MOORE

WHAT IS A DISCRETIONARY TRUST?

WHY A DISCRETIONARY TRUST?

Many clients find it difficult to understand the concept of a discretionary trust and the relationship with the trustee of that trust, especially when the trustee can be a company for asset protection reasons.

In Australia, a discretionary trust is a common structure to run a business out of because it offers many taxation advantages, for example: the flexibility to distribute profit to different beneficiaries (including streaming of dividends to a particular individual(s)), the ability to access significant capital gains tax concessions and streaming capital gains to a particular beneficiary.

WHAT IS A TRUST?

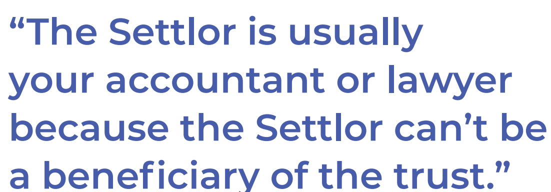
A trust is simply an agreement whereby a person or company agrees to hold an asset for the benefit of others. The person or company who controls the asset is known as the 'trustee' and those who benefit are called the 'beneficiaries'. The creator of the trust sets out specific terms how the assets are to be managed in a document called the 'trust deed'.

HOW IS A TRUST ESTABLISHED?

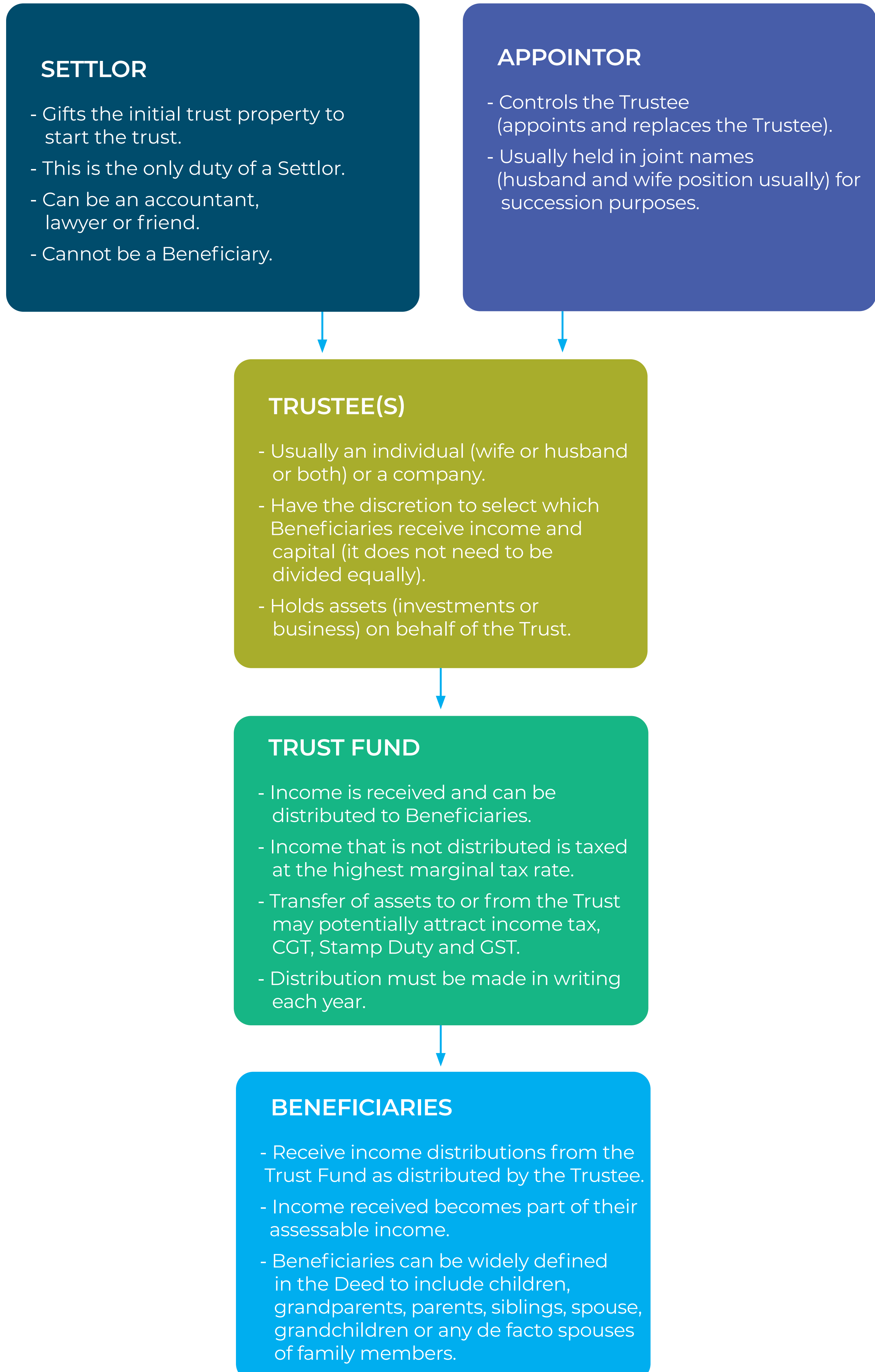
The Trust is established by an independent person (the Settlor) who makes a gift of a sum of money (the Settled Sum) to a person or company (the Trustee) for the ultimate benefit of nominated persons (the Beneficiaries) at some future time (the Vesting Day) under conditions which are evidenced in writing by the Settlor in a Deed. A Deed is similar to a contract at law, however a Deed requires no commercial exchange (i.e. no payment/consideration). The Settlor is usually your accountant or lawyer because the Settlor can't be a beneficiary of the trust.

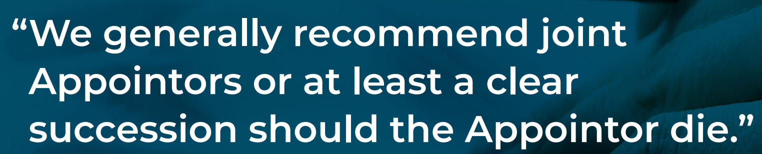
The Trustee may then acquire other income producing assets, including a business, for the benefit of the Beneficiaries upon the terms set out in the Deed.

A Trustee can, on behalf of the trust conduct a business operation, own shares in operating companies, own rental producing properties, carry out speculative ventures or any other activity that a company or individual can conduct without becoming liable to the income tax applicable to proprietary companies, i.e. the trust itself lodges a tax return and distributes profit to the Beneficiaries. A company acting solely as trustee generally does not need to lodge a tax return itself. In other words, a trust is not technically a seperate legal entity even though it may be treated as such for income tax and GST purposes.



STRUCTURE OF A DISCRETIONARY TRUST





> “We generally recommend joint Appointors or at least a clear succession should the Appointor die.”

ROLES, RESPONSIBILITIES AND TERMINOLOGY

The following should assist you in understanding the mechanics of the formation and operation of the Trust.

1. SETTLOR

The Settlor is the person who initiates the formation of the Trust by the provision of the Settled Sum. Apart from providing the Settled Sum and executing the Trust Deed, the Settlor takes no further part in the Trust operations.

2. APPOINTOR

The Appointor has power under the Trust Deed to remove and replace the Trustee as they see fit. Accordingly, the person holding the office of Appointor assumes indirect control over the whole operation of the Trust.

We generally recommend joint Appointors or at least a clear succession should the Appointor die. If there is no nominated successor, the Appointor's legal personal representative succeeds as the Appointor. Where an Appointor loses capacity (e.g. suffers dementia) and where an enduring power of attorney is in place, the attorney holder succeeds as the Appointor.

3. GUARDIAN

A Guardian is occasionally nominated under the Trust Deed and gives consent to distributions of income and capital by the Trustee. Certain powers conferred on the Trustee by the Trust Deed may be exercised only with the consent of the Guardian.

Many modern Deeds have done away with the appointment of a Guardian. We do not refer to this appointment further in this document.

4. TRUSTEE

The Trustee may either be a natural person or persons or, alternatively, a proprietary limited company usually incorporated specifically for the purpose of acting as Trustee. The Trustee can be liable for any of its actions in its capacity as Trustee (e.g. negligent acts, misrepresentations, fair trading breaches and for liabilities to unpaid creditors including the Tax Office, etc). Therefore, many business trusts have a “$2 company” acting as Trustee rather than having an individual trustee, whose personal assets could be exposed.

Therefore, where it is proposed to use the Trust as an asset holding vehicle or a trading vehicle, it may be appropriate to appoint a company as Trustee. This may avoid confusion between Trust assets and non-trust assets and also attracts the limited liability protection of a company.

Any individual discharging the function of a Trustee should always make it clear to other parties that he or she is acting in their capacity as a Trustee of the Trust, otherwise they may attract additional direct personal liabilities.

The Trustee is the legal owner of all property comprised in the Trust Fund, but that legal ownership is only held in the favour of those persons specified in the Trust Deed as Beneficiaries.

5. BENEFICIARIES

Beneficiaries are defined in the Trust Deed. As the Trust is a discretionary trust (as opposed to say a fixed unit trust), no Beneficiary has a vested interest in the Trust Fund and no Beneficiary can require the Trustee to exercise his discretion to appoint income or capital in their favour. The only right that a Beneficiary has is to require the Trustee to exercise his discretion bona fide and in good faith.

Under the terms of the Trust Deed, income may be distributed as desired annually in a tax effectives manner. This is done by the Trustee passing a resolution in writing to distribute the income. These advantages are obtained by distributing the Trust income among the whole series of Beneficiaries so that the benefit of lower marginal rates of tax can be obtained. Any one or more Beneficiaries can be excluded from the annual distribution as considered desirable. However, anti-avoidance provisions exist in the Tax Acts for various ‘sham’ arrangements.

6. VESTING DAY

The Vesting Day in most of Australia (except South Australia), is usually 80 years from the date of commencement of the Trust. That is, as a matter of law, the Trust must terminate or ‘vest’ at a date not later than 80 years after its commencement. However, a provision maybe included in the Trust, that enables the Trustee to nominate an earlier Vesting Day.

HOW DOES IT WORK?

The Trustee will contract on behalf of the trust in accordance with the terms of the Trust Deed. The Trust is required to get a Tax File Number (TFN) and where relevant, an Australian Business Number (ABN), GST registration, etc. and lodge a tax return. Other than that, there are no legislative provisions for registration of trusts and the naming of a trust is a question of personal preference.

The Trust Deed confers on the Trustee wide powers, which are usually sufficient to cover most commercial undertakings, enabling the Trustee to deal with and manage the Trust.

It is generally the Trustee who is empowered to distribute the income and capital of the Trust Fund.

Subject to the terms of the Trust Deed, in any year, the Trustee may deal with the income of the Trust in the following manner:

- All or any part of the income or capital may be paid out to any of the Beneficiaries in such proportion as the Trustee in their absolute discretion decides;
- Any part of the income not paid out is held in trust specifically for the Beneficiaries;
- If the Trustee so resolves in writing, all or any part of income can be accumulated, in which case the income would currently be subject to the highest marginal rate of tax under Section 99A of the Income Tax Assessment Act 1936.
- The powers of the Trustee in dealing with the capital of the Trust Fund, are generally subject to the terms of the Trust Deed are as follows:

    - The capital of the Trust Fund is generally distributed on the Vesting Date amongst the Beneficiaries nominated in the Deed (or, if they are deceased, among their children or grand children) in equal shares, unless the Trustee by Deed made prior to the Vesting Date, appoints the capital in favour of the Beneficiaries in other specified proportions.

    - Any part of the capital may be advanced for the benefit of one or more of the Beneficiaries from time to time at the discretion of the Trustee.

WHAT IS A FAMILY TRUST AND A FAMILY TRUST ELECTION?

Historically the words “family trust” were quite often used interchangeably with the words “discretionary trust”. However, a family trust for tax purposes is a distinctive term. For tax purposes, a family trust is one where the trustee has made a valid family trust election (FTE).

An FTE allows the trust to access certain tax concessions, and the election is typically made in circumstances including:

- There is a carried forward tax loss or bad debt in a discretionary trust and the ability to offset the tax loss against future taxable income or utilise the bad debt deduction, is technically much easier from a tax perspective if an FTE is done.
- A company which has losses and is owned by (the trustee of) a discretionary trust similarly has an easier tracing provision to access those losses if that shareholder trust has made an FTE.
- In many circumstances, the beneficiaries of a discretionary trust may not be able to access franking credits on franked dividends received by the trust unless the trust has done an FTE.
- Trusts that have made an FTE are excluded from having to comply with the Trustee beneficiary reporting rules.
- For the purposes of the capital gains tax small business restructure roll-over, there is easier access to these CGT roll-over concessions (applying where the trust it is part of the restructure), if the trust has done an FTE.

The trade-off of accessing these tax advantages availed through the FTE election is that family trust distributions tax (typically the maximum tax rate plus Medicare levy), is imposed when distributions are made outside the family group.

REVIEW

Legislation affecting discretionary trusts is often the subject to change. Trustees should therefore review trust deeds regularly to ensure that the trust remains relevant and is an effective structure that can be adapted to changed business, family and legislative environments.

You should periodically seek advice on the suitability of the structure, particularly where financial or family situations change in subsequent years or the tax rules relating to trusts change.

"You should periodically seek advice
on the suitability of the structure,
particularly where financial or family
situations change in subsequent years or
the tax rules relating to trusts change."

MOORE AUSTRALIA

At Moore Australia, it's not about us. It's all about you. When it comes to providing personalised and commercially astute audit, accounting, tax and business advisory services, it simply can't be anything else.

Our focus is about understanding you, your business, your needs, your challenges and, most importantly, how you define success. At Moore Australia, we're here to help you thrive in a changing world. We are mid-market specialists, so we truly understand your operating environment. What's more, all of our people are long-standing members of their local business communities, and when we work with you, we immerse ourselves in your world. We treat your business like it's ours and we give you all the time you need when you need it. We share our skills, expertise and knowledge, examining every detail and leaving nothing unnoticed.

So when you think about Moore Australia, think of us delivering the personal service and local market knowledge that you want, backed by a leading national and international network of expertise, knowledge and advice that you need to succeed. It's that simple.

CONTACT US

Find your nearest member firm at
www.moore-australia.com.au

Or email:
ma@moore-australia.com.au

An independent member of Moore Global Network Limited – members in principal cities all throughout the world.
Liability limited by a scheme approved under Professional Standards Legislation.

The information provided in this document is for general advice only and does not represent, nor intend to be advice. We recommend that prior to taking any action or making any decision, that you consult with an advisor to ensure that individual circumstances are taken into account.