



# The Practice Managers' Guide to Family Trusts and Unit Trusts

McMasters' Medical Practice Management



**McMasters' Medical Practice Management**

71 Tulip Street, Cheltenham Victoria 3192

PO Box 68 Sandringham Victoria 3191



## **The Practice Manager's Guide to Family Trusts and Unit Trusts**

---

### **Introduction**

---

The Practice Managers' Guide to Family Trusts and Unit Trusts has been developed to help explain the commercial advantages and disadvantages of conducting an investment or a business through a family trust or unit trust. It contains numerous practical tips and advice, and identifies the various planning opportunities and pitfalls giving consideration to how trusts may be used to create and protect wealth. It has been identified as an area where practice managers and doctors alike have a keen interest, and a lot of important information is contained in the guide.

The income tax, capital gains tax and asset protection attached to trusts means that they are often the preferred method of structuring a business or investment activity. This is particularly appropriate

where more than one un-related party is involved: for example, two separate family groups who are buying a commercial property together. However, it is also relevant when the business is of modest size.

This guide explains the roles played by the various parties to trusts, including the trustee, the beneficiaries, the appointor and the settlor. The trustee's duties are described, a sample trustee minute is provided and the life cycle of a typical family trust is explored, including the procedure for ending the trust.

Topics included in this guide include:

- Explanation of a family trust;
- Roles of the various parties;
- Advantages of family trusts;
- Family trusts as a retirement vehicle;
- Explanation of unit trusts;
- Advantages of unit trusts.

Further reading on this topic is encouraged and will be identified throughout the guide.

## 7.1 FAMILY TRUSTS

A family trust is a discretionary trust where the beneficiaries are all, or predominantly members of the same family. To differing degrees the beneficiaries see themselves as a common economic unit, and are happy for trust income to be distributed in a way that satisfies their common interests and objectives. Frequently these common interests and objectives include minimising the total tax paid on the trust's net income.

However, this raises the question "What is a 'discretionary trust'?" Indeed, what is a "trust"?

Trusts originated in England hundreds of years ago. Their original purpose was to avoid feudal dues payable on land transactions. A landowner would give a piece of land to a friend to "hold on trust" for his descendants thereafter. This arrangement avoided paying dues as the land passed from fathers to eldest sons, through the generations.

Modern trusts are far more evolved and sophisticated than these early primitive trusts; although, they have not lost their original tax planning advantages.

A modern trust is a fiduciary relationship rather than a legal person. The relationship requires one person to legally own an asset for the benefit of another person or set of persons, or in some cases, a purpose (e.g. a charitable cause). The person who legally owns the asset is called the trustee, and the person or persons for whose benefit the asset is held is called a "beneficiary" or, collectively, and rather pompously but rarely, the "cestui que trust".

A trust is defined in Underhill's Law Relating to Trusts and Trustees as follows:

*"A trust is an equitable obligation, binding on a person ("trustee") to deal with property over which he has control ("trust property") either for the benefit of persons ("beneficiaries") of whom he may be one, and any one of whom may enforce the obligation, or for the advancement of certain purposes."*

Most Australian businesses are carried on in trusts. Trusts can be small, for example, a family trust may own a small unit with a cost of less than \$80,000, or they can be very large: some of the managed investment trusts have more than 20,000 unit holders or beneficiaries. A trust can be very short lived, as is the case, for example, when a deposit for a house is left with an estate agent; or a trust can be very long lived, as is the case, for example, for most family trusts which may last for up to eighty years. The life cycle of a typical family trust is set out in [appendix 1](#) at the end of this guide.

Most trusts are evidenced by a trust deed. This is a legal document prepared by a solicitor which sets out the purpose of the trust, the rights and obligations of the beneficiaries, the powers of the trustee, and the identity of the beneficiaries, the trustee and the appointor. A formal trust deed is not essential to create a trust. But it is highly recommended and in practice mandatory, for taxation purposes at least.

### **Discretionary trusts**

The phrase "discretionary trust" deserves specific comment. Most family trusts are discretionary trusts. The word "discretionary" refers to the power or discretion the trustee has to decide which beneficiary or beneficiaries get the net income and the capital from the trust each year, or on winding up the trust. These discretionary powers are the critical element in creating the income tax, capital gains tax, asset protection and social security advantages of a trust and these are discussed in detail below.

So, in summary, a family trust usually involves a trustee (typically a shelf company) holding an asset on trust for the benefit of a group of family members known as "the beneficiaries". Family members usually own the trustee company's shares, and therefore it is they, through the trustee company, who decide how the trust's assets and income are dealt with. The trustee is appointed by a person called the "appointor" (or in some older deeds "the guardian"). The appointor is usually nominated in the schedule to trust deed, and is typically the person (or persons) who decides to set the trust up in the first place.

An important point to note is the nature of the duty owed by the trustee to the beneficiaries. It is one of the "utmost good faith" and it requires the trustee to act in the best interests of all of the beneficiaries at all times. This is the highest duty recognised by the law and requires the trustee to put the interests of the beneficiaries above those of the trustee at all times. The duty of utmost good faith stops the trustee from using the assets for its own purposes, and not for the benefit of the beneficiaries.

## **7.2 PARTIES TO FAMILY TRUSTS**

### **The beneficiaries**

The beneficiaries are the persons for whose benefit the trustee holds the trust property.

In most trust deeds the "primary beneficiaries" will be specified, and will usually be the people setting up the trust, and perhaps their children or other close relatives. The "general beneficiaries" will be defined by reference to the primary beneficiaries. For example, the class of persons who are general beneficiaries will usually be the parents, grandparents, brothers, sisters, children, grandchildren, aunties, uncles, nephews, and nieces of the primary beneficiaries. It is common for the definition to also include any private company or trust in which any natural person general beneficiary has an interest or expectancy.

Most of the advantages of family trusts stem from the trustee's discretion over which beneficiary receives net income distributions or capital distributions from the trust each year, or on the vesting of the trust. Because of this discretion the law does not recognise any property right in a beneficiary over the assets owned by the trust. This is because no single beneficiary owns the assets held in the trust. The trustee has legal ownership but not beneficial ownership of these assets, and is required to hold them for the benefit of the family members who are specified in the trust deed to be the beneficiaries of the trust.

As a group the beneficiaries own the assets, but no one beneficiary owns them, or part of them. This means it is usually not possible for a beneficiary to unilaterally do something that places the trust's assets at risk. Therefore, if the beneficiary becomes bankrupt there is usually nothing the trustee in bankruptcy can do to get his hands on the trust's assets (unless of course the trust has mortgaged the assets or guaranteed the performance of the beneficiary's debts, or otherwise involved itself in the bankrupt beneficiary's affairs).

Primary beneficiaries do not have any greater rights over the trust property than general beneficiaries. In fact, as indicated above, they do not have any rights at all: they only have an expectation that the trustee may exercise its discretion in their favour.

### **The appointor**

The appointor is the person who decides who will be the trustee of the trust. The appointor controls the trust; if the trustee did not follow the appointor's directions, the appointor would simply sack the trustee and appoint a more compliant trustee in its place. The appointor is normally the person or persons who decided to set up the trust originally. This is normally the doctor and, if the doctor is married, the doctor's spouse.

The "initial appointor" is usually specified in the trust deed. The deed normally states that the initial appointor may resign as appointor and instead nominate in writing some other person(s) as appointor in his or her place. If an appointor dies without making such a nomination then the deceased appointor's legal personal representative will become the appointor of the trust, subject to the trust deed.

### **The trustee**

The trustee is normally a shelf company owned by the client and set up specifically to act as trustee of the trust. The shareholders and directors control the trustee. The trustee legally owns the trust property but does not beneficially own the trust property. Beneficial ownership of the trust property lies with the beneficiaries.

The trustee can also be any competent natural person over the age of 18 who is not bankrupt or under some other legal disability.

The appointor, is the person who really controls the trust. This is because the appointor can terminate the trustee's appointment and appoint an alternative person as trustee in its place. The advantages of using a company as a trustee are that:

- (i) having legal ownership of the trust's assets in the name of the company makes it very clear that they do not belong to the individuals, and this means they are less at risk, particularly if the individual is in a risky business or profession;
- (ii) the company may stay in existence virtually forever, and will not die or become unable to manage its own affairs. This means things are simpler and there is less bother with changing trustees and re-registering ownership with authorities such as the various state Titles Offices;
- (iii) the reach of the Family Law Court is reduced, in some circumstances;

- (iv) the directors or other persons who control the company can exercise defacto control without being personally involved in the trust.

The disadvantages of using a company as trustee are largely the extra cost of setting up and running a company each year.

The full duties of a trustee are set out in [appendix 2](#) at the end of this guide.

### **The settlor**

The settlor (or, sometimes, the grantor) is the person who the law treats as establishing the trust. This is really a legal fiction: the settlor is usually someone connected to the trustee and the beneficiaries such as a friend or an accountant who pays a nominal sum, say \$10, to the trustee to formally establish the trust. Obviously the bulk of the trust's initial assets will be contributed later by the client and related persons, not the settlor.

Most modern trust deeds will contain a clause saying that the settlor is not able to benefit under the trust deed. This is because of a tax rule that may create a tax charge for the trust if such a clause is not included in the deed.

Sometimes clients are concerned that the name of a person such as their accountant appears in the trust deed, and query whether this creates rights in favour of that person. It does not. The role of the settlor is a mere formality once the trust starts, and the settlor has no rights whatsoever in respect of the trust. Inserting the accountant's name in the deed as the settlor is a convenient convention and is a simple way of setting the trust up.

## **7.3 ADVANTAGES OF FAMILY TRUSTS**

The major advantages of a family trust are:

- (i) income tax advantages;
- (ii) capital gains tax advantages;
- (iii) asset protection advantages; and
- (iv) as retirement planning vehicles.

Each of these advantages are dealt with in turn in the following paragraphs.

### **Income tax advantages**

A major advantage of a family trust is the ability of the trustee to select the person to whom the trust's net income will be distributed each year. Provided certain formalities are observed, which are discussed below, and subject to one qualification, which is also discussed below, trust net income may be distributed amongst the beneficiaries in a way which minimises the total income tax payable on it.

For example, a family trust controlled by a doctor may have two beneficiaries who are over the age of eighteen and who have no other taxable income. The trust has net income of \$10,000 attributable to administration services provided to the doctor's medical practice. The trustee may resolve to distribute \$5,000 to each of the two beneficiaries and, if it does so, no income tax will be paid on the

\$10,000 so distributed. Had the doctor derived the \$10,000 of income personally, income tax of \$4,800 would have been payable this year and provisional tax of about \$5,200 would have been payable early in the following year (for offset against the following year's income tax).

The family trust has therefore saved the doctor \$4,800 in tax each year forever. After ten years, at ten per cent interest, this accumulates to more than \$100,000 in total cash savings. After twenty years this adds up to more than \$300,000 in total cash savings.

### **Capital gains tax advantages**

Family trusts have capital gains tax advantages compared to companies. This is because the 50% discount factor on capital gains disposed of within a year applies to trusts but does not apply to companies.

Specific advice should be sought from your accountant before deciding to acquire a specific asset in the name of a trustee of a family trust.

### **Corporate beneficiaries**

Family trusts can be combined with private companies to get the benefit of the 30% tax rate currently applying to private companies. This is done by arranging for the trust to distribute net income to the trust each year. The main rule here is that the cash must be actually paid over to the corporate beneficiary, and then retained in the corporate beneficiary. If this does not happen there is a risk that special anti-avoidance rules applying to private company loans may apply.

Specific advice should be sought from your accountant before deciding to distribute net income to a corporate beneficiary.

### **Asset protection**

Another major advantage of a family trust is the ability to put valuable assets beyond the reach of potential creditors. We have seen family trusts save the day many times.

In most cases assets transferred to a family trust may not be able to be accessed by creditors if the transferor gets into financial difficulty or even goes bankrupt. This is because the transferor has no interest in the transferred property and has no interest in the family trust which is recognised at law.

For example, a doctor acquired a home worth \$1,300,000 through a family trust and rented it back off the trustee. The doctor also acquired a share portfolio worth \$200,000 as an inheritance from a grandparent: the doctor's family trust was the beneficiary under the grandparent's will. Some years later the doctor guaranteed a large business loan for his brother. The brother's business collapsed and the bank called up the guarantee. The bank could not touch the family home and the share portfolio. These assets simply did not belong to the doctor. They belonged to the trust. As a result the bank could not do anything to get its hands on these assets.

This asset protection can go on down through the generations. For example, if the doctor dies and leaves the share portfolio and the family home to a daughter, these assets will be a marriage asset should the daughter's husband one day divorce her. If these assets remain in the family trust they

will normally not be marriage assets in a divorce situation. This means that the (ex) son-in-law gets nothing. The same thing happens if a son gets into business difficulties or investment difficulties and is sued by creditors.

If necessary, your family trust's deed can be amended to make it more restrictive and protective of the next generation once control passes to it. For example, special rules can be inserted to guard against spendthrift children, or their spouses. Your accountant can advise you further on this.

#### **7.4 FAMILY TRUSTS AS A RETIREMENT VEHICLE**

Increasingly family trusts are being seen as retirement vehicles, either in conjunction with a self-managed superannuation fund, or as an alternative to a self-managed superannuation fund. Family trusts have the advantages of being able to acquire assets from related parties, borrow money, hold lifestyle assets such as holiday homes and company cars, are not subject to heavy prudential regulation, and do not need to be audited each year.

Careful tax planning can mean the effective tax rate on the trust's income is less than 15%, being the tax rate faced by most self-managed superannuation funds. The planning can be as simple as paying a deductible superannuation contribution to a self-managed fund each year, sufficient to reduce the trust's net income to a level where the effective tax rate is less than 15%.

Your accountant can advise you further on how this can be done.

#### **Death duties**

There are no death duties or similar imposts in Australia at present. However, if death duties are reintroduced then the ownership of assets through family trusts may have some advantages over the ownership of assets by individuals.

#### **Other advantages**

Other advantages of a family trust include:

- (i) confidentiality of information, particularly regarding the financial affairs of the trust. There are no statutory disclosure requirements for trusts in the way that there are for companies under the ASIC database. There is also no requirement for a trustee dealing with other persons to disclose that it is acting as a trustee of a trust and not in its own right. Thus bank accounts can be opened, leases signed, investments made etc, for the benefit of the trust without other people needing to know this. In most cases we suggest that they should not know that the trustee is acting for a trust;
- (ii) there are no formal audit requirements. Accounts have to be prepared but this is only to facilitate the preparation of an annual income tax return;
- (iii) the absence of any formal legislative framework, such as the Corporations Law, to control the activities of the trustee. Trusts are of course subject to the various Trustee Acts and all other relevant law for example, the Trade Practices legislation and the Income Tax Assessment Act. This makes trusts very flexible entities to use for your business activities);

- (iv) the easy entry and exit of beneficiaries, particularly in terms of who gets income and capital each year and on the winding up of the trust;
- (v) trusts are cheap to set up and run each year; and
- (vi) trusts are relatively simple to wind up.

### **Disadvantages of trusts**

The major disadvantage of a trust is that it cannot distribute capital or revenue losses to its beneficiaries. As a result, should a trust incur a net loss its beneficiaries will not be able to offset that loss against any other assessable income that they may derive.

Expert advice should be sought if it is expected that a trust may make a revenue loss or a capital loss for taxation purposes.

### **Some tax concerns**

From time to time concerns are expressed as to whether the income splitting advantages really do exist, and whether the tax avoidance rules apply to family trusts used for income splitting purposes. Traditionally advisors have found some comfort in the words of then Treasurer John Howard when the anti-tax avoidance rules were introduced. He said that the anti-tax avoidance rules would only apply to particularly blatant, artificial and contrived schemes and would not apply to ordinary commercial and family dealings.

It is unlikely these rules will apply to a person organising or re-organising their business and investment activities to achieve all of the non-tax advantages attached to family trusts as well the tax advantages. It is even less likely that the ATO will try to apply them. Most tax advisors believe that family trust arrangements are outside the tax avoidance rules, provided there are sound commercial reasons for their use, such as the protection of assets and estate planning.

If you have any concerns here you should discuss them with your accountant.

### **The 31 August "Deadline"**

Most family trust deeds require the trustee to distribute net income to the trust's beneficiaries prior to 30 June each year. In practice, however, this is rarely done. Most trustees (and, perhaps more importantly, their advisors) rely on the ATO's administrative practice of allowing trustees to distribute trust net income at any time up to 31 August. However, this leads to the strange position whereby most trust distributions are ineffective for income tax purposes, albeit with the indulgence of the ATO.

Although the ATO will in most cases follow the 31 August administrative practice, tax lore (cf "tax law") contains many examples of the ATO not doing so when it suits: for example, when confronted with a large distribution to a non-resident beneficiary, or some other unusual circumstance. For this reason clients should ensure that any trust distributions in which they are involved follow both the strict letter of the trust deed and the strict letter of the law. Care in this area now may avoid a lot of pain and angst in the future should the ATO decide to challenge the efficacy of a particular trust distribution.

As an example of the ATO abandoning established practice to enforce the strict law, doctors should note the Administrative Appeals Tribunal decision in Case X87. In this case the taxpayer relied on the statement made by the ATO in Taxation Ruling IT 2480 that if certain so called "variable income annuities" were terminated within a specified period then concessional tax treatment would be applied, notwithstanding that they were not strictly annuities at all. Nevertheless, the ATO later denied the taxpayer this concessional tax treatment. The Tribunal showed some sympathy for the taxpayer but in the end had to apply the strict law, not IT 2480. The taxpayer did not appeal from the Tribunal's decision (although he may have taken up the Tribunal's suggestion that he pursue the issue with the Ombudsman).

### **In whose name should assets be held?**

The trustee is the legal owner of the trust's property. This means the trustee's name should appear on all ownership documents, such as shares in private companies, units in private trusts, or title deeds for land ownership.

You may add the tag "... as trustee for the (name) family trust" if you wish, and this has the advantage of informing or reminding all concerned that the asset is held on trust and does not belong to the trustee personally. However, in some cases this will not be possible. For example, most Title Offices will only register a title in the name of the trustee, i.e. the legal owner, and will not allow the tag "... as trustee for the (name) family trust" to be used.

### **Estate planning: testamentary trusts**

Family trusts are useful tools for estate planning purposes. This means that their benefits may be available to subsequent generations as well, long after the founders have passed on. This means assets left to children and grandchildren via family trusts can be protected against divorce, business failure and litigation.

It also means children under the age of 18 can get significant tax advantages: income derived from trusts created on death is excluded from the rules set out in Division 6AA of the Income Tax Assessment Act regarding the taxation of unearned income for minors. This means the penalty tax rate normally applying to unearned income of a minor does not apply to this type of trust.

Assets transferred to or acquired by a discretionary trust are not owned by any individual person. This means they are not controlled by an individual person's will. Setting up a family trust and transferring assets to it does not mean that a will is redundant. The role of the family trust and its relationship with your will should be properly understood, and the two should as far as possible be consistent, both with each other and your general wishes and intentions.

### **Disabled children**

Disabled children are a special case. The tax law allows disabled children (under age 18) to receive distributions from family trusts and to pay tax on these distributions as if they are adults. For example, \$6,000 can be distributed tax free to a ten year old child with a vision problem, whereas normally most of this income would be taxed at penalty rates under the rules for unearned income derived by minors.

Ask your accountant or financial planner for more details if you have a disabled child or a disabled nephew or niece.

## 7.5 UNIT TRUSTS

A unit trust is a trust where the rights of the beneficiaries to income and capital are fixed. This is in the sense that they are not subject to any discretions on the part of a trustee, and are unitised, in the sense that those rights are divided amongst the beneficiaries based on how many units have been issued to them.

The beneficiaries are therefore usually referred to as “unit holders”. Each unit holder’s interest in the trust is fixed. Different unit holders or different classes of unit holders may have different rights to income, capital distributions and voting rights. These rights will be determined at the time the units are issued, or as otherwise agreed by the unit holders and the trustee.

Unlike the beneficiaries of a discretionary trust, unit holders do have rights to the underlying assets of the trust (adjusted for liabilities). These rights are recognised at law as a form of property, can be bought and sold and do have a value. These rights have a value because the unit holder is entitled to future payments of income and capital, and this means other people are prepared to pay to acquire the unit from the unit holder. (How much they are prepared to pay raises complex valuation principles that are very much outside the context of this guide. If these principles are of interest or concern to you they should be discussed with your accountant.)

### What is a unit?

A unit is a piece of property that entitles the unit holder to a specified proportion of the income and capital of the trust. The nature of a unit was considered by the High Court in *Charles v FCT* where it was said:

*“A unit held under this trust is fundamentally different from a share in a company. A share confers on the holder no legal or equitable interest in the assets of the company; it is a separate piece of property; and if a portion of the company’s assets is distributed amongst the shareholders the question of whether it comes to them as income or capital depends on whether the corpus of their property (i.e. the shares) remains intact despite the distribution. Units under the trust deed before us confer a proprietary interest in all the property which for the time being is subject to the trusts of a deed; Baker v Archer Shee [1927] AC 844; so that the question were the monies distributed to the unit holders under the trust part of their income or their capital must be answered by considering the character of those monies in the hands of the trustees before the distribution is made.”*

In other words, a unit in a unit trust confers on the unit holder an equitable interest in both the underlying capital and the income of the trust. Where an amount is distributed to a unit holder under a trust deed its character as capital or income, and even as different types of capital or income, in the hands of the unit holders will depend on its character in the hands of the trustee. The character will, of course, be the same.

### **Do unit trusts have asset protection advantages?**

Generally speaking, no, they do not. Unit trusts do not have the asset protection advantages for unit holders that discretionary trusts have for beneficiaries. This is because of the nature of the units, as explained above. However, asset protection can be achieved by arranging for your units to be held by a discretionary trust or perhaps some other related person.

### **Unit holders' agreements**

Because unit trusts are typically used by un-related parties to co-own assets it is possible that a unit holders' agreement is also required. A unit holders' agreement sets out the rights and obligations of each unit holder in respect of each other whereas the trust deed sets out the relationship between the unit holders and the trustee. This includes issues like what happens if someone wants to sell their units, or someone wants to sell the underlying assets of the unit trust and wind the unit trust up.

A unit holders' agreement is a form of co-ownership agreement and is very much like a partnership agreement.

### **Unit Trust Trustees**

The trustee is normally a shelf company owned by the client and set up specifically to act as trustee of the trust. The shareholders and directors control the trustee. The trustee legally owns the trust property but does not beneficially own the trust property. Beneficial ownership of the trust property lies with the unit holders.

The trustee can also be any competent natural person over the age of 18 who is not bankrupt or under some other legal disability.

The advantages of using a company as a trustee are that:

- (i) having legal ownership of the trust's assets in the name of the company makes it clear that they do not belong to the individuals who control the company;
- (v) the company may stay in existence virtually forever, and will not die or become unable to manage its own affairs. This means things are simpler and there is less bother with changing trustees and re-registering ownership with authorities such as the various state Titles Offices;
- (vi) the directors or other persons who control the company can exercise defacto control without being personally involved in the trust;
- (vii) unit trusts are relatively simple and cheap to set up and run each year.

If units are owned via family trusts the various income tax, asset protection and estate planning advantages connected to family trusts are also available to you.

The disadvantages of using a company as trustee are largely the extra cost of setting up and running a company each year.

## **7.6 ADVANTAGES OF UNIT TRUSTS**

### **Stamp duty savings on property transfers**

Where a unit trust owns real estate it can pay to transfer units in the trust rather than the underlying real estate. This is because stamp duty will be based on marketable security rates, typically about 0.5% of the value of the property, rather than land rates, typically about 5% of the value of the property.

This is particularly the case if it is likely that the underlying property may be transferred to related persons or to persons who are known to you and enjoy a mutual good faith. It may not be practical in the case of a transfer to a stranger, because the stranger may be concerned that the trust has borrowed money or incurred some other liability. This may not manifest itself until after the transfer is completed. This has obvious problems and it is understandable that the stranger would be happier to pay full stamp duty and be assured of full and unencumbered title.

In some cases such a transfer can trigger the so-called "land rich entity" rules. Where this happens the transfer is treated as being a property transfer and stamp duty is assessed at land rates.

Care should be exercised before transferring units in the trust. The procedure for transferring units is usually set out in the trust's deed.

### **Control of unit trusts**

The unit holders as a group control the trust. This is because the trust deed gives them the power to direct the trustee and to, if necessary, terminate the trustee's appointment as trustee and appoint another person to act as the trustee instead.

The deed specifies the percentage vote required for a resolution of a meeting of unit holders to be effective. Usually it is 50% unless decided otherwise as the trust deed is being prepared.

### **Corporate unit holders: 30% tax rate**

Unit trusts can be combined with private companies to get the benefit of the 30% tax rate currently applying to private companies. Arranging for the units to be held by the private company does this. This means that some or all of the trust's net income is taxed in the hands of the company each year.

The main rule here is that the cash must be actually paid over to the corporate beneficiary, and then retained in the corporate unit holder. If this does not happen there is a risk that special anti-avoidance rules applying to private company loans may apply.

Specific advice should be sought from your accountant before deciding to distribute net income to a corporate unit holder.

### **Other advantages of unit trusts**

Other advantages of unit trusts include:

- (i) confidentiality of information, particularly regarding the financial affairs of the trust. There are no statutory disclosure requirements for trusts in the way that there are for companies under the ASIC database. There is also no requirement for a trustee dealing with other persons to disclose that it is acting as a trustee of a trust and not in its own right. Thus bank

accounts can be opened, leases signed, investments made etc for the benefit of the trust without other people needing to know this. In most cases we suggest that they should not know that the trustee is acting for a trust;

- (ii) there are no formal audit requirements. Accounts have to be prepared but this is only to facilitate the preparation of an annual income tax return;
- (iii) the absence of any formal legislative framework, such as the Corporations Law, to control the activities of the trustee. Trusts are of course subject to the various Trustee Acts and all other relevant law for example, the Trade Practices legislation and the Income Tax Assessment Act. This makes trusts very flexible entities to use for your business activities);
- (iv) the easy entry and exit of owners, i.e. unit holders;
- (v) trusts are cheap to set up and run each year; and
- (vi) trusts are relatively simple to wind up.

### **Disadvantages of unit trusts**

The major disadvantage of a unit trust is that it cannot distribute capital or revenue losses to its unit holders. As a result, should a trust incur a net loss its beneficiaries will not be able to offset that loss against any other assessable income that they may derive.

Expert advice should be sought if it is expected that a trust may make a revenue loss or a capital loss for taxation purposes. For example, it may be wise to have debt held at the unit holder level, rather than the trust level, to avoid negative gearing type losses being locked up in the trust.

The taxation of trusts is discussed briefly below.

### **When does the trust start?**

The trust is expressed to start on the Start Date, being the date specified in Annexure A in the trust's deed. More technically, the Trust starts on the date that the Trustee first acquires property. This will probably be in the form of a small cash payment from the first unit holders to the trustee in return for the trustee issuing the first units. Something like 10 \$1.00 ordinary units is quite common.

The \$10.00 will usually be treated as being paid on the date specified as the Start Date in Annexure A. The Trustee will probably issue more units to the first unit holders and new unit holders as the trust gets up and running.

### **When does the trust finish?**

The Trust finishes in 80 years from the Start Date unless the unit holders determine a shorter period or a longer period. 80 years is a conventional period: there is an old rule of equity called the rule against perpetuities, which means it is not possible to set up a trust that runs forever. This reflects a policy desire that at some time property vest in a person who is capable of dealing with it absolutely, and that property is not controlled from the grave.

Most modern trust deeds specify 80 years as the life of the trust. It appears 80 years is chosen because it is usually longer than the initial unit holders (or the underlying individuals) expected life span. 80 years is also the period used in some related Acts of Parliament, for example, section 209 of

the Queensland Property Law Act. 80 years is certainly a common period and we see no reason to depart from it here.

#### **In whose name should assets be held?**

The trustee is the legal owner of the trust's property. This means the trustee's name should appear on all ownership documents, such as shares in private companies, units in private trusts, or title deeds for land ownership.

You may add the tag "... as trustee for the (name) unit trust" if you wish, and this has the advantage of reminding all concerned that the asset is held on trust and does not belong to the trustee personally. However, in some cases this will not be possible. For example, most Title Offices will only register a title in the name of the trustee, i.e. the legal owner, and will not allow the tag "... as trustee for the (name) unit trust" to be used.

#### **The taxation of unit trusts**

Unit trusts are efficient tax planning vehicles. Usually unit trusts do not pay tax themselves. Instead the net income flows through them and is attributed to the unit holders. The amount of tax paid by the unit holders depends on their individual tax profiles. For example, a unit holder with \$100,000 of carried forward tax losses will not pay tax on a distribution of \$10,000. This is because the unit holder's taxable income will still be less than nil. Another unit holder may pay up to \$4,700 tax, plus Medicare levy on a distribution of \$10,000.

The trust deed is drafted so franking credits, dividend rebates, different classes of income, capital gains and other tax amounts having particular tax consequences flow through the trust to the appropriate unit holders.

The taxation of trusts is a very complex area and it is not possible to cover the field in a few short paragraphs, or even pages.

## **APPENDIX 1 THE LIFE CYCLE OF A TYPICAL FAMILY TRUST**

### **Year 1**

A business or investment opportunity presents. At a meeting with his or her accountant and the client is advised to set up a family trust to take advantage of this opportunity.

The accountant instructs a company formation service to prepare the trust deed and, possibly, to set up a company to act as trustee.

The company formation service forwards the trust deed and related documents to the accountant who arranges for the clients to sign as appropriate. The accountant refers the trust deed to the State Revenue Office for stamping and, if a company is set up, lodges various documents with the ASIC.

In the case of a property or business purchase, the client advises the vendor that the purchaser will be "Trustee Company Pty Ltd as trustee for the Smith Family Trust".

In the case of a business start up, the client makes sure all documents and registrations are in the name of "Trustee Company Pty Ltd as trustee for the Smith Family Trust".

The accountant arranges for tax file number and ABN applications, GST registration, pay as you go withholdings registration, if employees are involved, workers compensation registrations, and various other compliance tasks as required.

The client opens a bank account or a cash management account in the name of the "Trustee Company Pty Ltd as trustee for the Smith Family Trust".

If the trust is borrowing money, loan documents are signed in the name of "Trustee Company Pty Ltd as trustee for the Smith Family Trust". In many cases where there is low security the bank will require personal guarantees from the clients in order to properly secure the loan, but it is better if these guarantees are not given, as this improves the asset protection aspects of the trust.

### **Year 1 to Year 80**

The client runs the business or the property.

The client records all receipts and payments made by the trust.

At the end of each financial year the client arranges for the accountant to prepare accounts and income tax returns in accordance with the Australian Accounting Standards and the income tax law. This includes a consideration of how any net income derived by the trust should be distributed between the trust's beneficiaries.

The decision to distribute net income each year is minuted by the directors of the trustee company, and payment is made as appropriate or, if payments are not made, the amounts are carried to "loan" accounts in the name of each beneficiary. (In strictness these amounts are not loans, but are

amounts held under separate bare trusts. But by convention they are shown as loans in the trust's balance sheet.)

From time to time additional amounts are paid to the trustee by the client or related parties. These are paid as "corpus" or capital and are tax-free in the hands of the trust. In some cases reinvesting unpaid distributions to beneficiaries can do this, but your accountant's advice should be sought before doing this.

From time to time capital amounts may be withdrawn from the trust by the client or related parties. These amounts will usually be tax-free but your accountant's advice should always be sought before doing this. This may happen when, for example, a beneficiary needs money to buy a new home or for some other personal purpose.

The trust may be used for other business and investment opportunities that present to the client. Whether the existing trust should be used or another separate trust set up to handle that opportunity should be considered in conjunction with the client's accountant on a case by case basis.

The trust deed may be widened to create more powers for the trustee or to include more persons to be included in the definition of "primary beneficiary" or "general beneficiary". This requires the trustee to sign a deed of amendment. Alternatively, the client may wish to narrow the range of powers held by the trustee or to delete some persons from the definition of "primary beneficiary" or "general beneficiary". This also requires the trustee to sign a deed of amendment. In each case your accountant's advice should be obtained before preparing the deed of amendment. But the point is the trust deed is a dynamic document that may need to be changed as the nature of the trust's activities evolve, and as the legislative and commercial world evolves.

#### **Year 80**

At the end of 80 years, or earlier if the trustee determines, the trust will "vest" or cease. The trustee will at that time get in all the trust's property and either convert it to cash and pay a cash distribution to the beneficiaries or will pay an in-species distribution to the beneficiaries. The duration of the trust may be extended or shortened if all concerned agree to this.

The life cycle of a typical unit trust is the same as that of a family trust.

## APPENDIX 2: THE DUTIES OF A TRUSTEE

The dominant duty of a trustee of a discretionary trust is to exercise the utmost good faith towards the beneficiaries at all times. This means the trustee must put the interests of the beneficiaries ahead of his or her or its interests at all times and generally act in a competent and responsible manner.

More particularly, the duties of a trustee include:

- (i) to be familiar with the terms of the trust. The best way to do this is to read the trust deed and to ask your accountant questions if the meanings of the various clauses are not clear;
- (ii) to hold and manage the trust property. This includes making sure all relevant records show the trustee as the owner of the trust property;
- (iii) to observe the trust deed. Any procedures or processes set down in the trust's deed should be observed at all times;
- (iv) to exercise reasonable care, in the sense of exercising the same care and skill that a reasonable man would take in respect of his own affairs. If there is any doubt as to what this standard is, it is safest to err on the side of caution and if necessary engage experts such as accountants and solicitors to help the trustee with the tasks at hand;
- (v) not to delegate the trustee's duties except as permitted under the deed. But delegation does not mean abdication, and the trustee is still responsible for the delegated task being completed appropriately;
- (vi) to invest the trust's assets in accordance with the law of trusts and any special rules set out in the trust deed. Most trust deeds contain extensive investment powers, and permit a very wide range of investments to be made;
- (vii) to act impartially between the beneficiaries;
- (viii) to maintain proper and complete books of accounts including minutes of meetings of the trustees/directors of the trustee company. Minutes of meetings of the trustees/directors should be created and retained to record all major transactions entered into by the trustee. An example of a minute of a meeting to record a trustee's decision to acquire a property is included as [appendix 3](#);
- (ix) to deal with the trust property properly and not for the trustee's own benefit;
- (x) prepare and lodge a tax return for the trust each year, and generally comply with the income tax law and related laws;
- (xi) to keep the trust's assets separate from other assets owned by the trustee; and
- (xii) insure the trust's assets, where appropriate.

The above list may seem onerous but usually trustees have no problems meeting these standards. Problems are only rarely encountered. Nevertheless a wise trustee will act conservatively and will create sufficient documents to show why and how a particular task was completed; acting on the assumption that one day he or she may have to demonstrate how the above duties were satisfied.

The duties of a trustee for a unit trust are the same as those for a family trust.

