Trusts

Different types of trust deeds

Key points

- Trusts come in many different types and forms
- The most appropriate type of trust will depend on individual circumstances and intended tax, commercial and estate planning outcomes
- Below are common types of trusts that can be established by Cooper Grace Ward, although trusts are highly tailorable, and we can specifically tailor the terms of a trust to suit individual needs

Background

1. This outline provides a summary of different trust deeds developed by Cooper Grace Ward.
2. The different types of deed are not necessarily mutually exclusive. For example, a client could have a deed that incorporates the features of the limited trust, the partially fixed trust and the direct descendants trust.

Traditional discretionary trust

3. It is usual to designate particular groupings of beneficiaries of discretionary trusts as primary, secondary and tertiary. Typically:
   (a) the primary beneficiaries will be a couple who are the clients and possibly their children
   (b) the secondary beneficiaries will be other family members and charitable organisations
   (c) the tertiary beneficiaries will be related companies and trusts and possibly charities.
4. The trustee has complete discretion as to how income and capital is distributed to beneficiaries. This means any beneficiary could theoretically receive 100% of any or all distributions.
5. The primary beneficiaries are also usually the default beneficiaries. This means any income not distributed at the end of each year is vested in those beneficiaries to avoid the trustee being taxed at the top marginal rate.

Direct descendants trust

6. This deed contains provisions that prohibit capital distributions to anyone other than a direct descendant of the initial clients unless the initial clients consent.
7. This deed may be attractive to clients who have concerns about the partners of their children or other third parties (e.g. trustee in bankruptcy) accessing the trust capital.
8. However, the trust has the usual wide range of income beneficiaries, so the clients still have substantial flexibility for tax planning purposes.

Generational transfer trust

9. These trusts contain similar restrictions as the direct descendants trust but also have some additional features to facilitate transfers of capital for estate planning purposes.
10. Many clients with family trusts are now finding that the flexibility that is inherent in discretionary trusts poses some difficulties in developing a certain estate plan if there are substantial assets held in the trust because no beneficiary has a fixed entitlement in the trust.
    (a) Clients may want the trust to continue after their death but only if they can be satisfied that each of the designated beneficiaries (usually their children) will be protected and will be able to call for their share of the trust capital.

(b) Cooper Grace Ward has developed a deed that, when coupled with appropriate provisions in the constitution of the trustee company, allows individual beneficiaries to require the trustee to transfer a particular proportion of trust assets to them after the death of the clients.

(c) This means that the beneficiaries (usually the next generation) have the option of continuing the family trust after the clients' death, but also have the protection of being able to call for their interest at any time (or subject to any restrictions the clients impose).

(d) It is possible to insert these estate planning amendments in existing trust deeds and constitutions without triggering stamp duty or capital gains tax issues when the amendments are made.

Child maintenance trust

11. Child maintenance trusts can be very beneficial for clients who have ongoing child maintenance obligations as a result of a relationship breakdown.

    (a) Maintenance obligations generally are now imposed by the Child Support Agency and, in most cases, clients have to meet these maintenance expenses out of after-tax income.

    (b) However, in appropriate circumstances it is possible for clients to effectively pay their maintenance obligations out of pre-tax income using a child maintenance trust.

12. An important change that was made some years ago is that the child maintenance trust does not have to be established as part of any property settlement and can be set up after the event by the spouse who has the maintenance obligations.

13. The essential requirements to have a valid child maintenance trust are that:

    (a) the client has a child maintenance obligation as a result of a 'family breakdown'

    (b) the client (or a related entity) transfers property to the child maintenance trust

    (c) that property generates income in the trust.

14. The income of the child maintenance trust that is distributed to children under the age of 18 will be taxed at normal adult rates rather than at the top marginal rates that are generally the case under division 6AA of the 1936 Tax Act.

15. However, the child maintenance trust can have the same range of income beneficiaries as a standard discretionary trust – including the parent who controls the trust. The only restriction is that the children must receive the capital when the trust is ultimately vested.

16. There is no requirement that the trust must vest when the children turn 18. It can run for the normal period, which is generally up to 80 years (but depends on what is specified in the trust deed).

17. This means that the client can distribute income from the trust to the children while they are under 18 (and there is an ongoing maintenance obligation) to get the most tax effective outcome. Any excess income or income generated after the maintenance obligation ends can be distributed by the client without any restrictions.

18. The client can continue to use the trust and to invest the assets in it in the normal way (including lending these to other entities) until the client dies or chooses to transfer the capital in the trust to the children.

19. Some clients are concerned about actually having to transfer assets into the trust in order to get the concessions. However, there are a number of options available for clients that may ease these concerns.

20. For example, clients who operate a business could transfer depreciating assets such as plant and equipment into the child maintenance trust and then lease these assets back to the business to generate income in the trust.

21. Provided the rental charged for the plant and equipment is determined on arm's length terms, there is no problem with this strategy.

22. In some cases, it may also be possible to transfer livestock or other trading stock to the child maintenance trust to generate income.

Partitioned discretionary trust

23. These trusts are really an alternative to unit trusts and are often used for clients comprising more than one family group (e.g. several siblings who want to use one trust but have designated interests).

24. In those circumstances, a single discretionary trust will not be appropriate because each family group will want to have a defined interest in the trust. On the other hand, a unit trust may not be an appropriate structure.

25. The partitioned trust provides that, while there is only one trust fund, the trustee has to distribute a fixed percentage of income and capital to beneficiaries within distinct classes set out in the deed.

26. For example, if there were two family groups with equal interests, the deed would provide that 50% of all income and capital must be distributed to beneficiaries within the A Family class and the balance can only be distributed within the B Family class.

27. This structure provides the flexibility of a standalone discretionary trust but allows each family to have a defined interest. It also provides cost savings because only one trust structure is required and avoids some of the difficulties that clients with unit trusts have in claiming the small business CGT concessions.

28. One advantage of these partitioned trusts is that they allow clients to make capital distributions to beneficiaries without triggering any capital gains tax consequences under section 104-70 (CGT event E4).

29. This can be particularly beneficial if trustee wants to distribute:

    (a) the untaxed 50% of a discount capital gain (division 115)

    (b) from an asset revaluation reserve.

Negative gearing trust

30. The negative gearing trust is intended to assist high risk and high income earning clients who want to claim negative gearing deductions in their own name in relation to investment loans while protecting the asset/investments from potential claims against the individual.

31. This is a dilemma for many high earning clients who can best use interest deductions in their own name, but who are concerned about building equity in assets that might then be subject to claim in the future.

32. The problem arises for many professionals because the tax office has imposed limits on the income that can be generated in service trusts. Professionals who are affected by these changes may find it much more difficult to generate sufficient income to justify the interest deductions in other entities.

33. Our negative gearing trust package involves a suite of documents including an advice on the tax implications of the arrangement, a special purpose trust deed and associated loan agreements.

34. The strategy is that the high risk/high earning individual borrows funds for a negatively geared investment from a third party lender and then advances them to the negative gearing trust.

35. The trustee of the negative gearing trust is not required to pay interest on the loan from the high risk/high earning individual but instead to make priority income distributions to the high risk individual.

36. Because of special provisions in the trust deed, the individual can claim the full interest deductions on their loan from the third party financier although income distributions from the trust may not match those interest payments in the early years of the investment.

37. Cooper Grace Ward has obtained a favourable private ruling from the ATO who determined that the applicant would be able to claim a full deduction for the interest. Our trust deed is based on the same deed used in the private ruling application.

Blind partitioned discretionary trust with company limited by guarantee

38. This trust deed is only used where the initial trustee is a company limited by guarantee.

39. It provides unique advantages for clients who are acquiring or developing a property and anticipate that they may sell it quickly or bring in additional investors after signing the purchase contract or completing construction.

40. The trustee will be a company limited by guarantee (CLG). Some features of a CLG are as follows:

    (a) A CLG has members rather than shareholders. New members are admitted as members by the Board without having to acquire any shares etc.

    (b) Members who wish to leave simply resign.

    (c) A CLG is a public company for purposes of *Corporations Act* and therefore its accounts must be audited. This means the ongoing administration costs are more expensive than a normal private company.

    (d) ASIC registration fees are substantially cheaper for a CLG.

41. The trust deed contains similar provisions to the partitioned discretionary trust deed. However, the trust deed does not stipulate that the trust fund will be partitioned into a set number of parts.

42. Instead the deed provides that, when distributing income or capital, the trustee must notionally divide the fund into a number of separate parts, which will be equal to the number of members of the trustee CLG.

43. The eligible beneficiaries for each notional part will be described by reference to the members of the CLG. For example:

    (a) the primary beneficiaries of each part will be the relevant member and their spouse or the directors of a corporate member

    (b) the secondary beneficiaries will be the usual relatives of the primary beneficiaries

    (c) the tertiary beneficiaries will be companies and trusts connected to the primary beneficiaries.

44. Therefore, if the client establishes a blind partitioned discretionary trust and subsequently two investors take up an interest in the property or project, they are simply admitted as members. If the client sells the property, the client can resign as a member and the new controller is admitted as a member.

45. This strategy may achieve significant stamp duty savings. If shares in a trustee company are transferred or allotted, stamp duty is payable (corporate trustee duty). The amount of duty is calculated on the basis of the unencumbered value of the underlying trust assets.

46. However, corporate trustee duty is only payable if a person acquires a share interest in the trustee company. Changes in the members of a CLG will not involve the acquisition of a share interest and corporate trustee duty will not apply.

47. In all cases where clients intend to use this structure, it will be necessary to consider whether the introduction of new investors will trigger a resettlement. If the investors are introduced shortly after the trust property is acquired this may not be a significant issue as there is unlikely to have been any significant uplift in value.

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