



Family Trust Deeds

By Tony Crilly

The Importance of Being Earnest

Recently, I spoke with a client who had a difficult dilemma in relation to their Family Discretionary Trust Deed. My firm was instructed by the client's accountant, just prior to 30 June, to assist them with a variation of the terms of the Trust Deed to include within the class of beneficiaries companies in which the primary beneficiary held a share.

Over the last five years, distributions had been made by the Trustee, pursuant to the advice from the accountant, to a corporate beneficiary with the net effect of reducing the taxable income of the family group during each of those years. The Trust operated a family business which was quite successful and involved one other family member, namely the son of the primary beneficiary.

My firm was instructed that in 1995, the original controlling individual of the Trust, namely the husband of our client, had passed away leaving a will appointing our client as Executor. There was no specific reference to the continuing control of the Family Trust or the shares in the Trustee Company. Prior to his death, the husband had instructed lawyers to prepare a Deed of Variation of the Trust, appointing a family company as Trustee. He was the sole Director and shareholder of that company. The shares were transferred on his death, by his Estate, to our client as the sole beneficiary and spouse. She then took over as the sole Director of the Trustee Company.

The issue was:

...whether the terms of the Trust allowed for the variation of the Trust Deed without the consent of the originally named Appointor who was now deceased.

Our client's previous lawyers advised that as there was no specific provision which empowered an Executor or legal personal representative to take over the powers of appointment, there was a problem in any variation to the Deed without the consent of the person who was deceased.

Therefore, their answer was to make an Application to the Court for an Order that the Deed be varied pursuant to the relevant Trusts Act of that State to include our client as the spouse and beneficiary of the deceased's Estate, as the Appointor or controlling individual of the Trust. The Court duly ordered that our client be appointed and that the Trust Deed be varied.

Unfortunately, the solicitors acting for the client failed to implement the Deed of Variation, including the signing of a Deed to confirm the inclusion of the further class of beneficiaries.

Specifically, there was no Deed which included the named company which had been intended as the corporate beneficiary of the Trust for taxation purposes. However, there was an Order of the Court, together with a resolution of the Trustee and our client at the relevant time, and prior to the end of the financial year in 2004.

The Deed of Variation was prepared in accordance with the resolution and the Court Order and it was signed by the Trustee and our client prior to 30 June 2009. This was done by way of confirmation of the prior actions and resolution of the Trustee. By doing this, we assisted the client to confirm the formal terms of the Deed had, in fact, been varied as originally intended and in accordance with the Order.

The concern was that the distributions for the intervening period might be challenged by the ATO as valid. On a review of the terms of the Trust Deed, it seemed that there was a subsequent power over the terms of the Trust by a legal personal representative of a deceased Appointor. In our view, the Executor, as the legal personal representative of the original Appointor, could have prepared and signed a Deed of Variation to the terms of the Trust to include a further class of beneficiaries. It should be noted that no change to the default beneficiaries was made to the Trust Deed, as this would have resulted in a re-settlement of the Trust itself.

That would mean that there would be CGT issues and stamp duty on the basis that there had been a transfer of the old Trust to the new Trust. Clearly, this was not a result our client intended and, in fact, our Deed of Variation included a specific statement that no change to the default beneficiaries had been made.

By a simple inclusion of a nominated class of beneficiaries within a wider class described in the Deed, no re-settlement of the Trust occurred.

The original Trust Deed:

- ▼ had limited powers and terms of investment;
- ▼ treatment of dividends, and particularly franking credits, was not dealt with; and
- ▼ a deadlock provision had been inserted which was inadequate.

My firm amended the Deed and the end result is that our client is better informed and covered in terms of their ability to distribute to the corporate beneficiary and save tax.

It is up to advisers to point out to a client how a Family Trust works and the fact that it does not directly form part of their Estate. The Estate planning for a client must be updated to include specific provisions about control of a Family Trust and who will be the Director and shareholder of a Trustee Company. It is vital to understand that if a Family Company is the controlling entity, then the shares in that company must be dealt with specifically in a will. It is not suitable for clients to wait until someone has passed away to then review the Trust Deed and find out how to make an Application to Court.

An earnest application of Trust knowledge can avoid unintended consequences in the future for the operations of these Family Trusts.