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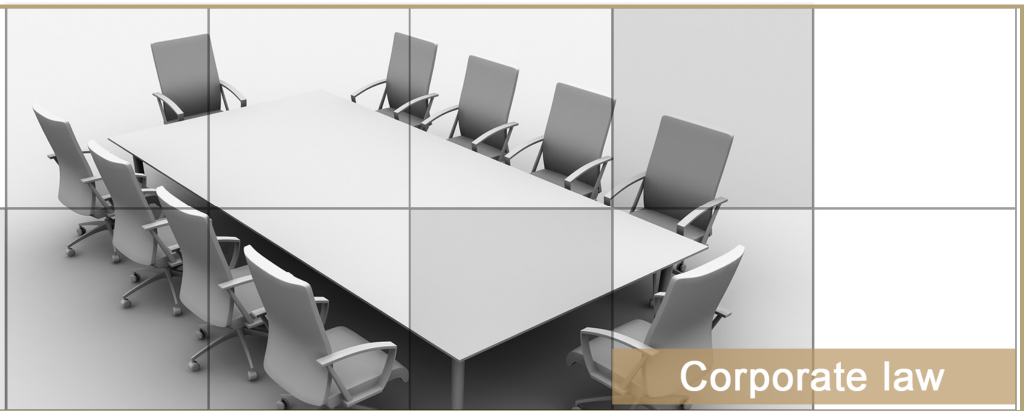

What is a discretionary trust?

17 July 2009

What is a Trust?

A trust is a relationship where a person (the Trustee) is under an obligation to hold property for the benefit of other persons (the Beneficiaries). The terms of the obligation are defined by the terms of the Trust Deed entered into between the Trustee and the Settlor.

The Trustee is the legal owner of the trust property and the beneficiaries hold the beneficial interest in the trust property.

What is a Discretionary Trust?

In a discretionary trust the beneficiaries do not have a fixed entitlement or interest in the trust funds. The trustee has the discretion to determine which of the beneficiaries are to receive the capital and income of the trust and how much each beneficiary is to receive. The trustee does not have a complete discretion. The trustee can only distribute to beneficiaries within a nominated class as set out in the terms of the trust deed.

Who are the players?

There are 4 roles that need to be considered when establishing a discretionary trust.

The Settlor

The settlor is the person who creates the trust by “settling” a sum of money or item of property on trust for the beneficiaries.

The Trustee

The trustee is the legal owner of the trust property although not the beneficial owner. The trustee carries out all transactions of the trust in its own name and must sign all documents for and on behalf of the trust. The trustee’s overriding duty is to obey the terms of the trust deed and to act in the best interests of the beneficiaries.

The Appointor

The Appointor is the person named in the Trust Deed who has the power to remove and appoint trustees. This would commonly occur when:

- the trustee dies, becomes bankrupt or is incapacitated;
- in the case of a company, the company is wound up.

The Beneficiaries

The beneficiaries are the people (including entities) for whose benefit the trustee holds the trust property. A discretionary trust usually has a wide range of beneficiaries, including companies and other trusts. The beneficiaries of a discretionary trust do not have an interest in the assets of the trust. They merely have a right to be considered or a mere expectancy until such time as the trustee exercises its discretion to make a distribution.

The general beneficiaries are those beneficiaries named in the trust deed who are eligible to receive a distribution of income or capital at the discretion of the trustee (subject to the approval of the Appointor). The remainder beneficiaries are the beneficiaries automatically entitled to receive a proportionate distribution of income or capital to the extent that the trustee has not exercised its discretion otherwise.

The Trust Fund

The trust fund is all the property of the trust including the settlement sum, accumulated income and any other money and property held by the trustee pursuant to the terms of the trust.

The Trust Deed

The trust deed defines the relationship between the trustee and the beneficiaries. The parties to the trust deed are the settlor and the trustee. The trust deed specifically sets out the duties and powers of investment of the trustee, the beneficiaries, and other important stuff.

Why use a discretionary trust?

- Tax Benefits
- Asset Protection
- Estate Planning

Tax Benefits

Land Holdings

As a general rule, trusts are a more tax effective structure as a holding entity for investment and commercial real estate and other fixed assets. This is because the government decided that from September 1987 they would tax capital gains on the disposal of assets (other than personal assets and your principle place of residence).

Individuals are provided a 50% exemption from CGT. This exemption will apply to a discretionary trust where the potential beneficiaries are all individuals (not companies).

Companies receive no such exemption.

Income

As the name suggests, a discretionary trust allows the trustee discretion in determining each year, which beneficiary receives any income from the activities of the trust. This has clear benefits where there is a disparity in the income of the beneficiaries and allows for the gift of income at reduced tax rates.

Some examples where a discretionary trust may be an effective vehicle for the distribution of income:

- **Husband and Wife**: Trust owns investment properties and receives income from those properties. Husband is a professional lawn bowler and earns $15,000.00 per year (after allowable deductions like bowling rags and travelling expenses to and from Europe). Wife is a partner in an elitist NSW Law Firm and earns squillions. It would be better to distribute the income to the husband as he will pay tax on a lower rate.

- **Uni Student**: Mum and Dad are trustees for a family discretionary trust, which makes big bucks each year as a holding company of the licence of the business name “Jeremy’s big toys”. Son goes off to Uni and the parents want to pay his way. Instead of paying him “after tax dollars” as trustee they can distribute income to him from the trust, which will no doubt be taxed at a lesser rate.

* Please note that this is not an attempt to give taxation advice. You should consult your accountant to seek specific advice on your circumstances before making any decisions relating to your taxation requirements. The name “Jeremy’s big toys” is fictional.

Asset Protection

A Trustee of a discretionary trust holds the property beneficially for the beneficiaries. Property held by a person as trustee cannot be taken by a creditor in bankruptcy, unless the debt relating to the creditor was a trust debt. Similarly, property held by a company, as trustee for a trust, cannot be taken by creditors in a liquidation of that company unless the debt is a debt of the trust. Any properties held in trust can only be attacked by creditors of that trust.

When will this be effective?

- A golfer is found negligent after hitting another player with a golf ball and is ordered to pay $2M in damages. The golfer owns no property in his name, but is trustee of a trust, which owns 5 investment properties with a total value of $2M. Can the creditor attack the trust assets? NO.
- A & B commence trading a deli at New Farm. They sign a lease for 5 years. The business goes bust and the landlord obtains judgment against them (jointly and severally) for $300K. A & B go bankrupt.
- A is married to X and they have a family home and an investment property with total equity of $200K. A loses the lot and his wife has to deal with the bankruptcy trustee and has to come up with $100K. She can’t and the family home is sold.
- B owns nothing. The family home is owned by his wife and there is a family trust that owns 2 investment properties owned by the family trust. B keeps the family home* and the trust assets can’t be touched.

*This position may differ depending upon circumstances. We recommend that specific advice be sought on protecting the equity of your principle place of residence.

Estate Planning

Examples:

- Mum and Dad die leaving one son who is a bankrupt. Mum and Dad leave all of their assets to their son. Their entire estate is lost to the trustee in bankruptcy.

Had Mum and Dad left their estate to a discretionary trust established for the benefit of their son and his family, the estate would have been saved. Alternatively, with proper estate planning, the assets could have been protected well before the death of Mum and Dad.

How do you set up a discretionary trust?

Contact Rostron Carlyle today on (07) 3009 8444

Greg Rostron

Partner

"The information contained in this article is general in nature and cannot be regarded as anything more than general comment. Readers of this article should not act on the basis of this comment without consulting one of Rostron Carlyle's legal practitioners who will consider their particular circumstances".

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