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FACT SHEET

Discretionary (Family) Trusts

Discretionary trusts are a versatile structure that many people can, and do, use to their advantage for a broad range of business activities. Whether it be a trust that trades, holds shares in an operating company, or holds personal assets, they can provide benefits such as protecting assets, distributing income, and minimising tax obligations if setup correctly.

We receive a high volume of questions about trusts because of their well-known benefits and as such, have answered some FAQs below.

What is a Discretionary Trust?

A trust is a relationship between a person or company, (the trustee) that holds legal title to property for the benefit of others (the beneficiaries). A discretionary trust is whereby the trustee can exercise their discretion as to which beneficiaries receive a distribution of income from the trust property. Beneficiaries can receive distributions of income or capital from the trust.

Who are the key players in a Trust?

Trustee
The trustee is who you trust to own all of your property legally and could be yourself or the company you act as a director for. You may want to retain the responsibility at arm's length and instead, appoint someone you trust such as your spouse, close friend, family member, or a professional.

Importantly, acting as a trustee can expose you to significant risks. Trustees must always act in the trust's best interests. They're unable to conduct any act which may further their interests ahead of the trust. For example, a trustee cannot sell their property to a trust. Another clear breach would be where the trustee uses the trust to purchase property for above market value. Even if the trustee buys the property at a fair market value, they may still have breached their duty if they prioritised their investment over an available and more suitable option.

This role attracts a significant amount of control of the trust property so ensure that the trustee will represent the best interests of the trust property.

Appointer
If the trustee dies, annoys you, or is no longer able to act as trustee, the appointer is the person that provides a replacement. They're also responsible for determining whether the trustee gets paid for their assistance running the trust.

Settlor
A settlor is a person that puts the first property into the trust (known as settlement/gift and usually for a nominal sum of $10). They need to be unrelated to the trust and not to receive any benefit from it. Typically, you could use a lawyer, accountant or friend.

Is the trustee subject to any rules or regulations?

In short, yes! The trust deed sets out the scope of a trustee's powers. So, if you have specific requirements, consider drafting a deed to limit/constrain/manage their powers. Trustees are also subject to a variety of other requirements imposed by both common law and statute.

Importantly, a trustee has a fiduciary relationship with the beneficiaries. This relationship exists because of the trust placed in the trustee. To protect those in a vulnerable position (those putting trust in the trustee) the law recognise this special relationship and places duties on the trustee to ensure they act in good faith and the best interests of the trust.

What's the difference between a trust with a Corporate Trustee and without a Corporate Trustee?

A trust without a corporate trustee will have a person that legally owns the property on trust for the beneficiaries. A corporate trustee is a company that is established to hold legal title to the property in trust for the beneficiaries.

What are the benefits of the Trustee exercising discretion to distribute income?

Beneficiaries have no claim to any portion of the trust income and only receive a benefit when the trustee exercises their discretion and distributes the income. The effect of this is that the status as a beneficiary does not result in a tangible gain or proprietary interest in the trust property. As there is no claim to the property, you're not subject to tax implications if you don't receive a distribution.

Disadvantages can include that the trustee can stop distributions to a particular beneficiary at any time, and a beneficiary can do little to change this arrangement. This can present a problem should a dispute arise with the trustee (for example, a family fall out) and is a key reason why you should exercise great care when selecting a trustee.

What's the difference between a Family Trust and Discretionary Trust and do all beneficiaries have to be from the same family?

A family trust and discretionary trust are essentially the same. The trustee maintains the discretion to distribute income as they see fit. It's more likely, however, that the beneficiaries are all members of the same family. As a family trust is simply a commonly used term, rather than a requirement that the beneficiaries all be from the same family, there's no restriction on you listing people outside your family as a beneficiary.

Who owns the Trust Property?

Unlike a person or a company, a trust is not a legal entity that can own property because a 'trust' is just a relationship between the legal owner (the trustee) and the beneficial owners (the beneficiaries). As such, documents including a house title, share certificate, or members' register, will list the trustee as the owner of the property. For example, if I were the trustee of a trust and purchased a house, the owner would be listed as "Thomas Richman as trustee for the XYZ Family Trust". If the trust had a corporate trustee, then the owner would be listed as "ABC Pty Ltd as trustee for the XYZ Family Trust".

Can beneficiaries claim distributions?

Beneficiaries do not have a claim to any trust distributions, rather a 'mere expectancy' that the trustee may distribute income if they so choose (hence the term "discretionary" trust).

A beneficiary can request that the trustee act in a particular way through a document known as a Memorandum of Wishes. This document can outline an arrangement that the beneficiaries may like to have in place but, as the name would suggest, it's merely a "wish" rather than an order that the trustee act in a certain way. This is another important reason why you should only appoint a trustee that you trust!

Can a Trustee also be a Beneficiary of a Trust?

Yes, a trustee can be one of the beneficiaries of a trust. For example, an individual could set up a trust, appoint themselves as trustee and distribute income to their family. However, a trustee cannot be the sole beneficiary of a trust. This is because they would be legally owning property for the benefit of themselves, which is problematic from a legal perspective.

Should I incorporate a new company to act as Corporate Trustee?

Generally, yes. As the trustee is the legal owner of the trust property, you should consider setting up a new company so there is no risk of the company having any previous liabilities that may affect the trust property. For example, liability may arise if you use a company that is currently trading (or has previously traded) and incurred a debt with the ATO, is subject to an unfair dismissal claim, or has a pending court case. As the company is the legal owner of the trust property, there is a risk that creditors who are owed money could claim the trust property.

What are the types of Beneficiary?

Companies and individuals can be beneficiaries of a trust, and they'll fall into one of the following categories:

Primary Beneficiaries
The primary beneficiaries are those whom the trust specifically names. In a trust set up for a family, this will most often be the husband and wife, de facto partners, etc. The relationship with the primary beneficiaries will typically define the classes of the beneficiaries (see below).

General Beneficiaries
These are the people that fall within a particular class of beneficiary depending on their relationship with the primary beneficiaries. For example, if a trust deed stated that general beneficiaries included brothers, sisters, children, grandchildren or other descendants, whether a person falls

into the class of general beneficiaries depends on their relationship with the primary beneficiaries.

Income Beneficiaries

Money that is generated by the trust (for example, through interest earned on trust money in a term deposit or rent earned from a residential property owned by a trust) can be distributed to a beneficiary.

Capital Beneficiaries

Capital beneficiaries may receive distributions of capital from a trust but not any income that is earned by trust assets.

Default Beneficiaries

Distributions are made by default to these beneficiaries unless the trustee decides they'd like to distribute it to others.

Can people under 18 be a Beneficiary?

Yes, but you should be aware that if a trustee distributes income to someone under the age of 18, they will be subject to a substantial amount of tax.

Can I transfer property I already own into a new Trust?

You sure can! You should know that the transfer of property into a trust will generally be classed as a sale. This can be an expensive exercise as, in addition to the appropriate sales contracts/agreements, this can incur Capital Gains Tax and stamp duty. Ensure that you speak with an accountant if you're looking to establish a trust and transfer existing property.

Can a Trust trade as a business?

It sure can! Approximately 5% of all businesses in Australia are operated through a trust. If you're going to run a business through the trust, you'll require an ABN. As with all trust property, the trustee will own the business' assets.

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