



Child Support Trusts

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Child Support Trusts (CSTs), also known as Child Maintenance Trusts, are Trusts established for the tax-effective payment of a child support obligation. The following circumstances must exist before a CST can be created:

- A family breakdown; and
- A binding child support obligation.

To satisfy the family breakdown requirement, the couple need not have been legally married. Hence a de facto couple who were living on a genuine domestic basis and who cease to live on a genuine domestic basis may be regarded as having undergone a family breakdown.

The binding child support obligation can be in the form of an order, determination or assessment of a court. In practice, often this is satisfied by a Family Court order or a child support agreement ratified by the Family Court.

What follows is an overview of CSTs including benefits and features.

The Tax Benefit

A CST is typically established when a separated couple have agreed on a child support arrangement that imposes an obligation on one parent to pay child support to the other for their children. In order to meet the child support payments, the obligated parent will generally pay child support from his or her after-tax income. Therefore, the

income required to generate the after-tax obligation amount is much higher than the obligation amount itself.

A CST is intended to provide relief for the obligated parent in respect to the income utilized for the benefit of children. If the obligated parent transfers income generating Assets into a CST, the income generated can be distributed amongst the children to meet the obligation, and the children will qualify for adult tax rates on the distributed income. The usual penalty rate of tax applicable to children therefore does not apply.

Rather than the obligated parent meeting the obligation from after-tax income, the income used to meet the obligation is generated by the CST and distributed directly to the children who pay tax on the income at their marginal tax rate. CSTs are therefore effective because the children's penalty tax rate does not apply to the income distributed, and because the children who receive the income are likely to be on a lower tax rate than the obligated parent.

Features of a Child Support Trust

Features of a Child Support Trust are as follows:

Transfer of Assets

The obligated parent must be able to transfer income producing Assets into the CST. There are no capital gains or stamp duty exemptions available



for the transfer of Assets in such circumstances. Therefore it can be an expensive exercise to transfer most Assets, with the exception of cash. However, as most parents do not have large cash reserves on hand for the purpose of child support, an asset transfer is most common. The alternative is to lend the quantum amount into the Trust and allowing the earnings minus the interest amount to be passed to the CST child beneficiaries.

Capital requirement

The capital in the CST must ultimately pass to the children. Generally this is consistent with what most parents intend in any event. The CST can be structured so that it ends on the death of the obligated parent. Thus in the event of death, the capital can be distributed to the children, together with any bequest made to them via their parent's Will. The capital restriction therefore prevents the obligated parent from taking back the capital when the child support obligation ceases.

Surplus income

Each financial year, the child support obligation is the Trustee's first priority when distributing the income. However, any excess income can be distributed to the other Beneficiaries of the Trust, including the obligated parent, at the discretion of the Trustee. The CST can be structured so that once the child support obligations have been met, the CST can operate as a discretionary family Trust that possesses full discretion regarding income distributions, subject to the capital restriction in respect to CSTs.

For more information in respect to the next ili workshop covering Family Provision Planning incorporating Child Support Trusts or instructions to establish a Child Support Trust visit the ili website www.ili.com.au.

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