

Vulnerable Beneficiaries

Have you ever thought about how the inheritance you leave someone may affect their personal and financial circumstances?

Unfortunately, not everyone has the required mental capacity to manage their own money. They may have a mental disability, a gambling problem, be a spend-thrift, or simply financially unsophisticated. Each of these circumstances can impact upon a person's ability to effectively manage their inheritance.

Who is a vulnerable beneficiary?

The term vulnerable beneficiary is used to describe a beneficiary of an estate who does not have the necessary capacity to manage their personal finances due to mental incapacity or some other impairment or addiction which may limit their ability to effectively manage their financial affairs.



As mentioned above, a vulnerable beneficiary can include a person with a disability, a gambling or drug addiction or a bankrupt.

Why should you protect a vulnerable beneficiary?

Leaving a sum of money or a property in your Will to a vulnerable beneficiary may have a negative impact on that beneficiary's life. In the case of a beneficiary with a gambling addiction, the inheritance could in fact enable their addiction resulting in the beneficiary gambling it all away; or in the situation where the beneficiary's addiction is drugs, the inheritance could support their drug addiction. And in the case of a bankrupt, they may never see their inheritance as it will be paid directly to the Trustee in Bankruptcy to discharge their debts.

It is unlikely that a will-maker intentionally plans to support the addictions of a beneficiary or have his or her hard earned wealth fall into the hands of a beneficiary's creditors; but when a person leaves a vulnerable individual something in their Will this is often the result. Unfortunately their good intentions to provide for that person's wellbeing and financial security can often lead to situations of financial abuse or misuse.

How can you protect a vulnerable beneficiary?

If you wish to protect your assets and ensure your beneficiary receives the greatest benefit from the inheritance you leave them, then establishing a trust in your Will for the benefit of the vulnerable person may be the best solution.

A trust is an entity created to hold assets for the benefit of one or more beneficiaries, with a Trustee managing the assets held on trust.

The terms of the trust are set out in the Will and these are the terms and conditions upon which the trust will be administered/managed. A trust



has the ability to protect an inheritance because the inheritance is managed by a third party whose role is to administer the trust in the best interests of the beneficiary.

Generally speaking there are three types of trusts used to protect the interests of a vulnerable beneficiary: a life interest, a protective trust and a special disability trust.

What is a Life Interest?

A standard life interest is a trust where an asset (eg a property, cash or shares etc) is held on trust for the benefit of an individual (the life tenant) for his or her life time. The life tenant is entitled to the income generated from the trust for his or her lifetime but has no entitlement to the capital of the trust (the assets). The capital is preserved for the benefit of the remainder beneficiaries. On the death of the life tenant the capital is distributed to the remainder beneficiaries.

However, when creating a life interest for the benefit of a vulnerable beneficiary, a number of other terms can be included to protect the interests and ensure the wellbeing of the beneficiary is protected.

For example you can include any of the following terms:

- Income can be distributed at the Trustee's discretion rather than the beneficiary having an absolute entitlement to the income of the trust.
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The income can be applied for the benefit of the beneficiary rather than paid directly to the beneficiary. This may be an important inclusion where the beneficiary is a spendthrift or has an addiction and there is a concern that the beneficiary will not use the funds to pay for necessities such as food and accommodation.

- Ability to pay one or more beneficiaries (a discretionary trust).
- Directions to the Trustee setting out how the income from the trust should be spent, eg First on accommodation etc.
- Discretion given to the Trustee to use the capital of the trust for the benefit of the beneficiary.
- Ability for the Trustee to end the trust early where the beneficiary has proven their ability to manage their own finances.

What is a Protective Trust?

A Protective Trust is as the name suggests a trust created to protect the interests of the principle beneficiary. *The Trustee Act 1958 (VIC)* sets out the terms of a Protective Trust.

Section 39 of the Act states that the income of the trust is to be applied for the maintenance education, advancement or benefit of the principal beneficiary, his or her spouse and his or her children or remoter issue (if any). The Trustee may elect to apply the income for the benefit of one or more of the beneficiaries.

What is a Special Disability Trust (SDT)?

A SDT is a legislatively designed trust established for the benefit of an individual with a severe disability. The trust is created for their care and



accommodation. A SDT can be created during your lifetime or on your death.

There are a number of legislative requirements which must be met for the trust to be recognised as a SDT.

These requirements include:

- There can only be one beneficiary (principal beneficiary).
- The trust deed or Will must include the compulsory clauses as set out in the model trust deed.
- The trust must meet the Sole Purpose Test. To satisfy this test the assets of the trust must be used to meet the reasonable care and accommodation needs of the principal beneficiary.
- Principal beneficiary must meet the eligibility criteria of a beneficiary with a severe disability. *Centrelink and the Department of Veterans Affairs will determine whether a beneficiary meets the severe disability requirements.*
- The trust must comply with investment restrictions.

One of the benefits of a SDT is the asset test exemption available to the principal beneficiary. This means that the assets of the trust will not form part of the principal beneficiary's assets for the purpose of assessing their entitlement to government benefits. The exemption amount is indexed each year and is currently \$563,250.

Mary's Story

Mary lost her husband 2 years ago. On his death he left the family cabinet making business to their only son, Simon. Although Simon worked with his father in the business he was not involved in the financial management of the business.

After her husband's death Mary prepared a new Will leaving her entire estate to her son Simon. At the time of preparing her Will Mary was unaware of the difficulty Simon was experiencing in managing the finances of the business. Simon did not wish to worry his mother and more than anything wanted to prove he had the business acumen to manage the family business his father had worked so hard to build.

When Mary died a year later, the business was in financial difficulty and Simon was forced to file for bankruptcy. Simon lost both the family business and his inheritance. His mother's estate was exhausted to discharge his debts.

Mary could have prevented her estate from falling into the hands of her son's creditors had she created a trust for the benefit of her son and his family in her Will. Moreover, she could have protected the capital of her estate for the future benefit of her grandchildren.

When deciding whether a SDT, a tailored life interest or a protective trust is the appropriate trust structure for your beneficiary, it is important to consider their needs and personal circumstances. ***Please contact us to discuss your personal situation and the right trust structure for your beneficiaries.***

