



Trust Me, I'm Family

Seven interesting points to keep in mind when thinking of your nearest and dearest

By Tony Crilly

The discretion of a trustee or appointor can be limited both by the Trust Deed and the circumstances in which that person finds themselves. The following case example looks at a variation to a Family Discretionary Trust and the implications under the *Family Law Act 1975*.

Spry vs. Kennon [2008] HCA56

In this case, an appeal from a Family Court decision to set aside a variation to a Family Trust was unsuccessful. In simple terms, the husband established over many years a Family Discretionary Trust, which continued to accumulate assets during the marriage. Approximately two years prior to any matrimonial dispute, he varied the terms of the Trust to change the beneficiaries to the four children of the marriage and excluded himself and his wife as capital beneficiaries. The husband established trusts in favour of the four children and applied to them one quarter of all of the capital and income of the Trust and conveyed to each shares held by him beneficially. An independent Trustee was appointed to act with the husband for each of the children's Trusts. The marriage subsequently was dissolved.

The wife filed an application in the Family Court seeking orders for property settlement and maintenance and, specifically under s.106B of the Act, set aside the instrument of variation and the disposition. The wife requested the husband be ordered to pay her 50% of the assets and resources held in their individual or joint names, the Trust and the children's Trusts.

The children were given leave to intervene in the matter. The Court set aside the instrument and the dispositions and made an order that the husband pay the wife the sum of \$2,182,302. The husband and the children appealed and when the matter came before the High Court, the application was dismissed in favour of the wife.

1. Appointor

As an essential part of the estate planning process, it is a high priority to review the exact terms of the Trust Deed to check the controlling individual or *Appointor*; that is the person who ultimately controls the Trustee and has the power to vary the terms of the Trust. This case example demonstrates that such a variation is not without risks and that the Family Law Act may ultimately prevail over any dispositions from a Discretionary Trust.

2. Default beneficiaries

It is important to review the default beneficiaries in a Trust Deed. That is, who will ultimately get the capital on winding up of the Trust. If the Discretionary Trust owns significant assets, including property or business, there are duty implications on a variation of the Trust to add or remove a default beneficiary. There are also potential CGT implications as it may be held that this is a re-settlement of the Trust; that is, that the fundamental purpose of the Trust has been altered and the Trust starts again. It could mean that there is a deemed transfer of the property from the old Trust to the new re-settled Trust, which incurs stamp duty and CGT at market rates. This is quite an expensive exercise in many cases.

3. Vested indefeasible entitlements

It is important to understand that nature of a Discretionary Trust when dealing with capital or income. The exact terms of the Trust must be carefully considered to ensure who can be a beneficiary within the nominated class to receive either income, or capital, or both. Each year the Trustee of the Discretionary Trust must lodge a tax return and allocate income to beneficiaries. If the Trustee accumulates the income in the bank account of the Trust, but allocates that income to a beneficiary in the books of account, that beneficiary must be taxed on that income.

At the moment, the Trustee resolves by Minute of a Meeting for the Trust to allocate income to a beneficiary. The beneficiary, if they are an adult, has a vested indefeasible interest in that allocation. That means, that it is open to that beneficiary to call upon the Trustee to have that entitlement to that money paid to them. Until such time as it is paid, it is a debt due and payable to the beneficiary. This can be quite a tricky situation for matrimonial property disputes under the Family Law Act where significant allocations have been made to the children of the marriage and they are now over eighteen years of age.

In the course of obtaining an order or settling the matrimonial property between the husband and wife, it is always recommended that the children sign an acknowledgment to release their entitlement as part of those proceedings and the debt will be removed from the books of account.

4. Loan accounts to beneficiaries

On the creation of a Trust, more often than not, a person contributes cash or other assets to the Trust with the intention that they become trust property. For asset protection purposes, if that person no longer wants to be able to claim it back from the Trust, then they need to sign a Deed of Gift of that amount of money or asset to the Trust absolutely, together with a Declaration of Solvency. This will prevent creditors or a trustee in bankruptcy seeking to force repayment from the Trust of the original amounts.

In circumstances where there has been a significant contribution of cash or large allocation of income by the Trustee for the Trust to a beneficiary in a financial year, this creates a beneficiary loan account due to that person from the Trust. It is essential that in any estate plan, consideration be given to those beneficiary loan accounts and if, on death, they must be repaid by the Trust to the estate of the deceased.

More often than not, the question then becomes whether it is best to have that money exit the Trust and be repaid to a Testamentary Discretionary Trust created in the will of the deceased. On many occasions wills might conditionally forgive such a loan to enable the Executors to determine if, for taxation purposes, it is best to leave that money in the Trust and the deceased estate forgive the loan. Otherwise, it may be more appropriate to call on the Trustee to repay the loan and get the cash back into the deceased estate. That money can then be utilised in a broader range of beneficiaries, which may have greater tax advantages as a Testamentary Trust.

5. Class of beneficiaries

It is important to read carefully the terms of the Trust Deed and understand the class of beneficiaries. If it is a very old Trust Deed, there may be a situation where the principal that established the Trust is in fact only an income beneficiary at the discretion of the Trustee, not a capital beneficiary. Many of those older Trusts were set up when death duties were still an issue. It is also important to check if other companies or trusts that are comprised of family members, are included as beneficiaries within the class. This will enable a wider distribution of income by the Trust in the future, or upon winding up of the Trust.

6. Splitting or cloning at an end

The tax office has now issued a ruling that splitting or cloning of Trusts no longer have CGT concessions. This is a significant disadvantage for estate planning purposes, especially where a principal wants to divide properties or assets contained within one Trust to a number of children so that they would control a separate Trust that then owns that property or asset. If distributions are made on that basis, they are now likely to attract CGT at market rates and that is likely to be sufficient to prevent such a strategy being employed.

7. Will drafting

It is important to consider carefully the terms of a Family Trust, beneficiary loan accounts and the controlling individuals when drafting a will. Clearly, if there is a company as Trustee of a Discretionary Trust, the shares and directorship must be specifically dealt with in the will. The appointor, controlling person or entity must be given a priority in the terms of the will and a specific statement made. The Trust Deed must be checked to ensure if there is a default clause appointing a successor or if it is open to the person to appoint someone in their place in a will during their lifetime. It is very easy to get this process wrong and the requirement is to read the Trust Deed carefully.

The extent of the assets contained within a Family Trust must be reviewed and considered in light of the ultimate objectives of the willmaker. In some cases, the willmaker might want to appoint an independent Trustee to assist in the management and control of a Discretionary Trust going forward, subject to family circumstances. There may be children in the family group that are not capable of handling the management of a Discretionary Trust and careful consideration must be given to part of the loan account for the willmaker to be allocated and repaid into the Testamentary Trust under the will. To that extent, there may then be a protective Trust created for that child or family member who requires assistance in the management of those assets. Corporate Trustees as appointors of a Family Trust can be utilised, but great care must be taken.