Common trust drafting mistakes and how to avoid them.

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1. Introduction

1.1. Trusts are a huge part of the landscape for accounting and legal advisers in the private client sector. This will be well understood by the readers. An understanding of trust deed drafting fundamentals is therefore a crucial skill for advisers.

1.2. The refrain that has become cliched is "read the deed" but it has become cliched because it really is the starting point in answering any legal question relating to a trust.

1.3. While the trust deed might not always answer your question – and in the worst case scenario you may have to delve into the dark, murky waters of old British equity law to find the answer, it is the trust deed (or sometimes, the absence of one) that will ultimately inform you and your clients on their rights, obligations and duties in relation to a trust.

1.4. For this reason (amongst many others) the quality of the trust deed is paramount in achieving client objectives.

1.5. The purpose of this paper is to discuss common mistakes that creep into trust deeds. There will be some overlap with the other presentations in this seminar, but I will strive to keep these at a minimum.

1.6. For this paper, I will generally discuss discretionary trusts. In my practice, I have generally found the discretionary trusts to often be a breeding ground of weird ideas and bad drafting. I will touch on other types of trusts when there are issues unique to them.

1.7. This paper has two purposes:

(a) first, to identify some problematic drafting (in my opinion), and explain my concern with it so that readers can identify bad drafting in their own practice;

(b) second, to discuss how to fix bad drafting, and the limits on doing so.

1.8. "Bad" trust deed drafting can be subjective. And I readily accept that some readers will not agree with my opinions on what constitutes "bad" and may disagree with the legal conclusions I draw.

1.9. With that in mind, I will consider this paper a success if I can help train readers to approach trust deeds critically, interrogate whether the drafting of the deed is appropriate for their client's circumstances, and if necessary, approach the "fixing" of the trust with appropriate caution.

1.10. From the outset I should note that I am predominately speaking from a Queensland legal perspective, as that is what I am most familiar with. Because core trust principles are drawn from old equity law, the applicable concepts generally apply in the same way in each state. Where differences might exist is in rights of obligations imposed under each states Trust or Trustees Acts and in each state's stamp duty legislation. I note these differences below where relevant.

2. What is "good" trust deed drafting?

2.1. This paper is titled "Common trust drafting mistakes and how to fix them", so it stands to reason that we should start with a discussion of just what a mistake *is* in this context.

2.2. To my mind, drafting mistakes fall into two categories.

2.3. First, there is the drafting mistake that has a direct (adverse) consequence for the client, beneficiaries or trustee. This is the type of mistake that gets a lawyer sued, and consequently, are the ones that advisers tend to be on the lookout for.

2.4. This is common where the drafting of a trust is not fit for purpose such that it prevents the client from achieving their goal. An example may be failing to ensure that the client is even a beneficiary or the trust, or omitting a key power of the trustee.

2.5. The other category of drafting mistake is more nebulous. They may not have a direct legal consequence, but make the life of the client, advisers, trustee, or beneficiaries more difficult. For example, confusing or ambiguously defined terms makes the job of the trustee – which is to administer the trust according to the words of the trust deed – much harder and usually more costly.

Case Study A[1]

Facts

Consider this definition of beneficiary taken from a testamentary discretionary trust:

"8.1 ***Beneficiaries***

The beneficiaries of the trust will be:

(a) any person who is a descendent of a grandparent of either the primary beneficiary of the trust or a spouse of the primary beneficiary;

(b) the spouse and children of any of the persons specific in the precede paragraph..."

The primary beneficiary is the son of the deceased.

[1] The clause in this case study was taken from a will in a matter I have worked on.

2.6. The drafting of the definition of Beneficiaries in Case Study A caused me and other experienced practitioners to do a double take. It is alarming that it was not immediately clear whether the person who the testamentary trust was nominally established to benefit was not immediately and obviously captured by the definition of Beneficiary. The question of whether his spouse was a beneficiary was also not clear – my reading is that yes, she was a beneficiary captured by (b) of the definition. Subclause (a) can be read in multiple ways – something else to be avoided wherever possible.

Case Study B[2]

Facts

Consider these definitions:

*"**Child** means any Child of the Appointor.*

***Grandchild** means and Child (whether adopted or ex-nuptial) of a Child.*

***Great Grandchild** means any Child (whether adopted or ex-nuptial) of a Grandchild"*

2.7. Case Study B is another example of unnecessarily complex drafting, even if it does not look like it. The definition of Child is circular, because it uses the defined term "Child" within the definition of "Child". The drafting of Grandchild and Great Grandchild is also counter-intuitive. Why not just define them to be the Grandchildren and Great Grandchildren of the Appointor? Does this include step-children?

2.8. The definitions are counter intuitive, and while it is easy (at least for a legally trained person) to understand what they trying to achieve, it may cause unnecessary confusion for the lay person, especially when more intuitive ways of achieving the same outcome are available.

2.9. With those examples in mind, it is a good place to stop and consider what is "good" trust deed drafting?

2.10. In my opinion, "good" trust deed drafting results in a trust deed that:

(a) suits the client's goals in establishing a trust;

(b) is as concise as possible;

(c) is precise in its terminology;

(d) is as comprehensible to the lay-person as possible; and

2.11. is unambiguous in terms of the powers and duties of the trustee. Most of these go to the same issue – that the trust must be understandable because this makes the administration of the trust as easy as possible. The reality is that most trusts will not be administered on a day to day basis by people who are legally trained. Trustees do not want to, and often cannot afford to, seek legal advice on a frequent basis to give legal sign off on every action the trustee wishes to take. With this in mind, you can see why I consider the definition of Beneficiaries in Case Study A and B are an example of bad drafting.

[2] These clauses were taken from an actual trust deed that a colleague worked on (not at the drafting stage!)

2.12. While it is generally the older trust deeds that are difficult to follow, because they use archaic language or formatting styles, I have encountered plenty more recent trust deeds and wills that have still caused seasoned trust law practitioners to get confused as to what the drafting was intended to achieve.

2.13. However, concise and comprehensible does not mean simple and basic. Precision in language is still necessary, and that can cause a deed to be more complicated.

2.14. Practitioners must find the balance – the deed must be precise and fulsome enough that there are no legal gaps in what the deed does, while still as much as possible being written in plain English so lay people can understand it.

2.15. This is not easy, and we should not pretend this is easy. It is a difficult skill to master – and I cannot pretend to be a master on this myself. It is as much an art as it is a science.

2.16. So having now had a discussion of what is "good" drafting, and the general sort of mistakes that drafters make, we can now discuss some more specific examples.

3. Fixing bad drafting

3.1. Before getting into specific examples of bad drafting, we need to discuss the process by which bad drafting can be fixed.

3.2. The answer here shouldn't come as a surprise to anyone – the answer to bad drafting is normally to amend the trust deed to rejig or replace the offending sections.

3.3. There are a number of processes by which variations to trusts can be made. The simplest and most common is the trustee exercising a power to vary the terms of the trust. Provided the variation power allows for the changes – I'll discuss this more later – a variation can be as simple as a deed or resolution by the trustee to replace the problematic drafting.

3.4. The process of exercising the variation power must be followed to the letter. If the trust deed requires "prior written consent" of the appointor, you need to have the appointor consent in writing, before the deed of variation is executed, in a separate document.

3.5. The other options to vary the terms of a trust deed can be beneficiary consent and court action.

Variation by beneficiary consent

3.6. Variations by beneficiary consent are not common. A variation by beneficiary consent involves the beneficiaries of the trust consenting to the variation of the terms of the trust. This would preferably be done by the beneficiaries each signing the deed of variation to evidence that they knew precisely what they were consenting to.

3.7. The legal basis for a variation by beneficiary consent is centred around the principal from the now 180 year old case *Saunders v Vautier*. The underlying principle behind *Saunders v Vautier* has been expressed to be '*any restriction on the enjoyment of a beneficiary who is sui juris*[3] *of a vested interest is inconsistent with the nature of that interest and must be disregarded'*[4]. This principle has also been expressed by the High Court as:

> *'The principle recognises the rights of beneficiaries, who are sui juris and together absolutely entitled to the trust property, to exercise their proprietary rights to overbear and defeat the intention of the testator or settlor to subject property to the continuing trusts, powers and limitations of a will or trust instrument.'*

3.8. The use of this principle to vary a trust has been considered judicially before, for example, in the New Zealand case of *Re Phillips New Zealand*,[5] Justice Baragwanath stated:

> *The rule in Saunders v Vautier…points the way: while all beneficiaries sui juris cannot direct trustees who bona fide oppose a particular course of action…their power to put an end to the trust is the ultimate exercise of unanimous consent. Since they can together use their possession of the total bundle of proprietary rights to terminate the trust it is difficult to see why they cannot use the same rights to permit the trustees to modify it.'*

3.9. The greatest difficulty with a variation by beneficiary consent is that it requires the consent of **every** beneficiary to proceed. For unit trusts or narrow special purpose trusts, this can be achievable, but for normal discretionary trusts this can be functionally impossible because the beneficiaries will likely include a vast number of potential beneficiaries, including potentially minors or unborn children.

3.10. Nevertheless, this is a tool that the adviser should keep in their back pocket.

Variation by court intervention

3.11. The state supreme courts are all granted powers to manage matters of trusts in accordance with each state's respective trusts legislation.[6]

[3] i.e., is over 18 years and has legal capacity.
[4] *Re Henley* [2013] NSWSC 975 at [51], quoting JD Heydon and MJ Leeming, Jacobs Law of Trusts in Australia 7th edition, LexisNexus Butterworths Australia 2006 [2314], citing *Weatherall v Thornburgh* (1878) 8 Ch D 261 at 270

[5] [1997] 1 NZLR 93
[6] *Trusts Act 1973* (Qld); *Trustee Act 1925* (NSW); *Trustee Act 1958* (Vic); *Trustee Act 1983* (NT); *Trustee Act 1936* (SA); *Trustees Act 1962* (WA)

3.12. Applying to the Supreme Court to authorise a variation to a trust deed is often seen as the last resort. It is orders of magnitude more expensive than any other approach to vary the terms of the trust deed and is only relied on where the trust property is sufficiently valuable and the value of getting the variation through is sufficiently high.

3.13. However, there are pitfalls and complexities involved in seeking the Supreme Court's approval for trust variations that practitioners must be aware of.

3.14. It is the position of the New South Wales Supreme Court that section 81 of the *Trustee Act 1925* (NSW) does not empower the Court to authorise variations on the basis that a variation is not a "transaction". This position is drawn from the decision of *Re Dion Investments.*[7]

3.15. Other jurisdictions have held that their equivalents of section 81 *Trustee Act 1925* (NSW) did authorise the variation of trust deeds. For example, the Queensland Supreme Court in *Re Arthur Brady Family Trust; Re Trekmore Trading Trust*[8] (the ***Arthur Brady*** case) considered that section 94 of the *Trusts Act 1973* (Qld) (the Queensland equivalent of section 81 of the *Trustee Act 1925* (NSW)) **did** allow the courts to authorise variations to trust deeds.

3.16. While the *Arthur Brady* case was decided before *Re Dion Investments* it did refer to the primary judge's in *Re Dion Investments* (the primary judgment being handed down before *Arthur Brady*) – and noted that although the earlier *Re Dion Investments* judgment stated that an amendment to a trust deed was not a 'transaction' for the purposes of section 81 of the *Trustee Act 1925* (NSW), the Queensland Supreme Court did not agree with that view and ordered that the amendments sought by the applicants be authorised under section 94 of the *Trusts Act 1973* (Qld), notwithstanding contrary New South Wales Supreme Court views.

3.17. Other jurisdictions have an equivalent provision to section 94 of the *Trusts Act 1973* (Qld). Accordingly, I consider it possible that other jurisdictions will not necessarily follow the New South Wales interpretation of those provisions that are the equivalent to section 81 of the *Trustee Act 1925* (NSW).

3.18. There are other relevant provisions of the trusts legislation. For example, section 95 *Trusts Act 1973* (Qld) grants the Supreme Court the power to authorise a variation on behalf of particular classes of beneficiaries. If those classes exist, the avenue should still be open for the Court to authorise a variation under section 95 *Trusts Act 1973* (Qld) and its equivalents.[9]

[7] *Re Dion Investments* (2014) 87 NSLW 753
[8] [2014] QSC 244;
[9] s63A *Trustee Act 1958* (Vic); s59C *Trustee Act 1936* (SA); s13-14 *Variation of Trusts Act 1994* (Tas); s90 *Trustees Act 1962* (WA).

3.19. New South Wales previously did not have a section equivalent to section 95 *Trusts Act 1973* (Qld), however the *Trustee Act 1925* (NSW) was amended in September 2020 to include a new section 86A, which explicitly allows the New South Wales Supreme Court to grant orders to approve an arrangement that varies the terms of the Trust drafted in similar terms to section 95 *Trusts Act 1973* (Qld).

3.20. While there are broad similarities in each state's trusts or trustee legislation and case precedent the above discussion highlights the need to engage with the legislation and precedent meaningfully in the relevant because there can be very significant divergences in the legislation and in the case law precedent.

3.21. The cost of seeking court approval for variations (tens of thousands, at least) often means it is simply impractical, however trustees should not be afraid to investigate this option if the cost of failing to vary the trust are significant – one such example could be if a vesting date is coming up and the trustee wishes to extend the vesting date but lacks the power.

Restructure into a new trust

3.22. For completeness I note that there is one final option to fix bad drafting. Throw the whole deed out and start again, or in other words, restructure the assets into a brand new trust with a modern deed (with hopefully better drafting).

3.23. This is often no real solution because the tax and duty costs of doing so can be prohibitive but can sometimes be a solution where capital gains tax rollovers are available or duty exemptions can be used.

4. Income powers that don't quite get there

4.1. Income powers are likely the most frequently "activated" part of a trust deed because most discretionary trusts will be required to make distributions of income every year. For other types of trusts, even if no active attention is paid to the income clauses, their operation will still determine the tax treatment of the trust's income.

4.2. Badly drafted income clauses can therefore have an outsized impact on the efficient operation of a trust and the economic status of the beneficiaries.

Definitions of income

4.3. How income is defined in a trust deed can often be a cause of considerable pain. The definition of "income" in a trust deed is critical. You must remember that for a trustee to make a distribution of income, there must be income to distribute.

4.4. If there is income for tax purposes, but no income for trust law purposes, the trustee cannot make a distribution of income that would satisfy section 97 of the *Income Tax Assessment Act 1997* (Cth) (**ITAA97**) meaning that the taxable income of the trust would be taxed to the trustee.

4.5. Some trust deeds – particularly old trusts – may not define income at all. In that situation, the meaning of income takes its ordinary meaning. In other words, income according to ordinary concepts. Other trust deeds will explicitly define income to mean income according to ordinary concepts.

4.6. This is a problem because many common forms of taxable income are **not** income according to ordinary concepts. The most common of these is a capital gain. Capital gains are not ordinary income – they are **made** to be taxable income by virtue of specific provisions of the tax law. I demonstrate the issue with this in the simple case study below.

Case study C

Facts:

The Deimos Trust holds vacant land. It has no other investments and derives no income.

The vacant land was bought for $100,000 many years ago and is now worth $1,000,000.

The trust deed for the Deimos Trust is an old deed and defines income as follows:

*"**Income** means the income of the trust as determined in accordance with ordinary concepts"*

The trustee of the Deimos Trust sells the vacant land for $1,000,000 in the FY 2023 year and crystalises a $900,000 capital gain. The Deimos Trust has no other income in FY2023.

On 29 June 2024, the trustee of the Deimos Trust resolves to distribute all income of the trust for FY2023 to Mr X, who has carry forward capital losses of $500,000.

Consequences:

The Deimos Trust has no income according to its trust deed meaning it has no trust law income. Therefore, it has made no distribution of income for the purposes of the tax law, notwithstanding a distribution resolution being prepared and signed before 30 June.

As a result, the taxable income of the trust, being the $900,000 capital gain is taxed to the trustee at the highest marginal rate. No capital losses can be used to reduce the capital gain.

4.7. Some trust deeds will have a default definition of income to be income according to ordinary concepts but allow the trustee to change it at its discretion.

4.8. This is better, but still not ideal, because it relies on the trustee and their advisers realising that the trustee must also make an active decision to adopt a different definition of income. This can be easily missed in the rush up to 30 June each year, and if the trustee fails to define the income in some other way, then it will be stuck with the ordinary income definition.

4.9. Many modern trust deeds will define "income" to be equal to taxable income of the trust. This is a relatively safe approach in most circumstances.

4.10. This comes back to my point about what constitutes good drafting. Good drafting makes it as easy as possible for the trustee to avoid adverse consequences.

Default clauses

4.11. Default clauses are the provisions that operate when there is an amount of income or capital of the trust that has not been distributed by the relevant date (normally 30 June for income or the vesting date for capital).

4.12. Typically, the default clause will operate to make the primary beneficiary or beneficiaries automatically entitled to any amount of income not validly distributed by the trustee. This includes income which the trustee purported to, but failed, to effectively distribute to others.

4.13. The absence of a default clause causes me considerable concern. While heavily debated, some commentators, myself included, consider that a trust is at risk of failure if there is no default beneficiary.

4.14. It is worthwhile to pause and explain why this is the case. Very briefly, for a trust to exist, there must among other things, be a "certainty of objects". Objects in this case refers to beneficiaries.

4.15. For this to exist, the courts have discussed the need to have enforceable "trust powers" – this means that the court should be able to step in, read the trust deed, and be able to enforce the "trust powers" of the deed. The trust powers normally include the income and capital distribution clauses of the trust deed.

4.16. If it is unclear who is intended to benefit from a trust power, then the courts may not be able to enforce it. If they are unable to enforce it, then the trust does not have certainty of objects and the trust fails. When a trust fails, in theory the assets are held on resulting trust for the settlor (and potentially the individuals who have made contributions of capital to the trust).

4.17. In practice this means that if there is no default provision for income, and the trustee fails to distribute part or all of the income of the trust for a particular year, some or all of the trust could fail. This could have disastrous tax consequences, not to mention severely impacting the ability of the trust to continue to function.

4.18. If you don't have default clauses, it can be difficult to add them to a trust deed especially in Queensland or Western Australia, as doing so may be a dutiable transaction.

4.19. I stress that there are very intelligent and capable lawyers who disagree with me on this risk of trust failure. It is my view that because there are limited drawbacks associated with having default beneficiaries, the conservative position is to **always** have default beneficiaries for both income and capital.

Defective default clauses

4.20. It is possible to have default clauses which are defective and fail to operate to prevent adverse tax consequences.

Case study D:

Facts:

The Titan Trust is a discretionary trust which generates income each year. In the 2023 financial year it generates franked dividends and capital gains.

It contains the following relevant clauses:

*"**Reasonable Time**" means that amount of time which is necessary to make a determination once the income of the Trust Fund is known or has been finalised by the Trustee's accountants or other consultants.*

...

The Trustee may at any time within a Reasonable Time after any year which ends before or upon the perpetuity date determine with respect to all or any parts of the net

income of the Trust Fund of such year... [to pay apply or set aside for beneficiaries or to accumulate].[10]

If the Trustee shall not have exercised its discretion ... within a Reasonable Time then such net income ... shall set aside for the primary beneficiaries as tenants in common in equal shares"

The trustees of the Titan Trust are on holidays from 20 June to 10 July 2024.

On 26 June, the accountant for the Titan Trust emails a resolution to the trustees for them to execute.

On 11 July on their return to Australia, they sign the resolution to distribute the income of the Titan Trust to themselves.

Consequences:

The trustees have failed to make a resolution to distribute the income of the Trust before 30 June, which is the requirement of the tax law.

The default clause which would have caused in the income to be distributed to the primary beneficiaries does not kick in before the financial year ends – meaning that for tax purposes at least, the trustee has not distributed its income to anyone, meaning the trustee would get taxed at the top marginal rates.

4.21. There are other problems that can arise from poor drafting of default clauses. For example, Queensland and Western Australia levy duty on transactions involving trusts interests. For discretionary trusts, only the default beneficiaries have trust interest. To see how bad drafting can cause duty issues, consider the below case study.

Case study E[11]

Facts:

The Hyperion Trust is a discretionary trust that holds considerable Queensland land interests. When the Hyperion Trust was established, Mr Bloggs and Mrs Bloggs had two adult children.

The trust deed contains the following clauses:

"***Primary Beneficiaries*** *means:*

(a) Mr Bloggs;

(b) Mrs Bloggs;

(c) the children of Mr Bloggs and Mrs Bloggs;

(d) the grandchildren of Mr Bloggs and Mrs Bloggs;

(e) the spouses of any of the persons listed above.

...

Default Distribution

If by 30 June of each year, the trustee has failed to distribute some or all of the income of the trust, then the primary beneficiaries are entitled to that income not distributed, as tenants in common in equal shares."

In 2023 Mr and Mrs Bloggs welcomed their first grandchild, Baby Bloggs, into the world.

Consequences:

The birth of Baby Bloggs meant that they became a primary beneficiary of the Hyperion Trust. In doing so, they acquired a 20% trust interest in the Hyperion Trust under Queensland Duties law.

This triggers duty in Queensland as if 20% of the value of the trust had been acquired by Baby Bloggs.

Thankfully, if the Hyperion Trust is a family trust for duty purposes, an exemption for trust acquisitions may apply to exempt Baby Bloggs from having to cut a cheque to the Commissioner of State Revenue.

Classification and streaming powers

4.22. I will not dwell on income classification or streaming powers too much as I believe they will be covered in more detail by other presenters at this Legalwise Seminar.

4.23. I will note generally that I have seen many "Bamford updates" as they are referred to that are overengineered and difficult to follow.

[10] This mechanism of "reasonable time" is taken from an actual trust deed. I have changed the default distribution clause for demonstrative purposes.

[11] This case study is based on a matter I have acted on.

4.24. My preference is to adopt a minimal changes approach, focussed on giving the trustee an additional set of powers that it can use when exercising its powers to distribute income. This set of powers includes the power to define income as the trustee sees fit (but including a default income definition that is workable most of the time), giving the trustee the power to segregate income into classes, and to make beneficiaries specifically entitled to classes of income.

5. Unexpected or unwelcome restrictions on powers

5.1. There are often very sound reasons to include restrictions on powers in a trust deed. It may be that a key beneficiary wants to maintain extra control over the assets and income of the fund, or because a testator wishes to leave a heightened level of protection over assets that they may be worried will be dissipated by a delinquent beneficiary or trustee.

5.2. However, it is not uncommon to come across restrictions on trust powers that seemingly exist for no real reason, other than perhaps that they were in the precedent document for some long forgotten reason.

Key person consent

5.3. Many trust deeds will have the role of appointor or guardian, who is granted powers that restrain the trustee's ability to act. Typically, this is achieved by requiring the consent of the appointor or guardian for certain actions of the trustee. Appointors normally also have the power to remove the trustee.

5.4. Care must be taken when including consent requirements in a trust deed. Even something as where the consent requirement is located in the deed can affect how readable the trust deed is.

Case Study F[12]

Facts:

The trustees of the Callisto Trust wish to amend the terms of the trust deed.

The variation power reads:

*"**10.1 Amending the Terms of the Trust:***

To the extent permitted by law, and subject to this clause, the trustee may amend the terms of the trust."

The trustees execute a deed of variation that invokes the above clause 10.1 to vary the terms of the trust. The primary beneficiary is not a trustee.

However, the trustees fail to notice this clause in the trust deed, which appears several pages before the variation power:

*"**6.3 Consent of Primary Beneficiary***

The written consent of the primary beneficiary will be required before the trustee may amend the terms of the trust... [the clause goes on to mention other actions of the trustee which requires consent]"

Consequences

The purported exercise to vary the terms of the trust has likely failed – because the procedure required by the trust deed has not been followed. Because clause 6.3 calls out that the written consent must be given before the variations, it is not enough to have the primary beneficiary consent after the fact.

[12] This clauses in this case study are drawn from the terms of a testamentary trust I have acted for.

5.5. In some trust deeds, the requirement for consent can be even broader, and they can complicate what would ordinarily be simple procedures for the trustee.

Case Study G[13]

Facts

The Ganymede Trust is a discretionary trust. Under the terms of the trust deed, Mr Bloggs is the guardian and appointor of the trust and sole director of the trust's corporate trustee.

The Ganymede Trust deed is a standard precedent trust deed used by Mr Blogg's former accountants, who helped him establish the trust.

The trust deed includes the following clause:

"10. Role of guardian

10.1 The Guardian must provide written consent to any proposed distribution of income or capital by the trustee."

On 30 June 2023, Mr Bloggs, in his capacity as director of the trustee, executes a resolution distributing all the income of the Ganymede Trust. He does not explicitly provide written consent as guardian. Mr Blogg's new accountants are not as familiar with this type of trust deed and did not check for additional restrictions on the power to distribute income.

Consequences

The trust deed for the Ganymede Trust is very clear that written consent from the guardian is necessary to distribute the income of the trust. Although Mr Bloggs signed the resolution as director, he has not signed off the distribution in his capacity as guardian.

The distribution has arguably failed because the trustee has not exercised the distribution power in accordance with its terms.

Mr Bloggs could potentially have consented to the distribution after signing the resolution but because this was not caught before 30 June, the distribution failed and default distribution provisions (if they exist) would apply instead.

5.6. Case study G illustrates a key drafting issue. Because Mr Bloggs already controls the trust as sole director and sole appointor, the additional level of control as guardian is unnecessary because he already had absolute control over the trust.

5.7. By adding another step to the income distribution process, another "failure point" was introduced for a successful distribution of income. Good drafting habits would be to exclude any unnecessary layers of complexity – in Case Study G this means potentially removing the role of guardian completely. Mr Blogg's accountants should have applied some consideration to this when they helped him establish the Ganymede Trust.

Notice periods

5.8. It is not uncommon for notice periods to exist for decision making in a trust deed. For example, many trust deeds require the trustee to give notice to the appointor of an intention to resign as trustee.

[13] The trust deed clauses in this case study are based on a matter a colleague has worked on.

5.9. This itself is generally not an issue. However, notice periods should be drafted to allow notice periods to be waived. I have seen trust deeds in which a change of trustee could not be implemented until the notice period had been completed – which would have caused an unnecessary month long delay to the clients proposed actions. You can often vary the terms of the trust deed to delete the notice period and proceed as normal, however the preparation of a variation deed is a cost that clients will generally want to avoid.

Restrictions on variation powers

5.10. Other presenters in this seminar will discuss variation powers in more detail, but readers should be aware of particular issues in the drafting of variation powers.

5.11. Many variation powers use terminology such as allowing the trustee to amend "trusts, powers, or provisions" of the trust deed. This is a good broad starting point for a variation power.

5.12. Language such as "hereinbefore" should be avoided because the Courts **will** give effect to that language.[14] If the variation power is located in a deed before other clauses, using language such as "hereinbefore declared" will prevent the variation power from affecting any clause that follows the variation power in the deed.

5.13. The courts have also determined that a variation that refers only to the "trusts" of the deed, rather than the "trusts, powers, or provisions" of the trust deed is limited to allowing the trustee to vary only the trusts contained in the trust deed. This is normally the income and capital distribution powers, but not any clauses such as appointor clauses or trustee powers.

5.14. These are recent cases that are affirming quite technical interpretations of variation powers. In this environment, you should always take pains to ensure that the precise words of a variation power are carefully considered to ensure they are not giving rise to any unexpected limitations on the power.

"Fixing" a variation power

5.15. When dealing with any other bad drafting, it is normally possible to fix the issues by using a variation power. However, this begs the question of what you can do when the variation power itself requires variation.

[14] *Re Owies Family Trust* [2020] VSC 716 – note that this case was appealed but the primary judge's position on the variation power was not overturned on appeal.

5.16. There is an open question on whether a power of variation can be used to vary the variation power. It is my view that there is no blanket prohibition on variations to the power to vary (as some commentators have posited), but instead an exercise of a variation power to remove restrictions on a power to vary may be a fraud on the power (and void) as contrary to the purposes of the variation power for the reasons discussed in *Kearns v Hill*[15] and *Cachia v Westpac Financial Services Ltd*[16].

5.17. The position that a variation cannot remove restrictions on the power to vary is generally drawn from *Jenkins v Ellett*, a Queensland case which involved the exercise of a variation power to change the role of appointor, as well as superannuation cases such as *UEB Industries Ltd v Brabant*.[17]

5.18. More recent case law has called into question this principle. Various courts have sanctioned the use of a variation power to remove or replace an appointor in recent years.[18] In doing so, they have apparently departed from the position in *Jenkins v Ellett*.

5.19. *Re McGowan & Valentini Trusts*[19] went further – Macaulay J considered that a variation power could remove the restrictions on a variation power.[20]

5.20. A distinction should be made between a restriction in the variation power that limits the ability of the variation power to change other clauses in the deed and a restriction in the variation power that prohibits the variation of the variation power.

5.21. While there is an argument now that the former can be varied based on the cases mentioned, I consider it still unlikely that a court would sanction a removal of a restriction on the variation power that prevents amendments to the variation power.

5.22. It may be possible therefore to use a variation power to remove unwelcome restrictions on the variation power itself – but this should be approached with caution.

6. Trustee or appointor succession dead-ends

6.1. Because most trusts can last for up to 80 years, they are frequently inter-generational vehicles. Proper estate planning takes into account how control of family trusts and companies should be passed to beneficiaries.

6.2. In some cases, testators do not appreciate the distinction between estate assets – the assets they personally owned – and the assets held by trusts they control and assume that the assets in the trust will end up in the right place.

[15] [2000] FCA 161
[16] (1990) 21 NSLWR 107
[17] (1995) 1 NZSC 40, 341
[18] *Mercanti v Mercanti* [2016] WASCA 206; *Cihan v Cihan* [2022] NSWSC 538
[19] [2021] VSC 154
[20] Ibid, at [123]

6.3. The succession of control clauses in a trust deed can be critical to ensuring a client's estate planning objectives are met.

6.4. All of the offices created by a trust deed need to be considered in this context – that is, the trustee and potentially the appointor and/or guardian.

Case Study H[21]

Facts

Mr Keppler is the sole trustee and appointor of the Europa Trust, a discretionary trust. Mr Keppler is married and has two adult sons from an earlier marriage. His new wife Mrs Tycho has a daughter from an earlier marriage with a severe disability.

Mr Keppler adores Mrs Tycho's daughter and wishes to ensure his considerable wealth can be used to ensure Mrs Tycho and her daughter can live comfortably and manage the daughters disability. Mr Keppler has given considerable amounts of money to his two sons, who are now independently wealthy, so he is happy to use his wealth to support his new wife and step-daughter.

Mr Keppler's will and letter of wishes set out his desire that his sons help his new wife by supporting her in terms of managing the Europa Trust's assets and makes it clear that he intends the income and assets of the Europa Trust to be applied to the purpose of the care and maintenance of Mrs Tycho and her daughter.

The terms of the trust deed set out that on the death of the trustee or appointor, the new trustee and appointor are the legal personal representative(s) of the original trustee/appointor.

The default beneficiaries of the Keppler Trust are Mr Keppler, or if he is dead, his children. The Keppler Trust is a "bloodline" trust and includes this definition of Child:

"***Child*** *means biological or lawfully adopted children. It does not include step-children unless the Trustee resolves otherwise*."

Mr Keppler dies suddenly leaving a will that appoints Mrs Tycho and his two adult sons as his executors. Mr Keppler's sons are incensed at seeing the family wealth go to Mrs Tycho, and their relationship immediately breaks down irrecoverably.

Consequences

Although Mrs Tycho is a trustee and appointor of the Europa Trust following her husband's death, she shares the role with his two adult children. The decision making of the trust is now utterly paralysed because trustee and appointor decisions must be made jointly.

Mr Keppler's sons are presumably quite happy not to cooperate, because the income of the Europa Trust will default to themselves each year, leaving no income for Mrs Tycho to care for her disabled daughter. They are not bound to follow Mr Keppler's will and letter of wishes in relation to the Europa Trust because Mr Keppler was not legally able to bind the behaviour of the trustee(s) of the Europa Trust in that manner.

Mrs Tycho would likely be forced to undertake expense litigation to have Mr Keppler's sons removed as trustee of the Europa Trust in order to see Mr Keppler's wishes met.

6.5. The above situation is not an extreme example. This problem was also solvable provided Mr Keppler's advisers had realised that the trust deed had the potential to result in a scenario contrary to Mr Keppler's testamentary desires.

6.6. The obvious drafting fix that could have been implemented is the automatic succession of trustee and appointor could have been removed and replaced with a succession by choice of Mr Keppler. Mr Keppler could then have made a binding nomination of Mrs Tycho to succeed him as trustee and appointor.

6.7. A note of caution: such an amendment may not be possible of the variation power in the Europa Trust was limited to "trusts" and not "trusts, powers and provisions" as discussed above.

[21] The definition of "Child" in this case study is based on a trust deed I have reviewed.

6.8. A more extreme example of when trustee/appointor succession clauses fail is where there is simply no succession mechanism at all. I have been involved in a matter where the trustee of a trust died and no mechanism existed in the trust deed to replace him.

6.9. While each Trust/Trustee Act has a legislative method for appointing a new trustee in the event the previous trustee dies,[22] the process is more convoluted than a simple succession clause. It may require notification to the state's public trustee and potentially court proceedings to have a new trustee appointed. It should be avoided whenever possible.

7. Bad choices for key roles

7.1. I have touched on the issues that can arise relating to bad trust deed drafting and key roles in a trust deed elsewhere in this paper – problems that can arise from base succession provisions for trustees and overly broad definitions of primary beneficiaries. There are other mistakes that can be made when choosing who will fill key roles in a trust.

7.2. It is an area where it may not be the drafting itself that causes issues, but the failure for the client and/or their advisers to take into account the flow on affects from choices of key roles which may make sense in the moment but have adverse consequences down the line.

7.3. Companies are sometimes used as appointors because they are a perpetual entity. It can also be a way to establish rules around how appointor decisions can be made outside of the trust deed.

7.4. Caution should be taken when using a corporate appointor – advisors need to be aware that the fundamental legal differences between a company and a trust mean that the governance of a company can be easier to change because the constitution exists essentially as a contract between the company and its shareholders. Shareholders can expect (and courts will allow) a much greater amount of influence in a company's affairs and governance than a beneficiary will have in a trust.

7.5. Traditionally discretionary trusts are established with individuals as the default beneficiaries, but I have on occasion seen a trust established with corporate beneficiaries are the default beneficiary.

[22] s6 *Trustee Act 1925* (ACT), s48 *Trustee Act 1958* (Vic); s36 *Trustee Act 1936* (SA); s13 *Trustee Act 1898* (Tas); s7 *Trustees Act 1962* (WA).

7.6. There are two practical issues with this approach. First, any if the default provision is active, and the entitlement not paid out, the resulting unpaid present entitlement will become subject to Division 7A[23] which causes a deemed unfranked dividend to arise and be taxed at marginal rates. This issue is compounded where the failure to distribute all income is not discovered until some years later, past the period in which an unpaid present entitlement can be converted to a complying Division 7A loan.

7.7. Secondly, while it can be a niche issue, a discretionary trust with a company as the default capital beneficiary cannot satisfy the definition of "family trust" for Queensland duty purposes. This means that any change in the default beneficiaries, or any change in the shareholdings of a corporate trustee, can trigger stamp duty in Queensland and no exception is likely to apply.

8. Unit trusts

8.1. In this paper thus far, I have focussed on discretionary trusts. I find them to be a rich vein of examples of bad trust deed drafting.

8.2. In the world of unit trusts, things can be simpler, but the most common mistake I see is the failure to establish a fixed unit trust for tax purposes.

8.3. Fixed unit trusts are a concept for income tax, and it can be critical for a trust to be a fixed unit trust if the trust has incurred tax losses it wishes to utilise or if it is in receipt of franked dividends.

8.4. Unhelpfully, the tax law is drafted such that almost no trust will meet the definition of fixed trust. The Commissioner of Taxation (**Commissioner**) does have the discretion to choose to treat a trust as a fixed trust for income tax purposes and has issued Practical Compliance Guideline PCG 2016/16 (**PCG 2016/16**) that sets out what he wants to see in order for him to exercise that discretion. Note that if you meet the requirements in PCG 2016/16, you can assume that the Commissioner will exercise his discretion retrospectively should it become an issue.

8.5. I am frequently asked to advise trustees of unit trusts whether they satisfy the Commissioner's requirements to be a fixed trust. They frequently do not, and the most common culprits are:

(a) the ability to issue special classes of units on terms that the trustee sees fit;

(b) the ability of the trustee to issue or redeem units on terms the trustee sees fit;

[23] *Income Tax Assessment Act 1936* (Cth)

(c) the ability of the trustee to vary the terms of the trust to potentially dilute the value of a unitholder's interest.

8.6. To summarise PCG 2016/16, the Commissioner expects to that in a fixed trust a beneficiary's interest is fixed, and the value of the interest cannot be diluted by any person's action – for example by issuing more units at less than market value, or issuing special units that take priority.

9. Conclusion

9.1. The quality of trust deeds and trust deed drafting varies, but for a document that is expected to apply in one form or another for up to 80 years (or perpetually in some narrow circumstances), the drafting must be held to a high standard.

9.2. It is common in legal practice to be warned by a colleague or client that a trust deed is old – because the assumption is that it will be confusingly worded or otherwise archaic. The legal profession must work to ensure that the next generation of lawyers do not approach our trust deed drafting with the same trepidation.

9.3. I have gone into perhaps too much detail and provided to many examples in this paper, but the take away should be this:

(a) good drafting means a trust deed that precisely achieves the client's goals and is comprehensible to the client even if they are a layperson; and

(b) bad drafting can be legal mistakes causing insurance claims, but is more commonly "merely" overwrought, ambiguous or just plain confusing drafting for both lay persons and professionals. This costs our clients time, money and stress all of which can be avoided with good drafting.

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