brennan law partners

Guide to Trusts

The 101 of Trusts

Trusts

Trusts can be an effective way to structure businesses or family assets to protect against liabilities and to share income for tax benefits. Trusts are especially popular for families and small businesses looking for some protection and tax benefit.

There are a number of different trusts that can be utilised, each with varying benefits and downfalls.

What is in a Trust?

Each trust must have 3 things:

1. A TRUSTEE – the person (or company) who holds the trust property for and on behalf of the nominated beneficiaries.
2. A BENEFICIARY OR BENEFICIARIES – the person(s) for whom the trust property is held. The beneficiary is the ultimate owner of the property and receives all of the benefits of the property.
3. TRUST PROPERTY – the property can be anything of value including real estate, money, personal effects, shares, intellectual property, contractual rights (basically anything that can be owned and transferred)

How is a trust created?

Trusts are generally created by a Deed. A Deed is a written agreement which identifies all of the necessary elements and parties to the trust, and sets out the terms of the trust.

There is, of course, legislation which governs trusts and their management, but priority is given to the terms identified in the trust deed (excepts in relation to tax and criminal matters).

A trust is an arrangement for holding property.

Legal title to the property is held by the trustee, and is managed for the benefit of nominated persons or companies.

Types of Trusts

There are a number of various trust structures available, and each suit different situations.

Fixed Trusts

Fixed trusts clearly define the proportions by which the beneficial property is to be provided to the beneficiaries. There is no discretion for the trustee to distribute the property in any manner other than that which is identified.

There are two main examples of fixed trusts – bare trusts and unit trusts.

Bare Trust

Bare trusts are the most simple trust structures, and are established simply for one party to hold property for the benefit of another (or others), to be transferred once an identified pre-condition has met.

Bare trusts are commonly used where a child is intended to be the owner of a property but is not yet able to be registered as an owner due to their age. Accordingly, under a bare trust, the property is to be held on trust until title can be transferred when the child reaches a certain age.

For example, Tony Trustee is to hold the property at 123 House Street until Billy Beneficiary attains the age of 21 whereby legal title to the property will transfer.

Unit Trust

A slightly more complicated structure than a bare trust, a unit trust sets out that each beneficiary is entitled to a fixed percentage of the trust assets.

For example, Tony Trustee holds the property at 123 House Street for the benefit of his 4 kids. In the unit trust, there will be 4 units, entitling each child to 25% of the property.

The benefit of the unit trust is that the underlying beneficial ownership can easily be changed by selling, transferring or issuing new units. If a new beneficiary is to be added, a new unit in the trust is created (thereby diluting each beneficiaries share to 1/5th).

Discretionary Trusts

Discretionary trusts vest the trustee with the responsibility of dividing the trust income and assets between the beneficiaries, in the manner in which the trustee sees fit (subject to any terms of the trust deed).

Discretionary trusts are very common for family structures, particularly family businesses, allowing trust income to be split between family members to obtain tax benefits.

There are two common examples of discretionary trusts – family trusts and hybrid trusts.

Family Trust

Family trusts are set up so that the trustee holds assets on behalf of the family members as beneficiaries. The trustee can distribute the income and assets of the trust between the beneficiaries in a discretionary manner. This allows the family members to obtain tax advantages and protect the assets from potential creditors or claimants.

Look at the following example:

Tony Trustee is the trustee of the family trust which holds a number of investment properties. Tony, his wife Betty and their sons Bobby and Billy are the beneficiaries.

The income for the trust is $50,000. Tony's personal income is $70,000. Betty's income is $40,000. Bobby and Billy are currently at university and only work part-time. Bobby's income is $10,000. Billy's income is $12,000.

If Tony distributes $8,200 of the trust income to Bobby and $6,200 of the trust income to Billy, no tax will be paid on that $14,300 portion of the trust income as both Bobby and Billy's income remain below the tax free threshold (currently $18,200).

Tony can then distribute the remaining $35,700 of trust income between himself and Betty. To avoid bringing either of their incomes within the higher tax bracket, Tony could distribute $15,000 to himself and $20,700 to Betty.

In this case, Tony will have minimised the tax payable on the trust income.

Hybrid Trust

As the name suggests, hybrids trusts have elements of both fixed trusts and discretionary trusts. The discretion given to the trustees is limited and is set out in the terms of the trust deed.

Testamentary Trusts

Testamentary trusts are created by the Will of a deceased person. Testamentary trusts are commonly used to protect the bequeathed assets and to avoid potential problems should a beneficiary encounter financial or relationship difficulties.

Instead of property passing directly to the beneficiaries under a Will, the testamentary trust establishes a separate trust for each of the beneficiaries. Each of the beneficiaries become the trustee of their respective trust and maintain discretionary power to decide who the beneficiaries of that trust are and how and when the trust property/assets are to be distributed.

The existence of the trust structure may prevent claims being made on the trust property by creditors, ex-partners, children's spouses, and may also limit the tax exposure of the beneficiary.

Constructive Trusts

There are also situations where a Court will step in and create a trust without regard to the intention of the parties. Where it would be equitable fraud to deny the existence of a proprietary interest in a party, the Court may 'construct' a trust to ensure that a fair outcome is achieved.

Obligations for Trustees

Trustees owe strict duties to the beneficiaries of the trust to ensure that the trust funds and assets are properly managed.

Trustees duties include:

- duty to avoid conflicts of interest
- duty to act prudently
- duty to act personally (that is, they cannot have someone else perform their trustee duties on their behalf)
- duty to act in the best interests of the beneficiaries
- duty to act impartially
- duty to keep trust funds separate from their own
- duty to act gratuitously and not derive income from their role as trustee unless it has been expressly agreed by or conferred by the trust deed or the beneficiaries
- duty to invest prudently
- duty to not purchase trust property
- duty to keep accounts
- duty to allow beneficiaries to access trust documents

If a trustee breaches their duties and loss is suffered by the trust, the trustee may be personally liable to make good the loss.

How can Brennan Law Partners assist?

We can provide assistance and advice with respect to:

- Appointing/Creating a trust
- Advising beneficiaries
- Advising trustees
- Advising regarding a dispute under a trust
- Making a Will
- Estate Planning

If you have any questions regarding any information in this BLP Guide, we welcome you to contact us at any time.