Estate planning

Generational transfer trusts

Key points

- Estate planning involving discretionary trusts can be difficult if clients want to ‘lock in’ fixed entitlements in trust assets for designated beneficiaries
- Generational transfer trusts allow a mechanism for designated beneficiaries to receive their share of income and capital
- Clients must consider issues such as who will control the trust and corporate trustee after their death, and whether the trust will continue after their death

Issues with discretionary trusts

1. Discretionary trusts provide clients with substantial flexibility, particularly in relation to distributions of income and capital. However, the discretionary nature of these trusts creates problems from an estate planning perspective because clients often want to ensure that designated beneficiaries (usually their children) will receive fixed entitlements in the trust assets, which is in direct conflict with the discretionary nature of these trusts.

2. There are four main issues that need to be considered when endeavouring to ‘lock in’ entitlements of future beneficiaries of discretionary trusts as part of an estate planning exercise.

   (a) Who will have the power to appoint or remove the trustee after the death of the current controllers? This role is usually exercised by an appointor or principal.

   (b) Assuming that the trust has a corporate trustee, clients need to focus on who will hold or control voting rights and the ability to appoint directors after the death of the current controllers.

   (c) Most discretionary trust deeds provide that the trustee can allocate different proportions to different beneficiaries and, theoretically, could distribute all of the income and capital to one beneficiary to the exclusion of the others. This is inconsistent with the objectives of most clients who want to ensure that their children or other designated beneficiaries receive fixed entitlements to income and capital.

   (d) Clients also need to consider whether:

      (i) the trust should be wound up on their death or continue indefinitely or for a fixed period

      (ii) if the trust continues, should designated beneficiaries have the right to call for ‘their share’ of capital.

Control by beneficiaries

3. The first step to ensure designated beneficiaries can control the trust when the clients pass away is to ensure those beneficiaries become the joint appointors/principals so that the trustee can only be changed if they all agree.

4. Assuming there is a corporate trustee, it is also important to ensure that the voting rights (at both shareholder and director level) automatically flow to the designated beneficiaries. If this is dealt with in the Will, there is always a prospect of a challenge, which could result in outcomes that are in conflict with the clients’ intentions.

5. We generally recommend the following:

   (a) Clients actually issue redeemable special class shares to the designated beneficiaries while the clients are alive.

   (b) These shares have no rights while the clients are alive but, on the death of the survivor, the voting rights automatically transfer to these special class shares.

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(c) If these shares are redeemable shares, the clients can always cancel the shares if they change their mind while they are alive.

6. The Cooper Grace Ward generational transfer trust provisions ensure the designated beneficiaries will receive their share of income and capital by including special purpose provisions that provide that:

   (a) the designated beneficiaries will be the directors of the trustee company

   (b) each of the designated beneficiaries has the unilateral power to determine how their percentage of trust income and capital will be distributed

   (c) certain key decisions must be made unanimously after the death of the survivor of the clients (e.g. decisions to amend the constitution or trust deed).

7. Further changes can be made so that each of the designated beneficiaries can, on the death of the survivor (or after some cooling off period), require that their share of trust capital is distributed to them.

8. These provisions require careful consideration and the clients need to consider issues such as the timing of requests, who is responsible for the costs associated with the realisation and transfer of assets, and how the tax consequences of any sale or distribution will be allocated.

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