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Tax implications of shareholder agreements and business succession: Part 2

Tom May *and* ***Ashley Moss*** *HERBERT GEER*

Introduction

Part 1 of this article discussed buy-sell agreements and their various forms and funding models, briefly considering the taxation implications. Part 2 will consider the most important tax associated with business succession — capital gains tax (CGT).

CGT events concerning the transfer of business interests, the rights associated with those interests and the underlying assets of the business are the most common taxation issues in business succession.

CGT assets and events

CGT assets are defined in s 108-5(1)[1] as "any kind of property" and a "legal or equitable right that is not property" and include both tangible and intangible property such as shares, options and legally enforceable rights. Generally, CGT events are a result of a transaction occurring in relation to a CGT asset such as a change in beneficial ownership. This may be caused by a transfer, creation, disposal or variation of a CGT asset. It is the CGT event which triggers the capital gain or capital loss and taxation consequences. With over 50 CGT events set out in the Act, the likelihood of a business succession plan attracting CGT is extremely high.

Upon the departure of a principal pursuant to a business succession plan the outgoing principal is likely to dispose of shares or similar business interests and rights under governing business agreements. Exiting principals may also be subject to restrictive covenants in the period following their departure. In exchange, the principal or their estate is likely to receive consideration which, as discussed in Pt 1, is, often, in the form of a payout of insurance proceeds.

The structure and selection of a tax effective business succession plan/buy-sell agreement can greatly assist in managing the associated tax implications.

CGT triggers and CGT events — some examples

Outlined below are examples of the most common CGT events that arise as a result of business succession arrangements. When preparing business succession plans, principals and their advisers should have an understanding of the different events and triggers and the best way to manage tax consequences.

Transfer of shares to remaining shareholders — CGT event A1[2]

The sale or transfer of a business interest involves a change in ownership of a CGT asset.

Shares in a company are one such CGT asset.[3] The transfer of shares pursuant to a buy-sell agreement or shareholders' agreement, therefore, constitutes a "disposal" under s 104-10(2) with the transfer of shares to the remaining shareholders resulting in a change in ownership.

A capital gain occurs if the consideration received in exchange for the interest (usually by way of an insurance payout) is greater than the cost base of the asset.[4]

The timing of the CGT event is usually when the contract for the disposal is entered into. However, as noted in Pt 1, where a trigger event, such as the death of a principal, acts as a condition precedent to the formation of such a contract, the taxable capital gain will not arise until that event occurs.

Note that shares are distinct from the rights under shareholders' agreements, which are considered below at CGT event C3.

Payout of insurance proceeds — CGT event C2[5]

As discussed in Pt 1 of this article, insurance proceeds are likely to be the most common form of funding used in buy-sell agreements, with the insurance proceeds applied as consideration for the departing principal's interest.

The payout of insurance proceeds in satisfaction and discharge of rights under an insurance policy triggers CGT event C2 — Discharge/Cancellation/Surrender of a CGT asset.

The capital proceeds which arise under s 116-20 are the insurance proceeds paid out by the insurer. The cost base of the CGT asset includes the insurance premiums plus incidental costs, such as legal fees paid by the policyholder. A capital gain will result if the insurance proceeds paid out are greater than the cost base of the CGT asset. Prima facie, this capital gain would be required to be included in the assessable income of the recipient.

However as discussed in Pt 1, this CGT event is usually avoided through the application of the exemptions in s 118-37 (for trauma or TPD policies) or s 118-300 (for life insurance policies).

Another example of CGT event C2 is a share buy-back (or capital reduction) pursuant to a shareholders' agreement. Share buy-backs were discussed in the second half of Pt 1 of this article and are considered further in Pt 3.

Forfeiting rights under a shareholders' agreement — CGT event C3[6]

At the point of departure, an outgoing principal, in addition to disposing of their shares, may be forfeiting their option to acquire shares in the company granted by the shareholder agreement. CGT event C3 — End of an Option to Acquire Shares or Units — deals with such situations and arises when the outgoing principal fails to exercise the option in time or cancels the option upon exiting.

The timing of the CGT event is when the option to acquire shares ends, being at the time that the outgoing shareholder's interest in the business is disposed. In business succession circumstances, it is unlikely that this will result in any capital gain or loss, with both the capital proceeds from the grant of the option and the expenditure incurred in granting it likely to be nil.

Use of an options buy-sell agreement — CGT event D2[7]

In circumstances where an options buy-sell arrangement is used (discussed in Pt 1), a legally binding contract to buy and sell shares is created. This consequently attracts CGT event D2 — granting of options.[8]

The timing of the event is upon the occurrence of a trigger event, which acts as a condition precedent to the formation of the shareholders' agreement or buy-sell agreement and not the date of the actual contract or agreement.

As there is usually no payment for the granting of the option and as the market value of the option is essentially nil,[9] it is unlikely that any capital gain will arise. Furthermore, s 104-40(5) states that any capital gain or loss relating to the option will be disregarded if the option is exercised.[10] When exercised in the context of shareholders' agreements, the option will become part of the transfer agreement and as such, the two agreements will be treated as one CGT asset under event A1, with the capital gain (if any) under event D2 being disregarded.

CGT discounts and concessions

While it may seem that the potential additional tax liabilities arising as a result of business succession arrangements are overwhelming, outgoing principals (or their estates) may be afforded a number of protections through the various CGT discounts and concessions.

The exemptions contained in ss 118-300 and 118-37 regarding CGT event C2 and the payout of insurance premiums have been discussed above and in Pt 1 of this article.

50% discount on 12 month asset ownership — s 115

Individuals and trusts who make a capital gain on the disposal, buy-back or cancellation of their business interests as a result of a business succession arrangement (CGT event A1) *may* be entitled to a 50% discount on that gain *if* they acquired the interest more than 12 months prior to the happening of the CGT event (33.3% for complying superannuation funds) (s 115-25). Note that this discount is not available to companies.

In circumstances where the estate of a deceased principal is the recipient of capital proceeds as a result of a business succession arrangement, for the purposes of the s 115 discount, the legislation deems the estate to have acquired the CGT asset at the same time as the deceased principal, ensuring continuity of ownership which will satisfy the 12 month rule.[11] However, where the recipient is not the original owner, the discount will not be as readily accessible by their estate.

A further restriction on this discount is contained in s 115-40 which provides that the discount will not apply if the CGT event or disposal occurs under an agreement made within 12 months of acquiring the asset. However, the Commissioner has clarified in ATO ID 2003/1190 that a buy-sell agreement is not a type of agreement contemplated in the context of s 115-40.

Small business concessions — s 152

These concessions are designed to assist "small business entities" and the following two conditions listed in s 152-10 must be satisfied in order for small business owners to utilise them:

(a) the CGT asset must satisfy the "active asset" test;[12] and

(b) one of either:

  (i) the entity's turnover is less than $2 million;[13] or

  (ii) just before the CGT event, the sum of the net value of the entity's (and related entities') CGT assets does not exceed $6 million. That is to say that (with some exceptions) the only liabilities that can be taken into account are those related to a specific CGT asset.[14]

It is important to note that each of these tests have themselves a long list of conditions and exemptions.

Following amendments to the Act (which were enacted in 2009 and apply for the 2006–07 and later years),[15] these concessions can now be accessed by a legal personal representative (LPR) or beneficiary of the deceased estate where certain conditions are satisfied. Previously it was the Commissioner's view that for CGT events which occurred before 1 July 2006, where an LPR or beneficiary disposed of a business interest, the concessions could not apply. However, following the introduction of s 152-80, an LPR or beneficiary can access the concessions *if* the deceased would have been eligible for the concessions just prior to their death and the CGT event happens (that is, the interest is sold) within two years of the original owner's death.[16]

Where these conditions are satisfied, the concessions available include:

(a) 15 year exemption — s 152-B
This exemption allows individuals to disregard capital gains entirely on certain CGT assets where they have held the asset for 15 years *and* the individual is retiring or permanently incapacitated *and* the individual is over 55. If the individual claiming the concession is an LPR or beneficiary, the CGT event does not need to have happened in relation to the deceased's retirement as long as the other conditions contained in s 152-B are satisfied.[17]

(b) 50% reduction concession — s 152-C
This concession allows all small business taxpayers (who satisfy the requirements in s 152-10) to reduce their capital gains on eligible assets by 50%. This concession should be used where the requirements of s 152-B cannot be satisfied. As s 152-C allows a further 50% reduction in addition to the 12 months ownership discount in s 115, it is possible that only 25% of the original capital gain will remain.

(c) Retirement concession — s 152-D
This concession allows taxpayers to disregard capital gains entirely on eligible assets subject to a lifetime "CGT retirement exemption limit" of $500,000. If the individual is under the age of 55, the amount must be paid into a superannuation fund for the benefit of that individual. However, if the concession is being exercised by an LPR or beneficiary, there is no need for the amount to be paid into a superannuation fund.[18]

(d) Small business rollover concessions — s 152-E
The final concession allows taxpayers to disregard all or part of their capital gains entirely on eligible assets subject to the taxpayer acquiring "replacement assets" within two years.

Pre-CGT assets

Capital gains and losses relating to assets acquired before the introduction of CGT (20 September 1985) are generally disregarded.[19]

Pre-CGT assets/shares — inadvertent conversion as a result of business succession

The potential tax saving available to businesses established pre-20 September 1985 as a result of the "pre-CGT status" of their assets or the underlying business interests in those assets can be very valuable. However, a possible unintended tax consequence of business succession can be to rob these assets or shares/interests of their pre-CGT status as a result of a change in shareholding or ownership of a business.

The ability of business owners to extract the value of pre-CGT assets/interests having regard to the application of CGT event K6 (to CGT *interests*) or Div 149 (to CGT *assets*) is, therefore, an important planning step in business succession which is commonly overlooked.

CGT event K6 — pre-CGT interests become post-CGT interests — "75% Rule"

A taxable capital gain will generally not arise on the disposal of shares in a company pursuant to a business succession plan if the shares were acquired prior to 20 September 1985.

However, CGT event K6[20] may cause a taxpayer/outgoing principal to incur a taxable capital gain on the disposal or cancellation of *shares or interests* in a company/trust in certain circumstances. Where the market value of the underlying post-CGT property of a company/trust is 75% or more of the total value of the company/trust, pre-CGT *interests* of outgoing principals will become post CGT *interests* and subject to CGT on disposal. For example, if a company established in 1984 purchased a significant amount of real estate in the 1990s and 2000s (post-CGT assets), such that those assets comprise more than 75% of the net value of the company, a disposal of pre-CGT shares/interests in that company in 2010 will not be afforded the pre-CGT exemption normally available despite the shares being acquired prior to September 1985.

In calculating the net value of the company, pre-CGT assets converted to post-CGT assets by the operation of Div 149 ITAA 1997 are excluded.[21]

Division 149 conversion — pre-CGT assets become post-CGT assets — "majority underlying interests test"

Similar to CGT event K6 which alters the status of the shares/interests in a business, Div 149 has the potential to create taxable capital gains for outgoing principals on the pre-CGT *assets* of a business.

Where a change in the "majority underlying interests" in a pre-CGT asset occurs on or after 20 September 1985, the asset will be deemed by Div 149 to have been acquired after that date and thus, be subject to CGT on disposal. Typically, this will occur where the majority shareholding in a private company which owns a pre-CGT asset changes after 20 September 1985, including by way of a business succession plan.

Upon the change, the asset will be deemed to have been acquired by the remaining principals for its market value at the time of the change in the interest in the entity.[22]

Therefore, an unintended consequence of a business succession plan, in a business which existed pre-20 September 1985, may be to cause certain business *assets* (such as business real property) to become post-CGT *assets* and subject to CGT on a later disposal *if* a departure of an outgoing principal causes a change in the "majority underlying interests" in the asset.

Majority underlying interest is defined to mean more that 50% of the *beneficial* interests held by "ultimate owners" (whether directly or indirectly through interposed companies, partnerships or trusts) in pre-CGT assets (and income derived from such assets).[23] However, as illustrated in the examples below, the change need not be a 50% change in the interests of the entity, rather, it may be the case that even a 1% change will trigger Div 149.

Example 1: immediately before 20 September 1985, the shares in X Co, which owns $8m worth of real estate, were owned as follows:

Tony — 40%	Carol — 37%
Kathleen — 9%	Angela — 14%

Following a change in shareholding in 2012, the shares are now owned by:

Tony — 25%	Angela — 14%
ABC Pty Ltd — 21% (which is 100% owned by Kathleen)	Meagan — 40%

As the individuals who owned a total of 63% of the shares in X Co before 20 September 1985 — Tony, Kathleen and Angela — still hold over 50% of the shares after the change in shareholding in 2012, Div 149 will not be triggered.

Example 2: immediately before 20 September 1985, the shares in X Co, which owns $8m worth of real estate purchased in 1984, were owned as follows:

Kathleen — 50%	Tony — 50%

A subsequent transfer of only a 1% interest by either Tony or Kathleen to the other will trigger Div 149. This is because initially, Tony and Kathleen together hold the majority underlying interests in X Co. Following a transfer from Tony to Kathleen after 20 September 1985, Kathleen will own a 51% interest in the X Co and as such will become the new sole majority owner, causing a change in the majority underlying interest in the assets of the company, thereby triggering s 149-30.

Exception:

A change in the "majority underlying interests" of an asset (for example shareholding) will not be taken to have occurred as a result of a change in interests occurring due to the death of a person owning an underlying interest in the asset (ss 149-30(3) or 149-60). This exclusion only applies where the interest in the asset is transferred to a natural person.

For instance, if in Example 2 Tony had left a 1% interest in X Co to Kathleen under his will rather than transferring it during his lifetime, Div 149 would *not* impact on the pre-CGT status of X Co's assets as the majority underlying interest in those assets would have only changed as a result of Tony's death.[24]

In Pt 3 of this article to be published in the next edition of this newsletter, the authors will discuss the other taxation implications of business succession arrangements, considering income tax, GST, fringe benefits tax and stamp duty issues.

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Footnotes

1. All references to sections of legislation are to the Income Tax Assessment Act 1997 (Cth) unless indicated otherwise.
2. Section 104-10 — Disposal of a CGT asset.
3. Defined in s 108-5.
4. PR 2010/18 states that capital proceeds will be equal to the amount received under an insurance policy.
5. Section 104-25 — Discharge/Cancellation/Surrender of a CGT asset.
6. Section 104-30 — End of an Option to Acquire Shares or Units.
7. Section 104-40 — Granting of Options by the Taxpayer.
8. ATO ID 2003/1190.
9. Even if the market value substitution rule applies (s 116-30), as no amounts are received for the grant of the options, the value is considered to be nil.
10. Section 104-40(5).
11. Section 115-30(1), Items 3 and 4.
12. Defined in s 152-40 as an asset which is "used, or held ready for use, in the course of carrying on a business … or is inherently connected with a business that is carried on by you…" (includes shares in a company). Whether or not a CGT asset satisfies the active asset test in s 152-35 will depend upon how it has been used during the period that the business has owned it — that is, as an active asset (as defined) or not.
13. Section 328-110 — Small Business Entity Test.
14. Sections 152-15 and 152-20 — Maximum Net Asset Value Test.
15. Tax Laws Amendment (2009 Measures No 2) Act 2009 No 42.
16. Section 152-80(1)(c) and (d).
17. ATO, Advanced Guide to Capital Gains Tax Concessions for Small Business 2011–12, p 58.
18. Above, n 17.
19. Section 104-10(5).
20. Section 104-230(1).
21. Ruling TR 2004/18.
22. Section 149-35.
23. See ss 149-15(1), (4), (5).
24. P Bobbin, "Estates and Business Succession Planning, A Business Wealth Health Check", *The Tax Institute*, 2012.

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Binding death benefit nominations — an estate planning tool

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All section and regulation references are respectively to the Superannuation Industry (Supervision) Act 1993 and the Superannuation Industry (Supervision) Regulations 1994 unless otherwise indicated.

Binding death benefit nominations: how and why do they work?

Abstract

This article attempts to explain how binding death benefit nominations work and what estate planning outcomes can be achieved using them. A binding death benefit nomination is a non-fiduciary special power of appointment, the terms of which are specified by the relevant superannuation trust deed. The objects of the special power and requirements as to effective exercise of the power are also set out in the relevant superannuation trust deed. As most superannuation funds are regulated superannuation funds, the requirements of the Superannuation Industry (Supervision) Act 1993 (SIS Act) provide the outer boundaries of the class of objects. As the superannuation trust deed specifies the terms of the power (subject to the SIS Act) it is possible to tailor the terms of the power in order to achieve various estate planning outcomes. While binding death benefit nominations in APRA regulated funds are also non-fiduciary special powers of appointment, the SIS Act imposes greater limits on such powers and thereby, has, by comparison with self managed superannuation funds (SMSFs), reduced the estate planning outcomes which can be achieved in APRA regulated funds.

In short, binding death benefit nominations in SMSFs can be tailored to achieve various estate planning outcomes which are not possible to achieve in APRA regulated superannuation funds.

For convenience, binding death benefit nominations will be referred to as "nominations" and any references to superannuation funds or funds will be taken as being references to SMSFs. Additionally, as most SMSFs only provide accumulation benefits, the article will only deal with nominations in relation to accumulation benefits in growth phase.

Background

Traditionally, death benefits in SMSFs have been structured as discretionary trusts. On the death of the member, the member's interest in the superannuation fund was the subject of a trust, the terms of which required the trustee to distribute the interest to or among the eligible beneficiaries of the deceased member as the trustee determined. Typically, the eligible beneficiaries included the deceased member's spouse, children, financial dependants and the legal personal representative of the deceased member.

The member was able to indicate his or her wishes as to the allocation of the benefit by means of a non-binding expression of wishes. However, the final decision as to the allocation of the death benefit was conferred on the trustee. The trustee could have regard to the member's expressed wishes, but was not bound to comply with those wishes or even have regard to those wishes. The trustee was under no obligation to explain and justify the decision not to have regard to the wishes of the member.

Historically, the choice of this structure greatly influenced testamentary and estate duty considerations. The concern was that if the nomination was binding, then the nomination would amount to a testamentary disposition and, to be valid, would have to be made in a manner which would satisfy the statutory requirements for a valid will. In relation to estate duty, the concern was that if the member could dictate the allocation of the benefit, then the value of the benefit would be included in the estate of the member for estate/succession duty purposes and estate/succession tax would be imposed.

The estate duty concern is now irrelevant as estate/death duties ceased to apply from the late 1970s.

The issue as to whether a binding direction by the member is a testamentary disposition has now been authoritatively settled. As the superannuation interest of the member is not the property of the member, any direction as to the allocation of that property can only operate as an exercise of a power of appointment.

Essentially, a power of appointment is the authority that a person has to distribute property which is owned by a third party.

Support for the view that a nomination is not a testamentary disposition of the member is provided by *Baird v Baird*;[1] *Re Danish Bacon Co Ltd Staff Pension Fund Trusts* (Danish Bacon Co);[2] *McFadden v Public Trustee for Victoria* (McFadden);[3] *Holmes v The Public Trustee*;[4] and *Re Application by Police Association of South Australia* (South Australian Police Association).[5]

Nominations and testamentary dispositions

Nominations certainly have a similarity with testamentary dispositions: both are ambulatory, both take effect on and by reason of death and both are revocable at any time before the death. However, the critical difference is that testamentary dispositions operate on the property of the deceased member while nominations operate on property which is not owed by the member.

The member is not the legal owner of the assets of the superannuation fund — the trustee is the legal owner, or where assets are held by a custodian, then the custodian holds legal title to the assets. The member does not have equitable ownership of the assets of the superannuation fund. A superannuation fund is an example of a trust (a discretionary trust is another example) where there is no equitable ownership of the assets of the fund. Even in the extreme case of a single member SMSF, the single member does not have equitable ownership of the assets of the fund: see *Kafataris v The Deputy Cmr of Taxation*.[6]

As the member holds neither legal nor equitable title to the assets of the fund, those assets cannot form part of the estate of the member. Therefore, a nomination, although it operates by reason of the death of the member, is not testamentary.

The member of a superannuation fund has an equitable right for due administration of the fund and, possibly, standing to seek declarations and junctions to prevent breaches of trust. However, as a general statement, the member does not have a right to require the trustee to transfer a particular asset of the fund to the member.

If the member has no legal ownership of fund assets and has no equitable ownership or equitable right to a particular fund asset, then a nomination cannot operate as an assignment of the member's ownership (the member has no legal or equitable ownership of the assets of the fund) and cannot operate as an assignment of an equitable proprietary right (being a right which falls short of ownership) as the member has no such right. The only rights the member has are personal rights which are not assignable.

Consequently, the nomination can only operate as a power of appointment, which is a power conferred on the member and exercisable by the member during his or her lifetime. This is the approach taken in *South Australian Police Association*,[7] *McFadden*,[8] by the Privy Council in *Baird v Baird*[9] and by Megarry J in *Re Danish Bacon*.[10]

The power conferred on a member by the trust deed is a power of appointment. The power is a special power (as the objects, ie, the persons who are permitted to benefit by the exercise of the power are limited) and is a power which, if exercised, must necessarily be exercised within the perpetuity period which applies to the power; namely the life of the member. The manner in which the power can be exercised is specified by the trust deed which creates the power. Further, the power is non-fiduciary as the member is under no obligation to exercise the power, or to consider whether the power should be exercised and if the power is exercised, may exercise the power capriciously. However as with all powers, the member cannot exercise the power excessively, ie, by attempting to exercise the power in favour of an individual who is not an object.

Legal structure of death benefits and nominations

The death benefit of a member is a contingent trust — the trust arising on the contingency of the death of the member. The subject matter of the trust is the member's interest in the superannuation fund. The trust is subject to a power of appointment conferred on the member which can only be exercised during the lifetime of the member. The member is under no duty to exercise the power of appointment. If the power of appointment is not exercised, the terms of the trust are that the trustee must allocate the death benefit to or among the eligible beneficiaries of the deceased member. The discretion of the trustee is to select which of the eligible beneficiaries is to receive the death benefit and, if more than one, in what proportions.

The nomination is, simply, the instrument by which the member exercises the power of appointment. The requirements for a valid exercise of the power of appointment are specified in the relevant superannuation trust deed (as governed by the SIS Act and Regulations). In relation to APRA regulated funds, reg 6.17A of the SIS Act does impose will-like execution requirements. However, as reg 6.17A does not apply to self managed superannuation funds, these requirements do not apply (unless self imposed by the terms of superannuation trust deed).

There can be variations to the structure of death benefits from that set out above. For example, the contingent trust could simply require the benefit to be paid to the legal personal representative of the deceased member. In this situation, there is no power of appointment conferred on the member and the trust deed, simply, creates a contingent fixed trust for the legal personal representative of the deceased member. In this situation, there is no facility for the member to make a nomination.

Another variation is that the interest is held for the benefit of the spouse of the deceased member (if the spouse has survived the deceased member) or the children of the deceased member. In this situation there is no power of appointment and presumably the provision of the trust deed which created the contingent trust will provide a taker in default for the benefit (such as the legal personal representative of the deceased member) or, alternatively, simply forfeit the interest to the fund (ie, to be held on other trusts or powers specified in the trust deed). In this situation there is no facility for the member to make a nomination.

SIS Act limits on the structure of death benefits

The SIS Act limits the structure of nominations by restricting both the persons who can be objects of the power of appointment and the persons who can be beneficiaries of the discretionary trust. This restriction applies to both SMSFs and APRA regulated funds. The restriction is imposed by ss 62(1)(b)(iii) and (iv) and by reg 6.22. Eligible beneficiaries of the death benefit are the legal personal representatives of the deceased member and the dependants of the deceased member. The trust deed of a fund could be more restrictive than the legislative restrictions. An increasingly common restriction is that the class of eligible beneficiaries are restricted to the issue of the deceased member (so called "bloodline restrictions").

The relationship between the range of objects of the power of appointment and the eligible beneficiaries of the discretionary trusts is found in the SIS Act, which sets out the exhaustive list of who the objects of the power may be (ie, SIS Act dependants), whereas the beneficiaries of a discretionary trust can be much more extensive and often includes the class of individuals who are SIS Act dependants (including the legal personal representative) of the deceased member or can be more restrictive than that class. However, neither the objects nor the eligible beneficiaries can include individuals who are not SIS Act dependants. In short, the SIS Act sets the outer limits to the class of objects while the trust deed can be more restrictive but not more expansive.

The SIS Act also restricts the manner in which death benefits can be paid. If the recipient of the death benefit is the legal personal representative of the deceased member or an independent adult child of the deceased member, then the death benefit must be paid as a lump sum. This restriction is imposed by SIS reg 6.21(2A). If the recipient of the death benefit is a dependent of the deceased member (other than an independent adult child) then the benefit can be paid as a lump sum or as a pension. If the benefit is paid as a pension, then the pension must be an account-based pension.

Finally, the SIS Act specifies that in the case of APRA regulated funds, the nomination must satisfy particular requirements and can only specify the proportion of the benefit to be allocated to each nominated object. This restriction is imposed by s 59(1A) and SIS reg 6.17A. Essentially, these restrictions require that the nomination must be executed in a testamentary manner and ceases to be valid after three years (unless refreshed by the member). These restrictions do not apply to SMSFs.[11]

Difference between a death benefit and an unpaid member benefit

Consider the situation where a member has attained age 65 and is by that reason entitled to be paid their super benefit. However, the member does not request payment and makes no effort to obtain the benefit. Equally, the trustee made no effort to effect payment of the benefit. The member subsequently dies with the benefit still unrequested and unpaid. Should this situation be treated as a death benefit or as an unpaid benefit? For the purposes of the question, the member has made no nomination.

The difference between these two situations is that in the former, the trustee must decide to which of the beneficiaries of the member to pay the benefit. While in the latter situation, the trustee is the debtor of the deceased member and the benefit must be paid to the estate as a debt owed to the deceased.

This very contest between the beneficiaries of the death benefit and the executor of the deceased member's estates arose for consideration in *Moss Super Pty Ltd v Hayne*.[12] In this case the deceased member attained age 65 and was, therefore, entitled to access his benefit. The benefit was payable to the member as a pension subject to the member electing within a specified period to take the benefit as a lump sum. The member made no effort to commence his benefit and made no election. The member and the trustee simply did not take any action in relation to the member attaining age 65. The member died shortly after attaining age 65 while still working. The court held that the member had to be treated as if the pension was in payment. The trust deed provided that on the death of a pensioner (and in the absence of a reversionary beneficiary) the benefit was to be allocated by the trustee in its discretion. Consequently, in this case, the benefit was treated as a death benefit rather than an unpaid member benefit.

A similar contest occurred in *Barfund Pty Ltd v McNab*.[13] In this case, the member attained an absolute entitlement to his retirement benefit but did not access his benefits. On his subsequent death, the issue was whether the deceased's benefit was to be paid to his estate (as a debt owing to the deceased member) or at the discretion of the trustee as a death benefit. In this case, the court held the benefit was payable to the estate as the entitlement to the benefit was absolute and not subject to any divesting. The court held that the trust deed did not, on its true construction, have the effect of deeming the member to be in the same position as if he had died before attaining the qualifying age or event. Had the trust deed had this effect, on the death of the member, his benefit would have been held on a contingent trust for distribution with the trustee selecting the eligible beneficiaries who are to receive the distribution.

The reconciliation between these two cases depends ultimately on the language of the trust deed of the fund. If the trust deed confers upon the member an absolute right to their retirement benefit upon attaining their qualifying age or event then it is likely that upon their subsequent death, the trustee is bound to pay the benefit to the estate of the deceased member as a debt owing to the deceased member. If, on the other hand, the trust deed confers only a contingent right to claim the benefit or a determinable right to claim the benefit, then (as the contingency has not been satisfied or the determining event of death occurring), the benefit will be treated as a death benefit of the member.

Rule against perpetuities and death benefits

In most jurisdictions the rules against perpetuities have been reformed (by the adoption of an 80 year perpetuity period and the saving "wait and see" provisions) and in relation to regulated superannuation funds, the SIS Act[14] provides that the rules "do not apply… to the trusts of any superannuation entity...". Therefore, the application of the rules in relation to death benefits and nominations is not a live issue.

However, should the precise scope of the rule against perpetuities be an issue in relation to death benefits and nominations, then the issue arises: how does the rule against perpetuities apply to death benefits and nominations?

Based upon the views expressed by the Privy Council in *Air Jamaica Ltd v Charlton,*[15] a superannuation fund can be viewed as being a collection of individual settlements which operate under the terms of the trust deed. On this basis the rule against perpetuities applies to each individual settlement. The life in being of the individual settlement is the member. Consequently the common law perpetuity period will be the life of the member plus 21 years. As the nomination must be made during the lifetime of the member, the nomination will necessarily be made within the perpetuity period. It should be noted that the particular superannuation scheme considered by the Privy Council was a defined benefit scheme. However the reasoning would apply equally to a defined contribution scheme.

Conclusion

Once the correct legal structure of binding death benefit nominations is understood, it is then possible to craft the nomination to achieve particular estate planning objectives. For example, by being more restrictive as to the class of possible objects of the power than that set by the SIS Act, the possibility of challenge by a disappointed relative is reduced. If the disappointed relative is not an object of the power, the relative has no standing to challenge the exercise of the power.

Further, the terms of the power of appointment could require the object to have survived a survivorship period; to permit the member to make alternate appointments; and even to specify that the object is to take the benefit as a pension or as a pension on particular terms.

Finally, the terms of the power of appointment could be crafted to provide that a particular asset of the fund be, in effect, gifted to a particular object by creating a superannuation interest of that asset. This could occur by the asset (for example an income producing primary production property) being segregated to support a pension interest of the member (thereby creating a discrete superannuation interest) and the nomination applying to that superannuation interest.

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Footnotes

1. *Baird v Baird* [1990] 2 AC 548.
2. *Re Danish Bacon Co Ltd Staff Pension Fund Trusts* [1971] 1 WLR 248.
3. *McFadden v Public Trustee for Victoria* [1981] 1 NSWLR 15.
4. *Holmes v The Public Trustee* (Supreme Court of Western Australia, 1995 unreported BC9503647).

5. *Re Application by Police Association of South Australia* (2008) 102 SASR 215; (2008) 258 LSJS 325; [2008] SASC 299; BC200809780.
6. *Kafataris v The Deputy Cmr of Taxation* (2008) 172 FCR 242; (2008) 73 ATR 531; [2008] FCA 1454; BC200808388.
7. Above, n 5.
8. Above, n 3.
9. Above, n 1.
10. Above, n 2.
11. SMSFD 2008/3.
12. *Moss Super Pty Ltd v Hayne* [2008] VSC 158; BC200803523.
13. *Barfund Pty Ltd v McNab* [1999] VSC 493; BC9908212.
14. Superannuation Industry (Supervision) Act 1993 s 343.
15. *Air Jamaica Ltd v Charlton* [1999] UKPC 20 at [32] per Lord Millett.

Powers of administrators in private companies and trusts — *Public Trustee and GB*

Phil Lambourne *APS WILLS & ESTATES PTY LTD*

In an article published in a previous edition of this newsletter,[1] the writer concluded that the donor of an enduring power of attorney cannot delegate any powers the donor might have as a director of a company or as a trustee or appointor of a discretionary trust, but what is the position of an administrator appointed by a court or tribunal?

The recent decision of the Western Australian State Administrative Tribunal (the Tribunal) in *Public Trustee and GB*[2] (GB case) provides some guidance in this area.

Facts

Mrs B had lost capacity and her nephew had previously been appointed as her plenary administrator. The nephew's performance as administrator came into question, culminating in Mrs B's two adopted children applying to become administrators.

Mrs B was the governing director[3] of a private company, as well as the appointor, guardian and one of two individual trustees of a discretionary trust. The other trustee was the nephew who proposed to resign as trustee.

The decision

The positions held by Mrs B in the company and in the trust proved to be significant factors in the Tribunal's decision as to who should be her administrator.

The Tribunal, first, noted that:

> In general terms, an administrator of an individual cannot, by virtue of that role, act as the director of a company or as the trustee of a trust in place of the represented person.[4]

This is consistent with the writer's view of the legal position as it applies to any person appointed to act on behalf of another, whether it be under an administration order, a guardianship order or a power of attorney.

The trust

The Tribunal referred to its specific statutory power to authorise an administrator to exercise powers vested in a represented person as trustee as contained in local legislation which provides as follows:

> The State Administrative Tribunal may—
>
> … (h) where a power is vested in a represented person in the character of a trustee or guardian, or the consent of a represented person to the exercise of a power is necessary in a similar character or as a check upon the undue exercise of the power, the State Administrative Tribunal may, upon the application of the administrator or any person interested in the exercise of the power or the giving of the consent, authorise the administrator to exercise the power or give the consent in such manner as the Tribunal may direct.[5]

Having concluded that this was a case where the Tribunal could and should exercise this power, the Tribunal determined that it should appoint the Public Trustee as administrator rather than the two children. The principal reason for this was the Tribunal's view that the two children would have a conflict of interest as trustees of the discretionary trust because the interests of Mrs B as a beneficiary of the trust would not necessarily coincide with the interests of the adopted children, who were also potential beneficiaries of the trust.

This conclusion appears to assume that the appointed administrator would be under a duty to exercise the powers as trustee of the trust for the benefit of Mrs B alone at the expense of other beneficiaries. That would, in the writer's view, indicate confusion over the capacity in which the administrator would, then, be acting. Surely, if a person is authorised to exercise powers as trustee then that person must exercise those powers in accordance with the terms of the relevant trust, which, in the context of a conventional discretionary trust, would mean considering the interests of *all* beneficiaries. If the children had been appointed as administrators instead of the Public Trustee then their *conflict of interest* would be no different to the position of Mrs B when she had capacity.

The company

In contrast to the position with the trust, there was no applicable legislative provision empowering the Tribunal to make any orders affecting the governance of the company or to assist the parties to manage the ongoing governance of the company.

Mrs B was the governing director and the nephew was an ordinary director. The company had old articles of association (which presumably still required there to be two directors), so it appeared that another director would need to be appointed due to Mrs B's incapacity and due to the nephew's intention of resigning as director.

However, as governing director, Mrs B had sole control of the appointment of directors, and the articles did not provide for any succession to the role of governing director while Mrs B was still alive.

As the company was not a sole director company, s 201F of the Corporations Act[6] had no immediate application (however that might change if the nephew resigns as director).

This apparent catch 22 is a stark reminder of the need to keep a company's governing rules up to date and workable.

Relevance outside Western Australia

Both the Tribunal's general statement about administrators not being able to act as directors and trustees and the above discussion about the governance of private companies are relevant throughout all jurisdictions in Australia.

As to the specific legislative provision relating to an administrator exercising trustee powers, no other state or territory has a provision with exactly the same effect as the WA provision referred to in the GB case.

Victoria has a provision in almost exactly the same terms, but it is of wider effect as it simply confers authority on an administrator without the need to obtain an order of the Tribunal.[7]

Tasmania has a differently worded provision with an effect similar to the Victorian provision.[8]

In NSW the Supreme Court may order the manager of a managed person to exercise a power vested in the managed person as a trustee or guardian.[9]

The writer has been unable to identify provisions in any other state or territory which have a comparable effect.

Conclusion

This case illustrates the difficulties that can arise when a person loses capacity and their affairs include other separate entities such as companies and trusts.

In Western Australia, Victoria and Tasmania, if an administrator is appointed then that administrator may be able to act to overcome some of those difficulties; however, the situation in other Australian jurisdictions may be problematic.

If the provisions of the applicable state or territory legislation regarding guardianship and administration do not assist then there may be other options to consider in other legislation, such as the Corporations Act[10] or the applicable state or territory legislation regarding trustees.

Overall, the best advice would have to be to try to avoid the issues arising at all by always ensuring that:

- each private company has an up to date constitution and the shares held by the right people; and
- each discretionary trust has a corporate trustee and appropriate clauses allowing a replacement for any personal fiduciary roles (such as appointor or guardian) where the named person loses capacity.

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This article was peer reviewed by:

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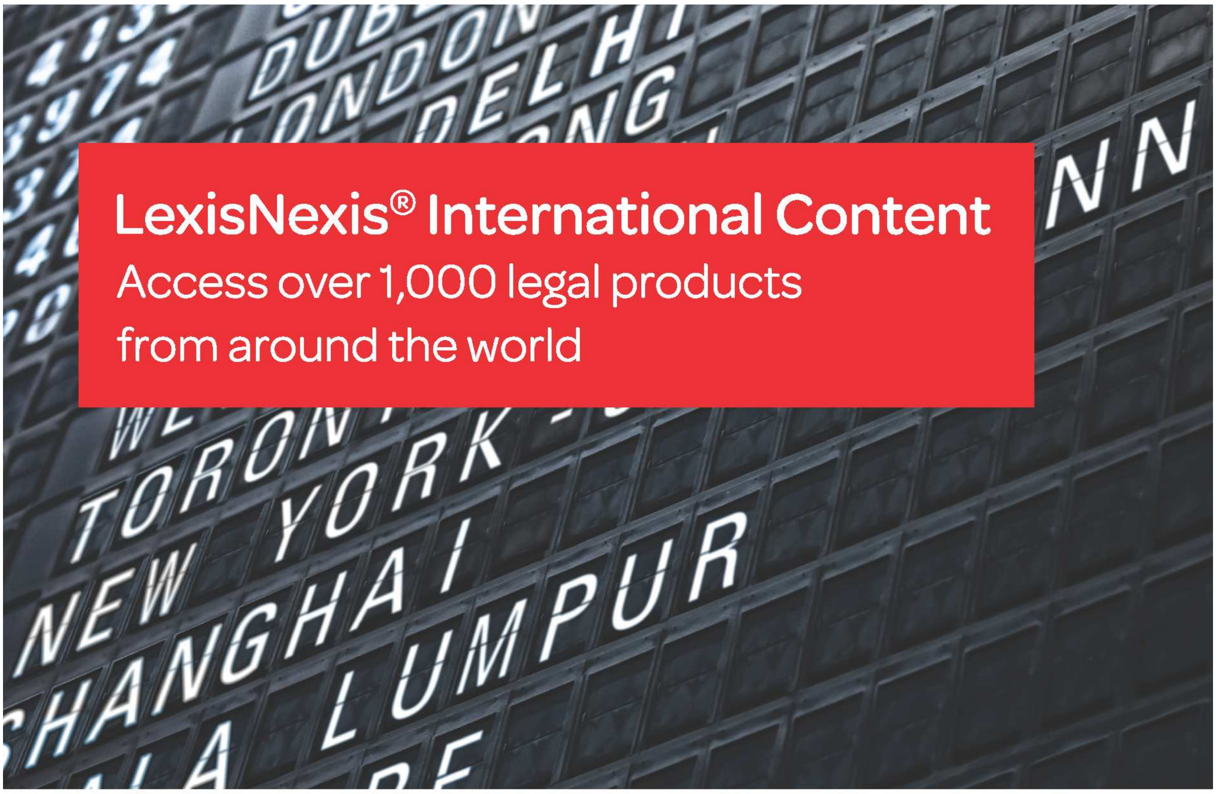
Andrew Frankland, *Executive Lawyer, BARTIER PERRY (Sydney, NSW)*

John Stewart, *BARRISTER (Darwin, NT)*, who commented that there are no equivalent provisions in NT.

Footnotes

1. P Lambourne "Delegatory and Succession Documents — (Powers of Attorney and Other Animals)" (2011) 14(5/6) *REP* 62 at 74.
2. *Public Trustee and GB* [2013] WASAT 97 — 26 June 2013.
3. The position of governing director was a specific position created by the company's constitution, conferring special powers on the holder of the position, including the sole power to appoint and remove directors.
4. Above, n 2, at [30].
5. Guardianship and Administration Act 1990 (WA), sch 2 Pt B, para (h).
6. Corporations Act 2001 (Cth), s 201F. This useful and often forgotten section provides a mechanism for the appointment of a director of a company by the personal representative of a sole director who has lost capacity.
7. Guardianship and Administration Act 1986 (Vic) s 58C(2).
8. Guardianship and Administration Act 1995 (Tas) s 56(2)(t).
9. NSW Trustee and Guardian Act 2009 (NSW) s 78(1)(a).
10. Above, n 6.



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Compensation for dealings by attorneys

***Richard Williams** QUEENSLAND BAR*

Section 107 of the Powers of Attorney Act 1998 (Qld) provides a wide discretionary power for the court to award compensation where a person loses a benefit because of a sale or other dealing with property by an attorney. As there have been very few reported cases on this section, the basis on which this discretion is to be exercised has, therefore, been unclear. The recent decision of *Neuendorf v Public Trustee of Qld (as Executor of Estate of Dickfos) (decd) (Neuendorf)*[1] is helpful, in that it confirms various circumstances that are to be taken into account in determining an appropriate amount of compensation.

In this article, the writer will examine the Queensland position and how this compares with the positions in other jurisdictions.

The statutory remedy

The risk of an attorney disposing of property of their principal (also referred to as the donor), and thereby causing an ademption of a specific gift, is well known to estate practitioners. A common scenario is that an attorney sells a house in order to raise funds to pay for an accommodation bond, but the house is specifically referred to in the principal's will and gifted to a named beneficiary. The attorney may or may not be aware of the contents of the will. The person who "loses out" as a result of the sale may be the attorney or a third party.

In these circumstances, the apparent injustice that would result has been tempered, in some jurisdictions, by statutory provisions.

In New South Wales, s 22 of the Powers of Attorney Act 2003 (NSW) confers on a named beneficiary an interest in surplus money or other property arising from any sale, mortgage, charge or disposition of any property or other dealing with property by the attorney. This is, however, subject to the power of the Supreme Court of New South Wales, under s 23, to make another order, if the named beneficiary would otherwise gain an unjust and disproportionate advantage.

The position is similar in South Australia pursuant to s 11A of the Powers of Attorney and Agency Act 1984 (SA).

There is no corresponding provision under Victorian legislation.

In Queensland, the statutory remedy is widely drawn. Section 107 of the Powers of Attorney Act 1998 (Qld) is not limited to situations involving ademption: the section applies "if a person's benefit in a principal's estate under the principal's will, on intestacy, or by another disposition taking effect on the principal's death, is lost because of a sale or other dealing with the principal's property by an attorney of the principal".

It is further provided, in s 107(1A), that the section applies even if the person whose benefit is lost is the attorney by whose dealing the benefit is lost. The essence of the section is that the person who has missed out is able to apply to the Supreme Court for compensation out of the principal's estate.

It is possible that more applications may be brought under this section in the future, given recent decisions in Queensland[2] that have cast doubt on the exception to ademption recognised in *Re Viertel*.[3]

Two practical questions that arise from this are:

(a) What principles should the court apply to determine whether compensation is to be paid, and if so, in what amount?
(b) What procedural requirements apply when making claims of this kind?

Compensation

Section 107(3) provides a wide discretion: "the court may order that the person, or the person's estate, be compensated out of the principal's estate as the court considers appropriate".

There is, however, a cap: the compensation must not exceed the value of the lost benefit.

As mentioned at the outset, there have been very few published decisions to date concerning the application of s 107. In 2010, the section was referred to by McMurdo J in *Ensor v Frisby*,[4] but in that case the question of the calculation of compensation did not arise. In *Moylan v Rickard*,[5] Lyons J approached the measure of compensation by considering the change in value of the property that had been sold by the attorney between the date of sale and the date of death of the attorney's principal. Evidence was adduced of the movement of median house prices in the relevant area over time. Apart from this decision, the basis on which compensation is to be ordered has not, to date, been clear (although there has been one decision in respect of a similar provision under the Guardianship and Administration Act 2000 (Qld)).[6]

This brings us to the 2013 decision of *Neuendorf*. In *Neuendorf*,[7] Ms Dickfos executed an enduring power of attorney appointing her close family friend, Ms Neuendorf, as her attorney. Ms Neuendorf was unaware of the contents of Ms Dickfos' will, which included a gift to her and another close friend, Ms Brandon, of Ms Dickfos' house.

Acting as attorney, Ms Neuendorf sold the house in order to pay an accommodation bond. As a result, the gift under the will adeemed. Under the terms of Ms Dickfos' will, a named charity was entitled to the residue of her estate.

Justice Martin found that the action of Ms Neuendorf, in selling the house, was consistent with her duty as an attorney and was for the benefit of the donor of the power. It resulted in the failure of the gift in the will to her and Ms Brandon, warranting an award of appropriate compensation. His Honour did not focus solely on the loss suffered by the beneficiary, but indicated that the interests and conduct of the charity also needed to be taken into account. Given the charity was "as innocent of wrong doing as the applicants",[8] if the costs of the application were, in the usual way, ordered to be paid out of the residue of the estate, the charity would lose a substantial amount, which did not seem to be consistent with the wishes of the testatrix.

The court, therefore, made an order that Ms Neuendorf and Ms Brandon be compensated out of the estate in an amount equal to 84.5% of the value of the estate remaining after the payment of the parties' costs of the application, the charity's legal costs, and the deceased's funeral, testamentary and administration expenses. The reason that the compensation was calculated in terms of a percentage of the estate was to ensure that the burden of the legal costs (of the applicants, respondent and charity) was spread across the beneficiaries, rather than borne by the charity alone.

Importantly, his Honour stated[9] that the matters which might be the subject of consideration when determining an appropriate level of compensation will change from case to case, but that some matters will always be of general interest, including:

(a) the size of the estate;
(b) the identity of the other beneficiaries and the nature of the gifts to them;
(c) the proportions that the gifts to the applicants bear to the whole estate. In cases involving real property, some valuation will be necessary;
(d) the actions of the attorney;
(e) whether there was any default by the attorney;
(f) whether any action could or might have been taken under s 106 of the Powers of Attorney Act 1998 (Qld);[10]
(g) what was done with the funds after the sale took place;
(h) the costs which have been incurred and which will be paid out of the estate; and
(i) had the property not been sold, what would the position have been?

This analysis has clarified, for the first time, the basis on which the court is to approach the question of the appropriate measure of compensation under s 107. This provides valuable guidance for practitioners advising clients who are considering a s 107 claim.

Interestingly, one factor that is not mentioned in the list by Martin J is whether the attorney was aware of the contents of the will. That may be a relevant factor in other cases, depending on the particular facts.

Procedural requirements

Section 107(4) imports various requirements that apply to claims under Pt 4 of the Succession Act 1981 (Qld) (family provision claims). In particular, the time limits that apply in respect of family provision claims apply equally in respect of a s 107 compensation claim, and personal representatives need to be aware of the risk of distributing in circumstances where a claim may be made.

Conclusion

Section 107 provides an important remedy. It is to be expected that there may be more claims in future under this section, given the prevalence of powers of attorney and the obvious risk of a specific gift being disposed of by a well-meaning attorney. *Neuendorf* provides a framework for advising clients as to the likely approach of the court.

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This article was peer reviewed by:

Morgan Solomon, *Director, BOWEN, BUCHBINDER & VILENSKY LAWYERS (Perth, WA), who commented as follows:*

1. *Corresponding provisions in WA*

   There is no corresponding provision under Western Australian legislation.

   In WA, s 109 of the Guardianship and Administration Act 1990 (WA) very modestly reflects s 11A of the South Australian Act in that a person who has a 'proper interest' may apply (to the State Administrative Tribunal rather than the Supreme Court) for orders requiring the attorney to file records or have the records audited or to revoke or vary the power of attorney. This provision does not extend as far as the ability of a beneficiary to claim compensation. A beneficiary under a Will however is likely to be a person with a "proper interest".

   Pursuant to s 107 of the abovementioned WA Act, an attorney is liable only to the donor of the power of attorney by reason of a failure to exercise reasonable diligence in protecting the interests of the donor, but such liability does not extend to protecting the interests of a beneficiary of the Will of the donor.

2. *Application of Re Viertel in WA*

   Re Viertel may or may not apply in WA, depending on the facts of the particular case.

   In the WA case Re Hartigan (December 1997, unreported, BC9707385), Parker J distinguished *Re Viertel* saying that the attorney's knowledge of the contents of the Will at the time of the disposal of the asset in question is immaterial in circumstances where the testator did not have capacity to sell the asset or remake a Will, and the proceeds of sale are used only for the maintenance, welfare and benefit of the testator.

   In *Re Hartigan*, the proceeds of sale and income accruing on them were ordered to be kept in a separate fund precisely for this purpose and all funds not used for the welfare of the testator were not adeemed.

John Stewart *BARRISTER (Darwin, NT) who commented as follows:*

1. *Corresponding provisions in NT*

   There does not appear to be any corresponding provision in the NT.

2. *Application of Re Viertel*

   It would seem that in the cases cited in this article at fn 2, the courts declined to uphold the exception recognised in Viertel, confining it to circumstances where the subject matter is extinguished by fraud or tortious acts unknown to the testator.

Footnotes

1. *Neuendorf v Public Trustee of Qld (as Executor of Estate of Dickfos) (decd)* [2013] QSC 156; BC201310253.
2. *Trust Co Ltd v Gibson* [2012] QSC 183; BC201205055 at [22]–[27]; *Public Trustee of Queensland (as litigation guardian of Brigg) v Stibbe as executor of Will of Butler* [2012] QSC 357; BC201210997 at [23]–[26].
3. *Re Viertel* [1997] 1 Qd R 110; BC9601509.
4. *Ensor v Frisby* [2010] 1 Qd R 146; (2009) 4 ASTLR 169; [2009] QSC 268; BC200908165.
5. *Moylan v Rickard* [2010] QSC 327; BC201010256.
6. Above, n 2.
7. Above, n 1.
8. Above, n 1, at [33].
9. Above, n 1, at [22].
10. Section 106, unlike s 107, is concerned with an attorney being ordered to compensate the principal (or their estate) for a loss caused by the attorney's failure to comply with the Act in the exercise of the power of attorney.

Digital registers and estate planning

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Introduction

The internet and other digital technologies are an important part of everyday life. We are, increasingly, using them to upload and download files, communicate with family and friends, store and share documents, listen to music, read books, watch videos and so forth. These files accumulate throughout life and become an important record of that life.

Digital files and assets commonly include personal emails, material on social networking sites such as Facebook, music files on services such as iTunes, images on services such as Flickr, videos on services such as YouTube, documents of many kinds on cloud storage services such as DropBox, books and newspapers on services such as Kindle, domain names and personal websites, and financial credit on services like PayPal or eBay.

An increasingly common and important question to address is: what happens to a person's digital assets and files when they die, and how can they be passed from one generation to the next?

Some of our digital files and assets may have monetary value, such as online auction, gambling and financial accounts, and some are of personal value, such as videos, documents and photos. Digital technologies are increasingly utilised in daily life and are important records of a life, especially to friends and family who wish to remember the person who has passed away. Without considering the management of these digital assets, there is danger that they may be lost, inaccessible and/or destroyed when a person dies or loses capacity.

In the same manner that estate planning is needed for the distribution of material and financial assets, it is becoming increasingly important to plan for the distribution of a person's digital material. It is important to consider who will have access to these digital files and assets and how they will be managed, passed on and/or deleted. A good way to make these preparations is through the creation of a "digital register".[1] We use the term "digital register" to refer to a private record of the account details, user names and passwords needed to access a person's digital assets and files, along with instructions on what to do with those digital materials, once the person has passed away. Usually, the digital register will be created and maintained by the person himself or herself. It should be stored safely (such in a solicitor's safe custody, safety deposit box at the bank or locked filing cabinet at home), often together with the person's will, to maintain the security and privacy of the person's digital files and assets.

In this article, we report on recommendations for creating private digital registers arising from a research project supported by the Australian Communications Consumer Action Network (ACCAN) conducted at the University of Melbourne.[2] In this project, interviews were conducted with "key informants" drawn from various professions and industry sectors that had expert knowledge of the issues surrounding the management of digital files and assets following the death of an individual. These professionals included spokespeople for various religious groups, senior executives of telecommunications companies and internet service providers, estate planning lawyers, moderators of online memorial sites and archivists. The second source of information was current research literature on death, memorialisation and digital heritage. The third source of information was the existing *Terms of Service* and policies of leading social media and telecommunication companies.

Digital files and assets

Ownership in digital environments is complex and is an important consideration in determining what can be bequeathed. Digital property may include emails, photos, blogs, websites, electronic documents and content uploaded to social media accounts.

Ownership of digital media and the conditions of posthumous access to it usually depends upon the particularities of the *Terms of Service* agreement entered into when the (now) deceased person initially signed up for that particular online service. Overarching contractual rights, intellectual property rights and various forms of copyright law further complicate the situation.

In addition, digital media may be held remotely on a server, very often in another country and in another legal jurisdiction.

While there are well-established procedures for locating, valuing and transferring ownership of physical property such as real estate, cars and books, the task of locating, accessing and distributing digital files and assets is, often, more difficult. For example, many online services (ie, Facebook, Flikr) have *Terms of Service* agreements that disallow the transferring of a person's account to another person. These companies have agreed to provide a service to a named individual and the agreement ends with that individual's death. Many years of photos, videos, text and other digital files and documents uploaded to an online service may be irretrievably lost if posthumous access to them is not arranged and local copies are unavailable.

A common-sense solution to this problem is for individuals to make a list of services (Flickr, PayPal, Facebook, Dropbox and so on), and record the relevant username and password for each service, along with instructions for friends, relatives and the executor of the will in a private digital register. Although this may be commonsense advice, it is often against the *Terms of Service* of many service providers (Gmail, Hotmail) who prohibit the transfer of username and password to a third party and forbid any person from accessing another person's account, deceased or not. These *Terms of Service* are, often, designed to protect the privacy of an individual, even in death.

Other internet service providers (particularly Australian providers such as iiNet and Telstra) allow access to user accounts and consider an individual who has been given the username and password to be an authorised agent of the owner of the account. Of course, for all practical purposes, the identification of the person using the username and password cannot be verified.

Wills and digital registers

Agencies such as the State Trustees of Victoria recommend that passwords and account locations should be recorded in a private digital register that accompanies a will. The private digital register would record the locations, usernames and passwords of online accounts, so that the digital files held in such accounts may be transferred to friends and relatives. It is also possible within a digital register to request the closure of some or all online accounts so that sensitive or irrelevant material is deleted.

Solicitors taking instructions for wills should encourage their clients to consider their digital assets. Some of the items that clients should consider when creating a private digital register are listed below.

Identify important digital files and assets

The client should be encouraged to undertake an audit of all of their digital files and assets, including the entire breadth of social networking services, cloud services, personal email accounts and blogs, photo and video storage services, online gaming accounts and all other internet services and accounts associated with an individual. These may include iTunes, Flickr, Facebook, LinkedIn, eBay, PayPal, online gaming and email accounts. Other digital assets can include domain names, blogs, websites, application software, phone apps, and data held on the cloud through services such as Amazon, Google Docs, and DropBox as well as other data storing facilities.

List locations and access methods

Clients should be encouraged to record the details needed to find digital materials and assets, as well as provide clear instructions on how to access files and groups of files, and what the client's wishes are in respect of such materials and assets on their death or incapacity. Solicitors should emphasise to their clients the importance of storing such information about locations, usernames and passwords securely, as well as ensuring that it is kept up to date. Finding and gaining access to accounts after death can be extraordinary difficult, if not impossible, without this information. Enabling a digital legacy to be disbursed or deleted, as appropriate, also reduces the possibility of identity theft and helps protect the privacy of the dead person.

As previously noted, passing on account details may be against the *Terms of Service* associated with the account. For this reason, if clients do not wish to risk breaching these *Terms of Service*, they should also be encouraged to regularly download important digital assets and files and store them in a local archive. Clients should consider whether these digital files and assets need to be stored securely and protected with encryption and password access. Valuable digital assets and files should also be backed up to prevent loss through computer failures such as a hard-disc crash. Of course, locally stored materials should be included in the client's private digital register.

It is also worth noting that in most cases music files and eBook files purchased from iTunes, Amazon, Kindle and others cannot be bequeathed. The consumer has purchased a licence to use the file while they are alive, but does not actually own it.

Nominate a digital "executor"

Clients should also be encouraged to nominate a person to manage the digital assets upon their death or incapacity. The nominated person should have the technical skills to locate and access accounts, to identify the files associated with these accounts and to carry out instructions in respect of these files. The nominated person may be the same person as the executor of the will.

Alternatively, a friend or family member may be nominated to assist in this regard. A digital register and associated instructions may be included as an appendix to a will, and like the will, it should be kept in a safe place known to the digital executor. However, for privacy and security reasons it may be desirable to ensure that the digital executor only gets assess to the digital register at the time of death and not before. Commercial service providers (for example *Security Safe* or *Legacy Locker*) offer specialist services that will store important data and passwords that allow nominated individuals to access accounts and files in the event of death or disability.

Maintenance and security of the digital register

Individual's digital profiles, the services they use and the usernames and passwords they use to access such accounts, are in constant flux. For this reason, it is important to maintain and update the information contained in a digital register regularly. It is also crucially important to ensure the security of the digital register. A digital register may contain much valuable information and unauthorised access to it can expose a person to possible breaches in privacy, theft of identity or financial assets and fraud.

Clients should be encouraged to consider the competing demands of maintaining a private digital register that can be accessed and regularly updated but which also needs to be held securely. For example, special online services are available that will store and regularly update important account details such as usernames and passwords. These services are controlled by a "master password" which can be included in a personal digital register that is stored safely in a place that is not easily accessible on a day-to-day basis such as with the client's will that is held in a solicitor's safe custody or safety deposit box at the bank. Alternatively, clients may decide to keep their private digital register locked in a filing cabinet or similar receptacle in their home, where it is secure yet easily accessible for updating.

Prepare paperwork

If accounts are to be closed upon death, most companies require a formal process in which proof of death is provided (usually a death certificate or published obituary notice) by a person authorised to act on the deceased behalf (usually the executor of the will). They may also require proof that this person is authorised to act on the deceased's behalf.

Conclusion

Given the current possibilities and limitations for bequeathing digital files and assets, the following issues should be considered when preparing instructions in a digital register:

- Decide what should happen to the content of files stored on cloud services, messages stored in email accounts, images stored in photo sharing accounts and so on. There may well be many thousands of files in these accounts, and providing individual instructions for each may be impractical. Thoughtful categorisation of files into archives is a useful thing to do for everyday purposes and will also make the job of deletion or disbursement of a digital estate much easier and more effective.
- Decide whether to create local archives (back-ups) of online personal files periodically. This is increasingly easy to do and most of the larger social media and software companies now offer download facilities that can be used for this purpose. However, once the data is downloaded and stored locally it is also important to consider its safety in terms of data security and privacy. If stored on a removable hard-disk for example, consider password protecting or encrypting the disk and keeping it in a secure place, or giving a second copy to a trusted friend or relative for safe keeping.
- Decide if an individual social media profile will be deleted or memorialised. Or, alternatively, if a memorial site should be established as a legacy. If converting or creating a memorial profile it is important to consider what content will be on display, who will be able to view it and who will be curating or moderating any posts made to the site.

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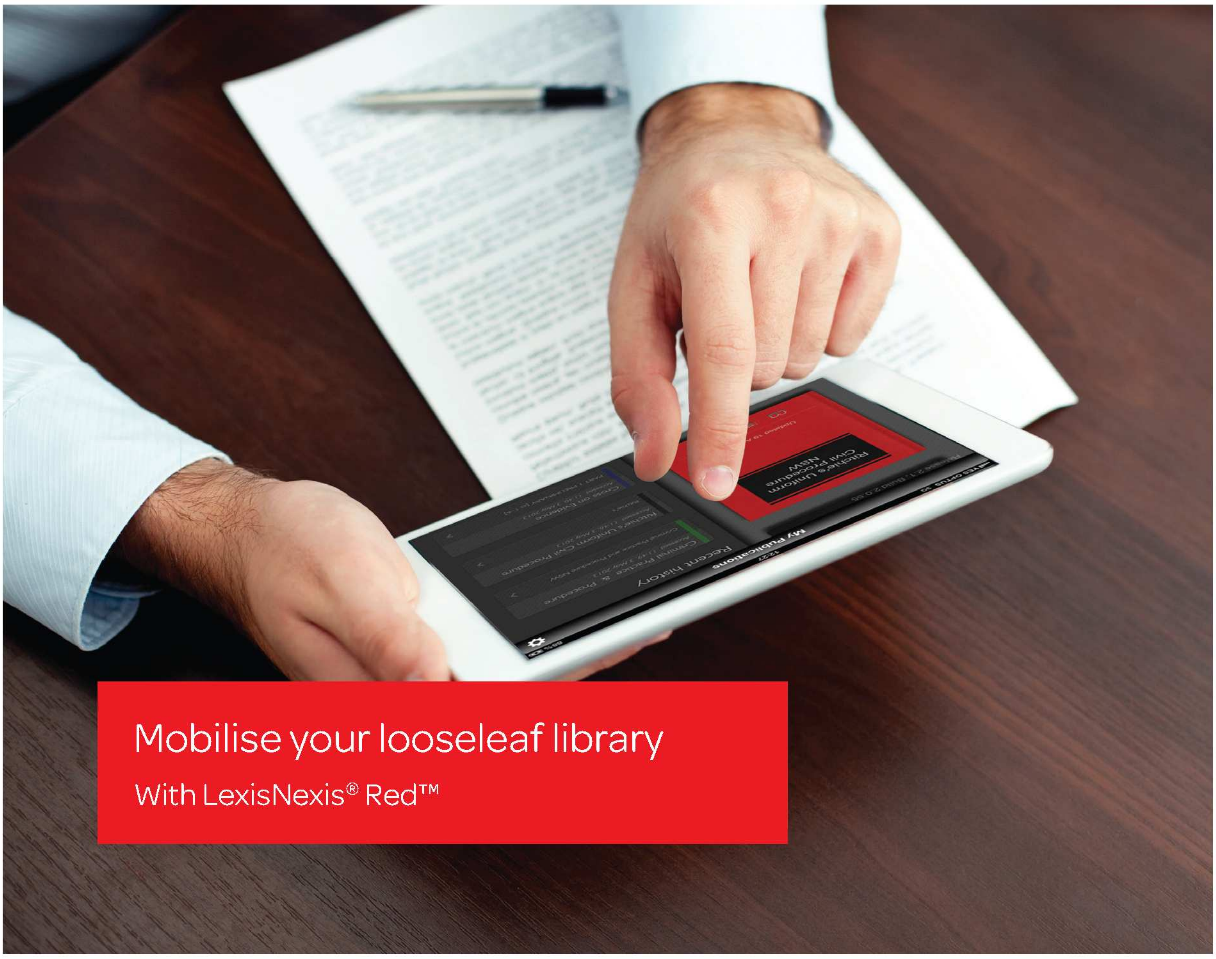
Footnotes

1. For further advice and information to assist Australian consumers in the planning, maintenance, and transfer of their digital accounts and resources see the Digital Heritage website: www.digitalheritage.net.au.
2. For the full report of this project see: C Bellamy, M Arnold, M Gibbs, B Nansen and T Kohn, "Death and the Internet: Consumer issues for planning and managing digital legacies" Australian Communications Consumer Action Network, Sydney, 2013, www.accan.org.au.



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