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SIMPLE SOLUTIONS

Family Trusts Explained

The term "Family Trust" refers to a discretionary trust usually set up for the benefit of one family to hold assets or conduct a family business. They are generally set up for asset protection and tax purposes.

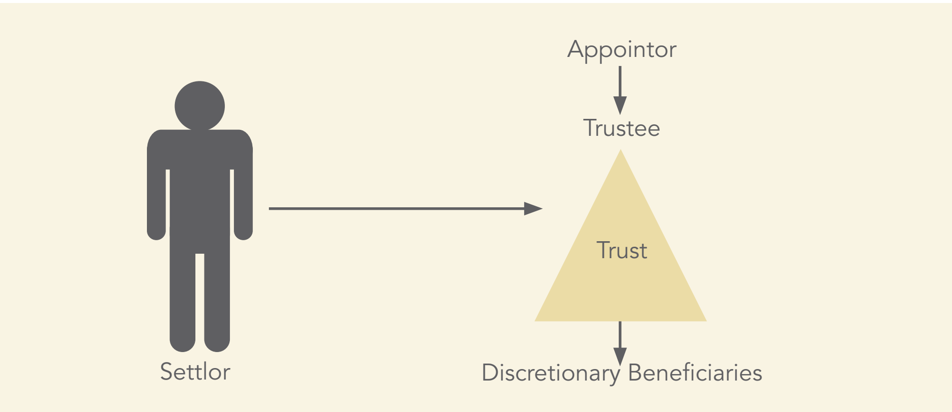
What is a Trust

A trust is basically a legal structure whereby a person or company (the trustee) holds assets on trust for the benefit of a group of beneficiaries. In a family trust, the beneficiaries are usually all related, however they can also include family companies, other family trusts and charities.

The trustee is responsible for the trust and its assets and has day to day control over the management of the trust. The terms of the trust will be set out in a Trust Deed between the person who originally sets up the trust (this is usually a solicitor or accountant and is known as the settlor) and the trustee.

The appointor is the person with real control of the trust. The appointor has the power to hire and fire the trustee in his or her discretion.

A basic trust structure is shown in the following diagram:



What is a Discretionary Trust

With a family or discretionary trust, the trustee has discretion as to which beneficiaries will receive income and capital from the trust. This is distinct from a fixed trust (such as a Unit Trust) where the beneficiaries' entitlement to the income and capital of the trust are fixed.

If the Trust is set up correctly, the trustee can also decide to distribute different types of income to different beneficiaries. For example, the trustee may decide to distribute franked dividends to one beneficiary and capital gains to another. The capacity for the trustee to decide how to distribute the income each year means family trusts can be very tax effective structures.

Asset Protection

While the trustee has legal ownership of the trusts assets, the trust assets cannot be used to satisfy debts owed by the trustee in his or her personal capacity. Similarly, the assets of the trust are generally protected from creditors of the beneficiaries, unless the trust owes money to the beneficiary. It is important to note that a beneficiary cannot force a trustee to distribute income or capital to the beneficiary in any year. This means if a beneficiary becomes bankrupt, the trustee is not obliged to distribute any income to that beneficiary and may choose not to do so until the bankruptcy has ended.

Once a person transfers assets from his or her own name into a trust the person ceases to be the owner of the assets. This means if the person is subsequently sued, the assets should be protected, provided they have not been transferred into the trust with the intention of defeating creditors or gifted to the trust in the four years before the transferor went bankrupt.

Family Trusts can also be used to help avoid or reduce challenges to a Will following the death of a family member. Generally disgruntled beneficiaries can only claim against assets which are in the estate of the deceased person. As the assets in a family trust do not form part of the estate of the deceased person, if set up correctly they will essentially be quarantined from any claims against the estate.

Pitfalls

Family trusts are not, however, without some pitfalls. Disputes can arise where control of the trust is passed down to the next generation. The problem is the assets are all tied up together and when moving from the first generation to the next, the assets will need to be controlled by and distributed amongst a greater number of people. It is therefore important to have an appropriate succession plan in place so that the control of the trust passes to the right people at the right time. This includes succession of the role of appointer, trustee and the directors and shareholders of any corporate trustee.

It is always important distributions are made in accordance with the Trust Deed and the proper records are kept regarding distributions. Distributions of income which are decided upon but not paid to the beneficiary become a debt owing by the trust to that beneficiary and you need to obtain advice from an accountant to ensure you are complying with the taxation legislation in this regard.

The decision to establish a family trust involves many factors and we strongly recommend you obtain professional advice from both a solicitor and an accountant to ensure the trust is set up and managed correctly.

This information sheet is provided for general information only and does not constitute legal advice. For advice on your circumstances please contact us on 5443 1566