



An Introduction to Trusts

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Overview

The basic principle of a Trust is that a legal person (that is the Trustee) manages assets on behalf of another person, (the Beneficiary).

In a Trust a relationship is therefore a separation between legal ownership and beneficial ownership of assets. The Trustee is the legal owner of the Trust assets. The Trustee's name is therefore recorded as the legal owner. The Beneficiaries on whose behalf the trustee holds the Trust assets are regarded as the beneficial owners. Depending on the nature of the Trust, the beneficial owners are entitled to capital and/or income.

Given the legal relationship between the legal and beneficial ownership of assets, the Trustee is under a legal obligation to act in the best interests of the Beneficiaries when dealing with the assets of the Trust. These obligations are known as fiduciary duties.

There are two types of express Trusts:

- Trusts created by Deed that is during a person's lifetime - referred to as Inter Vivos Trusts; and
- Trusts created by a Will that is on the death of the Willmaker - referred to as Testamentary Trusts.

What follows is an overview of Trusts, that are created intentionally by a Trust document.

Benefits

Trusts created during a person's lifetime can provide for the following benefits:

- Management of Assets on behalf of Beneficiaries - e.g:
 - Family
 - Spouse
 - Children
 - Parents
 - Special Needs Beneficiaries
 - Vulnerable Beneficiary
 - Disabled Beneficiary
 - Other Beneficiaries
 - Blended Family Members;
 - Bequests;
 - Charities;
 - Related
 - Corporate Entities
 - Trusts
- Tax Benefits
- Asset Protection;
- Flexible distribution of capital and/or income in respect to Family, Special Needs Beneficiaries and Other Beneficiaries.

Parties to a Trust

The parties to a Trust depending on the type of Trust may include the following:

- The Settlor
- Trustee
- Beneficiaries



- Appointor
- Guardian
- Unitholder

Settlor

In an Inter Vivos Trust (that is a Trust established during one's lifetime), the Settlor is the person who creates the Trust relationship by paying to the Trustee a nominal sum, called the settled sum, to be held on behalf of a Beneficiary or class of Beneficiaries. There is no Settlor in a Testamentary Trust.

After contributing the settled sum, the Settlor has no further involvement in the Trust. The Settlor should not be a Beneficiary of the Trust and should not receive a benefit from the Trust. Adverse tax consequences may result if the Settlor is a Beneficiary. Therefore, a family member should not be nominated as Settlor of a Trust.

A professional adviser involved in the establishment of the Trust such as an accountant or family solicitor should not act as Settlor. This may raise queries as to whether the sum was paid in return for a service rendered. If the latter is the case, the Trust would not be properly constituted.

Usually, the bank account for the Trust is opened by depositing the settled sum in the name of the Trustee. The settled sum will generally appear as an asset on the Trust balance sheet for the duration of the Trust.

Trustee

The Trustee is the legal owner of the Trust property. At the commencement of the trust, the Trustee receives the settled sum from the Settlor.

The Trustee performs the following roles:

- Holds Assets of the Trust for the Beneficiaries of the Trust;
- Manages the Assets for the Beneficiaries of the Trust;
- Obtains a tax file number on behalf of the Trust;
- Opens and manages all bank accounts;
- Ensures that the assets of the Trust are protected (that is they are insured)
- Distributes the income of the Trust (for non fixed Trusts);
- Distributes income to the Beneficiaries of the Trust;
- Keeps the book of accounts;
- Prepares balance and profit and loss statements;
- Lodges income tax returns; and
- Makes general day to day decisions regarding the management of the Trust.

The Trustee may be a corporate entity and/or one or more individuals. The Trustee of the Trust can be replaced in accordance with the terms of the Trust Deed. If the Trust is likely to be involved in trading activities and incurring liabilities, it is preferable for the Trustee to be a corporate entity. The benefits of a Corporate Trustee include:

- The existence of a 'Corporate Veil', which separates the activities of the Trustee from that of the individual;
- Continuity over the duration of the Trust - unlike a person who may die or retire, a corporate entity continues until such time as it is dissolved; and
- Control of the Trustee can be altered simply by a change in



directorship and shareholding of the corporate entity.

Beneficiaries

The Beneficiaries of the Trust are the people or entities on whose behalf the Trustee holds the assets of the Trust.

In a Discretionary Trust, the terms of the Trust contained in the Deed will generally specify the identity of the primary Beneficiaries (sometimes referred to as the specified Beneficiaries). The primary Beneficiaries are usually referred to by name.

If the Trust is a Discretionary trust, a class of general Beneficiaries will be described with reference to the primary Beneficiaries. These general Beneficiaries typically include family members and Trusts and corporate entities in which any of the Beneficiaries have an interest.

Charities are also often included as Beneficiaries of Discretionary Trusts. A Trust will not be valid unless it is clear who the Beneficiaries are. Therefore the class of Beneficiaries cannot be too large or uncertain. If the definition of Beneficiaries is not sufficiently precise, the Trust may be declared void for uncertainty.

It is important to make sure that the class of Beneficiaries is as intended from the outset. Generally the Beneficiaries of the Trust cannot be added or deleted without triggering adverse tax implications.

Appointor

The role of Appointor is only relevant to Discretionary Trusts (as opposed to unit or hybrid Trusts). While not generally regarded as a party to the Trust relationship, the Appointor is critical to the management of the Trust.

The Appointor holds the power to remove the Trustee and appoint a substitute or additional Trustee. Depending on the Trust Deed the Appointor may also possess the power to consent to amendments or variations to the Trust Deed. The precise powers held by the Appointor will be determined by the terms of the Trust Deed itself. It is often the Appointors role that is crucial to Estate Planning and the future control of the Trust.

Guardian

This role is only relevant to Discretionary Trusts, although not every Discretionary Trust has a Guardian. The Guardian is not generally a party to the Trust relationship. While a Guardian may hold similar powers to an Appointor, the two roles are often different.

The Trust Deed may state that the Guardians consent is required before the Trustee can exercise certain powers, such as the power to amend the Trust Deed, distribute capital or remove a Beneficiary. It is critical that this issue is dealt with from in respect to Estate Planning to ensure that the flexibility of the entity is not compromised in the long term.

Unitholders

Unitholders are relevant to unit or hybrid Trusts (not generally to Discretionary Trusts). In Unit Trusts and Hybrid Trusts, the initial Unitholders are parties to the Trust Deed. Often Unitholders will have other roles in relation to the Trust, such as consenting to the transfer of units and the reclassification of existing units.

The Trust Deed

For an express Trust, the Trust Deed is usually the governing document for the Trust. It sets



out the rules or parameters of the relationship between the Trustee, the Settlor and the Beneficiaries. For a Trust created by a Will the Will itself is the Trust Deed.

In reality, most Trust Deeds contain standard terms, particularly in relation to the powers and duties of the Trustee. However, care in relation to the powers must be exercised to ensure that the Deed is specifically tailored where the circumstances are unique or were the initial parties to the Trust have particular objectives in creating the Trust. As has been mentioned earlier, care must also be exercised when defining the category of Beneficiaries at the outset. Any amendment to the definition of the Beneficiaries after the Trust is established may have significant CGT and stamp duty consequences.

Construction of the Deed

A Trust Deed usually contains the following:

- A recital setting out the manner in which the Trust is to be constituted. This usually includes a statement regarding the intention of the parties to create the Trust.
- Various definitions, including the definition of the Beneficiaries of the Trust.
- The identity of the Trustee.
- A nomination of the Appointor to the Trust.
- The powers and discretion that the Trustee possesses.
- Provisions relating to the lifespan of the Trust.

Sources of Powers of the Trustee

The Trustee of a Trust may also be subject to other rules or restrictions. In this respect, each State and Territory has its own Trustee Act.

Agreements entered into between Beneficiaries, Unitholders and other parties will also affect the terms of the Trust. It is common for Unitholders to a Trust to agree in writing on the way the units are to be dealt with in the event that one Unitholder wants to dispose of its units.

Furthermore Common law may impose on a Trustee or other party to Trust new responsibilities or grant new rights and responsibilities.

Elements of the Trust

While the creation of an express Trust relies on the existence of the initial parties to the Trust and the existence of the governing rules of the Trust Deed, there are three essential elements required in order to create an express Trust. These are discussed following:

Intention

No Trust is constituted unless there is an intention to create a Trust. If the Trust property is held by a person but without an intention to create a Trust, then the person to whom the property has been given or transferred takes that property personally.

The Trust Deed will therefore expressly contain a statement of intention.

Subject Matter

In order for a Trust to exist, there must be assets over which a Trust obligation exists. That is, there must be property held by the Trustee for, and on behalf of, the Beneficiaries of



the Trust. The property held by the Trustee is called the capital or corpus of the Trust and can take any form.

The subject matter of the Trust must be clearly expressed. This means that it must be possible to identify the Trust property at any time. When the Trust is created, the settled sum paid by the Settlor to the Trustee creates the initial capital of the Trust. Obviously, there can be further capital additions to the trust over time. An application for units in a Unit or hybrid Trust creates the initial subject matter.

Objects

In order for a Trust to exist there must be nominated people or 'objects' to whom an obligation is owed by the Trustee. The objects are typically referred to as the Beneficiaries. As with the subject matter of a Trust, the objects must also be certain if the Trust is to be validly constituted.

Lifetime of a Trust

In relation to most Trusts, there is a principle of law that restricts the length of time for which property can be held on Trust. This rule is known as the rules against perpetuities.

The rule against perpetuities determines when a Trust must end (referred to as 'Vesting'). Importantly, there is no rule against perpetuities in South Australia. Therefore Trusts governed by the law of South Australia can continue to operate indefinitely. At the end date of the Trust (the 'vesting date'), the Trust is wound up and the assets of the Trust distributed to the Beneficiaries of the Trust in accordance with the terms of the Trust.

Determining the Vesting Date

The vesting date or ending date of a Trust depends on which State or Territory the Trust is created in. Most Trust documents also contain specific provisions relating to the date of vesting. There is also usually scope in the Trust Deed for the vesting date to be altered and the Trust wound up earlier than the 80 year perpetuity period which applies to most jurisdictions.

Amending a Trust

Once a Trust has been established, the Trustee is bound to obey the directions contained in the Trust Deed and exercise its powers and directions contained in the Trust Deed. Unless a specific provision is contained in the Trust Deed allowing an amendment to be made to its terms, the Deed cannot be altered (except by an order of the court). In each State and territory there are legislative provisions enabling a court to make an order varying the terms of a Trust.

Most modern Trust Deeds contain specific provisions allowing the Trustee to vary the terms of the Trust, often with the consent of the Appointor or Guardian. Sometimes there are prohibitions disallowing certain amendments for example, stating that the Trustee cannot add Beneficiaries.

Avoiding a Resettlement

If an amendment of a Trust is contemplated to an existing Trust Deed, care must be taken to ensure that the Trust is not inadvertently resettled. A resettlement occurs when the Trust Deed is amended and the changes are regarded as being so substantial that, in effect, the Trust is ended and a new Trust is created. This can have



significant stamp duty and CGT consequences, as a resettlement is regarded as a transfer and disposal of assets from the initial Trust to the newly created Trust.

Therefore, if the Trust holds dutiable assets which are also subject to CGT, these taxes will generally be payable as the transfer of cash does not generate a CGT or stamp duty liability.

In August 2001, the Australian Tax Office made available a document entitled *Creation of Trust - Statement of Principles* in relation to Trust settlements. Before amending an existing Trust Deed, the statement of principles should be referred to. It should be noted that the Statement of Principles is not a public ruling, nor is it a statement of the law. It is merely the commissioner of taxation's interpretation of the law.

The taxation commissioner draws a distinction between changes that are procedural in nature and changes which fundamentally alter the relationship between the Trustee and the Beneficiaries in relation to the Trust property. It is the nature and effect of a proposed change that is the important issue.

The statement sets out the commissioner's view that amendments of the following

nature will generally be regarded as a resettlement:

- Adding a Beneficiary.
- Extending the vesting date of the Trust (unless the Deed already contained this power).
- Changing the Trust from being a Discretionary Trust to a unit Trust.

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