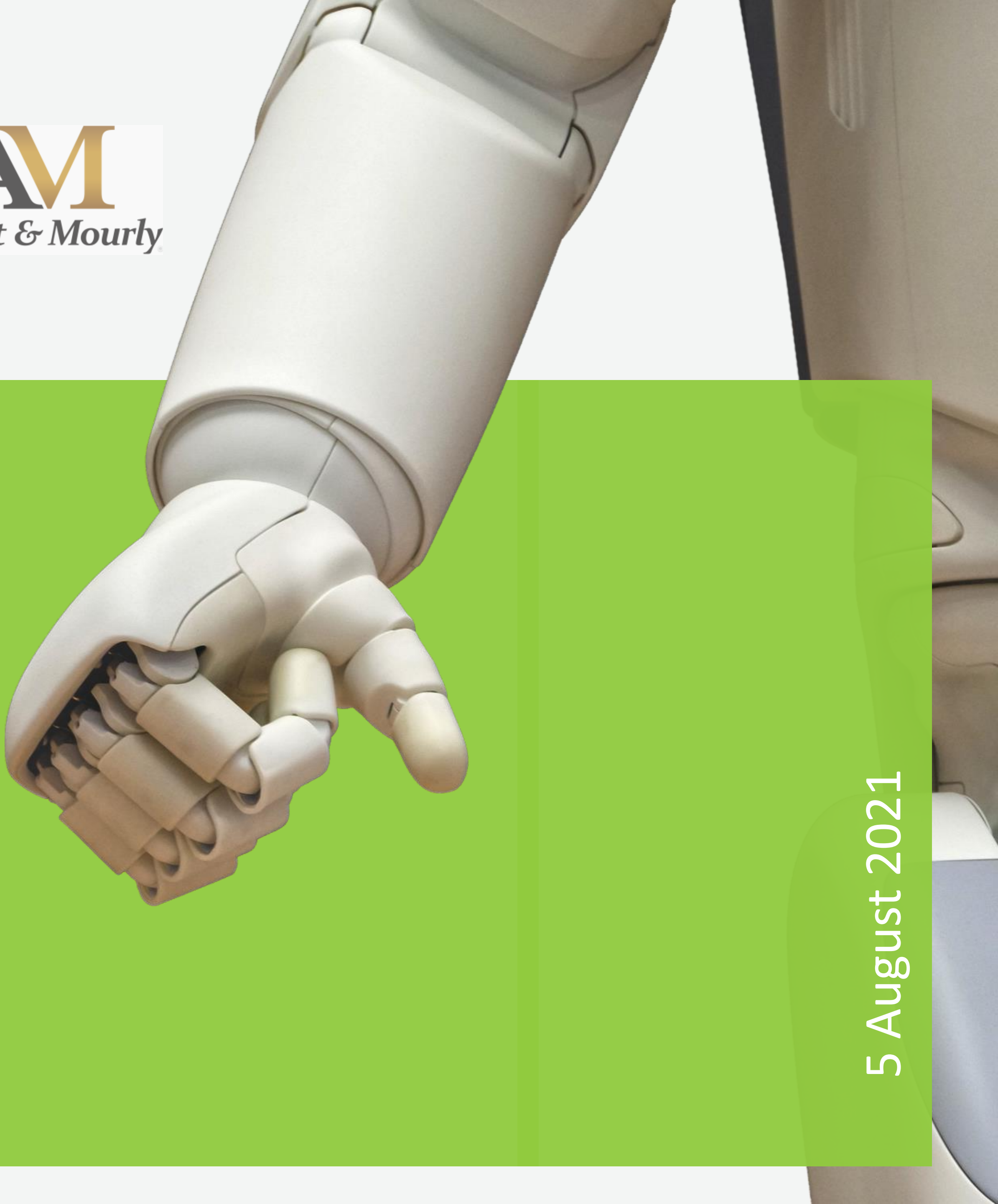
LIGHT YEAR TRAINING GROUP

LightYear DOCS

AM Abbott & Mourly

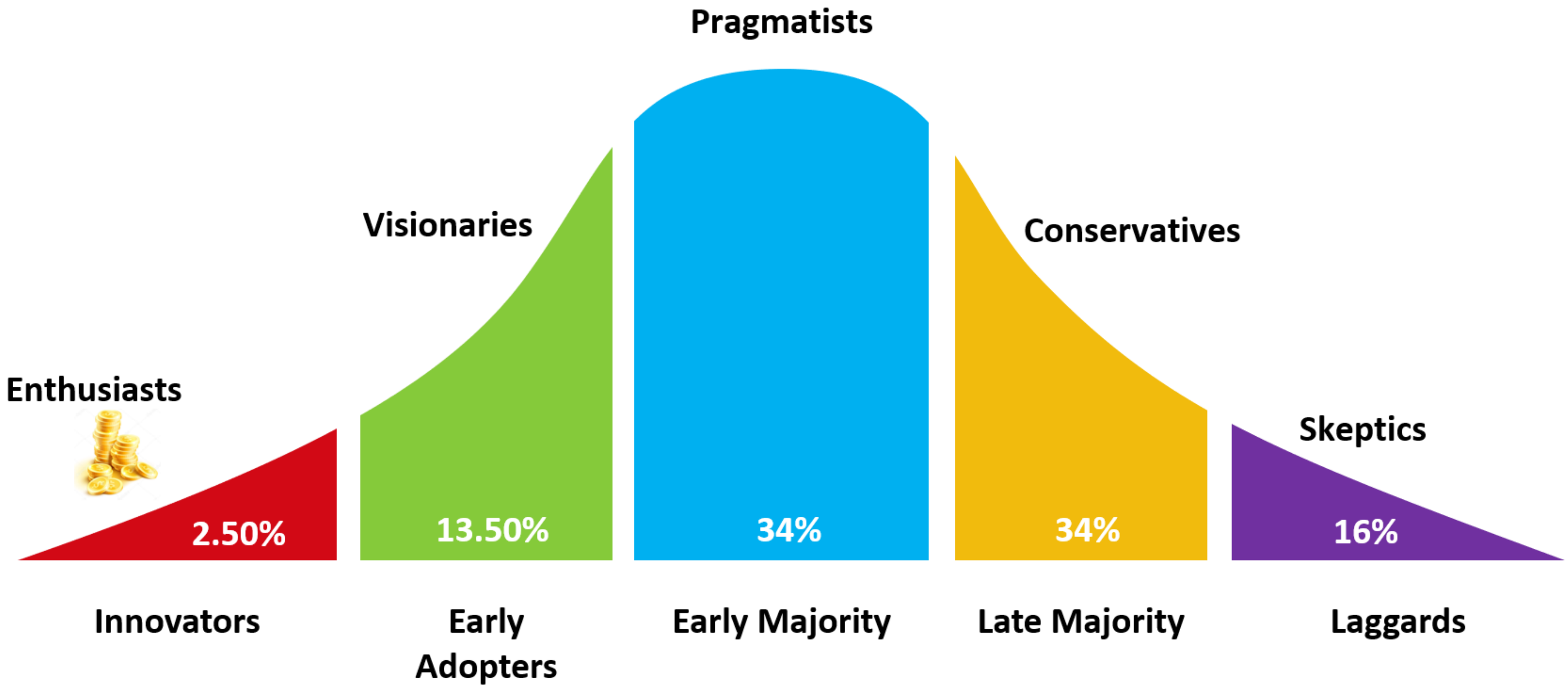


The World of Trusts

There is so much out there yet to be discovered

5 August 2021

Each new trust idea brings a new growth opportunity



“The Romans developed the first trusts (fideicommissum), which were testamentary trusts created by wills. The first living trusts (inter vivos), were developed in England during the 12th-century crusades. When a landowner left England to fight in the crusades, he conveyed ownership of his lands in his absence to manage the estate and pay and receive feudal dues, on the understanding that the ownership would be conveyed back on his return. However, crusaders often encountered refusal to hand over the property upon their return and unfortunately, English common law did not recognise the crusaders claim.

The unhappy crusader would then petition the king, who would refer the matter to his Lord Chancellor (who could decide a case according to his conscience). The Lord Chancellor considered it unconscionable that the legal owner could go back on his word and deny the claims of the crusader (the ‘true’ owner). Therefore, he would find in favour of the returning crusader, and the Court of Chancery would continually recognise the claim of a returning crusader. From this developed what we now know as trusts, with the crusader the beneficiary and the acquaintance the trustee.” *from Tax Fitness Blog*

Importantly the law of equity (fairness) was introduced through this process and covers areas of law that all advisers are aware of including the law of Torts whereby negligence – a duty of care is born. Building a trust creates its own set of laws and rules enforced by equitable principles and also various State Trustee laws.

The Core Types of Trusts

- **Discretionary** – The trustee has discretion as to the distribution of capital and income amongst a range of beneficiaries
- **Fixed Trusts** – There are fixed entitlements for fixed beneficiaries. Beware some fixed trusts are not fully fixed.
- **Hybrid Trusts** – Functionally a fixed entitlement but with discretionary entitlements at the direction of the fixed user

Some Important Themes

- **Settlor is a figurehead** - in Australia it is the person who creates the trust with cash or other property. They have limited involvement due to section 102 of the ITAA 1936 for revocable trusts:

(1) Where a person has created a trust in respect of any income or property (including money) and:

(a) the person has power, whenever exercisable, to revoke or alter the trusts so as to acquire a beneficial interest in the income derived by the trustee during the year of income, or the property producing that income, or any part of that income or property; or

(b) income is, under that trust, in the year of income, payable to or accumulated for, or applicable for the benefit of a child or children of that person who is or are under the age of 18 years;

the Commissioner may assess the trustee to pay income tax, under this section, and the trustee shall be liable to pay the tax so assessed.

Some Important Themes

- **Beneficiaries** – Have no right or entitlement to any assets of the trust - Gartside v Inland Revenue Commissioners [1968] AC 553 and Lygon Nominees Pty Ltd v Commissioner of State Revenue [2005] 60 ATR 135
- **Deed is the Law** – When dealing with any provision of a deed you are dealing with a set rule of law. If a deed says on vesting that all capital must be paid to bloodline beneficiaries the Trustee is bound by that – albeit with a discretion as to the quantum.
- **Rule against perpetuities** – designed for use when there were death duties in Australia so that the Trust had to vest at some time. Applies in all States except South Australia
- **Updating Deeds** – there is a law within the deed providing for an upgrade of one or more rules in the Deed and in many cases the entire deed – provided the Settlor is not benefited.

Trusts are good for Bankruptcy

- **Exempt Assets**: Section 116 deals with superannuation both before and after retirement – excluding pensions. For SMSFs need to shift to a retail or industry super fund
- **Void Transactions:** Subject to clawback:
  - For undervalued transactions – section 120 – five years/four years if a related party and transferor was solvent and two years for unrelated
  - If the transfer was done to avoid trustee in bankruptcy where the transferor was about to become insolvent – section 121
- **Valuations:** It is important to get valuations to show that a transaction is valued both at the gift and loan level

Trusts are good for Tax Minimisation

- **Income**: Need to review the income clause of the laws of the Deed. Accounting income that is not "net income" under section 95 can be distributed tax free
- **Income and Streaming:** *Bamford v. FCT [2010] HCA 10* brought what is income to the fore and enabled the Trustee to distribute a capital gain as income courtesy of the deed.
- **Bucket Company:** With companies taxed at 30% for business income and now 25% for passive income it is an important tool:

Tax Scale For Year Ended 30 June 2022

Taxable Income	Tax On This Income
$0 to $18,200	Nil
$18,201 to $45,000	19c for each $1 over $18,200
$45,001 to $120,000	$5,092 plus 32.5c for each $1 over $45,000
$120,001 to $180,000	$29,467 plus 37c for each $1 over $120,000
$180,001 and over	$51,667 plus 45c for each $1 over $180,000

Not so good for Family Law

- **Kennon v Spry [2008] HCA 56** – interesting case with multiple judgements and investigation of numerous discretionary trust updates and upgrades over a period of 30 years. All came back to control which Dr Spry never gave up. High Court looked through amendments.
- **Control is the Key** – appointor/trustee
  - **Harris v Harris [2011] FamCAFC 245** – held Mother controlled the Trust
  - **Morton v Morton [2012] FamCA 30** – brothers controlled the Trust
  - Even more effective post death for next generation:
    - **MacDowell v William [2012] FamCA 479** cannot review Mother's Trust
    - **Balken & Vyner [2020] FamCA 955** husband did not control deceased father's Family Trust

Good for Estate Planning

- **Pass control to the Family** – with the right chain of appointors and a defined set of beneficiaries family assets can be held within the trust for the benefit of generations to come – subject to vesting and the rule against perpetuities
- **Family Provisions Claims** – they sit outside the estate and are not subject to a family provisions claim except if the trust comes from the estate such as a testamentary trust
- **But NSW** – there is a three year claw back if assets are transferred with the intent to minimise the distribution of assets for family provisions purposes

Discretionary Trust

- **Income**: Wide range of income and up to the trustee to determine and if no determination by year end (distributions0 then it is net income
- **Principal Beneficiary:** They are named in the Deed and can include spouse and children as well as companies, trusts and SMSFs
- **Capital:** Trustee can set aside for one or more beneficiaries to the exclusion of others. Can settle specific property to a separate trust however have to watch the settlement is not a new trust and thus subject to CGT
- **Appointors:** Succession of Appointors
- **Trustee:** Company – use a special purpose discretionary trustee company. The appointor can appoint and remove the trustee

Leading Member Discretionary Trust

- **Core Terms**: The same as a standard discretionary trust
- **Principal Beneficiary:** It is the Leading Member Appointor and their bloodline
- **Capital:** Trustee can set aside for one or more beneficiaries to the exclusion of others. To come: building sub-trusts on the death of the main Leading Members for the benefit of next generation
- **Appointors:** Succession of Leading Member Appointors
- **Trustee:** Company – use a special purpose Leading Member discretionary trustee company. This ensures shares are passed to the next Leading Member and not caught up in litigation or the estate of a deceased

Trust Definition of bloodline

‘bloodline’ *includes a person's children or other lineal descendants such as grandchildren and great-grandchildren and may include any child deemed to be bloodline by the Leading Member Appointor.*

A Family Protection Trust = a Leading Member Discretionary Trust

with the Leading Member Appointor replaced with the Family Protection Appointor

Estate Testamentary Trust – comes from a Will

- **Core Terms**: The same as a standard discretionary trust but can be a Leading Member trust
- **Principal Beneficiary:** It is the person or persons nominated under the Will
- **Capital:** Trustee can set aside for one or more beneficiaries to the exclusion of others.
- **Appointors:** Often the Executor to start with a transfer to the beneficiary at some time if they can be trusted
- **Trustee:** Company – use a special purpose discretionary trustee company. Perhaps consider using a Leading Member discretionary trustee company

SMSF Death Benefits Testamentary Trust – comes from a SMSF Will

- **Use**: Where a dependant, including an adult child with the Trustee of the SMSF settling a death benefit for the dependant into a discretionary trust that has the same advantages for taxation of minors as a testamentary trust
- **Principal Beneficiary:** The dependant
- **Capital:** Trustee must maintain capital for the dependant beneficiary which includes on vesting but can go to their bloodline.
- **Appointors:** Will depend on the terms of the SMSF Will
- **Trustee:** Company – use a special purpose discretionary trustee company. Perhaps consider using a Leading Member discretionary trustee company

Unit Trusts – Fixed or semi-fixed

- **Unit Trust**: Strong unit trust which can be used for syndication and tailored with a unitholder agreement within or outside
- **NSW Fixed Trust:** On vesting all capital must go to unitholders with no flexibility as in unit trust unlike standard unit trust
- **SUIT:** The same base as a unit trust but with a range of special superannuation features to limit a breach of the in-house assets provisions
- **13.22C Trust:** For SMSFs but units can be held by a related entity for transfer to the trustee of the SMSF
- **Appointors:** Unitholders have power to hire and fire the trustee
- **Trustee:** Company – use a standard company and be careful with SUIT that control at board level does not reside with SMSF members

New Trusts on the Horizon with LYD 2.0

- **Hybrid Trust**: A mix of the Leading Member discretionary trust with the unit trust
- **Principal Place of Residence:** Provides protection while using a surrender of long term peppercorn lease as capital gains tax free
- **Living Trusts:** Based on the Leading Member Trust with sub trusts to spring into action on the happening of an event such as the death of the Leading Member or successor Leading Member with an option to roll into separate trust
- **Special Disability Trust**: Used for assets test exempt thresholds for disabled children

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