particular country;
- Appointment of immediate and reserve executors, as well the nomination of any preferred advisors – given the vulnerability of the “protective” beneficiary, the choice of trustworthy and competent executors is critical;
- Provisions (if applicable) dealing with the control of self managed superannuation funds, family trusts and other non-fixed trusts (these clauses are always subject to the trust Deed governing the particular fund or trust);
- Executor options for the protective arrangements for the vulnerable beneficiary;
- The terms of the all needs protective trust; and
- Division of remaining estate provisions.

Parts B, C and D

Part B of the Will instructs the executor to adjust estate distributions to reflect benefits that the primary beneficiaries might receive from non-estate sources. Part C sets out general administrative provisions for the estate. Part D sets at the definitions applying to particular words that are used in the Will, eg “child”.

Part E

Part E of the Will sets out the terms of the special disability trust (which will need to be approved by Centrelink) and includes a completed Schedule B setting out who is to benefit when the principal beneficiary dies.