

For various reasons, accountants, financial planners and other advisors may suggest that you accumulate part of your family's wealth through a discretionary trust (more commonly known as a family trust).

Family trusts are used for:

- Flexibility of income and capital distributions
- Potential income tax benefits
- Providing financial support for minors or people with incapacities
- Less regulation than companies
- Protection of assets

It is important that you understand the way in which a family trust operates before deciding whether it is a suitable investment structure for you.

What is a Family Trust?

A family trust is created when property (usually money) is given to a person or company (the trustee) by a third party (the settlor) and the trustee holds that property for other members of a family (the beneficiaries of the trust).

To create a trust, the settlor and the trustee agree on the rules and conditions under which the trustee must hold any trust property. They sign an agreement called a trust deed containing these rules.

The trust deed also contains the names of the beneficiaries. The range of beneficiaries of a family trust usually extends to a wide class of people. The group can include you, your spouse, children, grandchildren (existing and future), parents, brothers, sisters, etc. The person who created the trust (the settlor) cannot be a beneficiary of the trust.

The trustee has complete discretion over the distribution of income from the trust or the trust property itself. None of the beneficiaries have a right to require any income or capital to be distributed to them from the trust.

It is this feature of a family trust that gives it a great degree of flexibility. Depending on the circumstances of the trust and the beneficiaries from year to year, the trustee can exercise that discretion differently.

How is a Family Trust taxed?

If the trust has income, the trust itself will not pay any tax provided all of the income of the family trust is paid out to adult beneficiaries who live in Australia. The beneficiaries then pay tax on their share of trust income. The trustee can distribute income among the beneficiaries in the most efficient manner.

For example, if one of the adult beneficiaries of the trust earns little or no income in a particular financial year, the trustee may decide to distribute income to that beneficiary because he or she will pay no tax on that distribution. You should seek professional advice from your accountant or tax agent to help you decide how trust income should be distributed in each year.

Who should be the Trustee?

The trustee can be just one person, a number of people, or a company. If you do decide to use a company as trustee there will be some additional expense in setting up and maintaining that company.

Because the trustee has wide powers under the trust deed to deal with trust property and an absolute discretion to decide which of the beneficiaries receives distributions from the trust, it is important that the trustee be either you or a company controlled by you.

If the amount of property or assets of the trust is particularly large, you may need to have a company as trustee to provide adequate asset protection.

It is usual for the trust deed to give power to a nominated person (usually referred to as the appointor) to remove and appoint trustees. Usually the first appointor will be the person who initiates the setting up of the trust.

Generally the trust deed provides that the power of appointment can be passed on to another person nominated by the appointor. For example, if you are the appointor named in the trust deed, you could nominate your spouse as your successor in your Will. If you do, you should reconsider your Will when your personal circumstances change significantly to ensure the appropriate person gains your power of appointment.

How does the Trust acquire the assets?

The trust deed specifies the powers of the trustee. The deed will invariably allow the trustee to purchase assets and property. The trustee will also have the power to borrow money from banks and other financial institutions and also from the beneficiaries, in order to carry out transactions.

Most banks will lend to trusts if they have been provided with a copy of the trust deed and are satisfied that there are adequate assets in the trust to cover the loan. If a company is trustee, directors' guarantees may also be required.

Money or other assets can also be given to the trust (by the settlor or any other person). Professional advice should be sought before this occurs as tax and stamp duty costs may be incurred.

How long can the Trust last?

Due to recent changes to legislation, a trust may now continue indefinitely.

Most trust deeds provide that the trustee can terminate the trust at any time determined by the trustee. When the trust is wound up, the assets of the trust are distributed among the beneficiaries in the manner decided upon by the trustee.