Estate Planning

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Review of your clients' trust deeds

We are happy to review your clients' trust deeds **free of charge** to ensure that they have been established with appropriate trustees, appointors and beneficiaries. We will review the terms of the trust to ensure the clauses are adequate for the decision in *Bamford* and for estate planning purposes.

We can prepare a letter of advice with recommendations and variation deeds to make amendments with fixed costs.

If you would like to learn more about trusts or how we could review your clients' trust deeds, we are always happy to meet over a coffee.

ACORN LAWYERS

The Basics of Discretionary Trusts – How they work, the key features and potential pitfalls

What is a trust?

A trust is a relationship in which the Trustee is obliged to hold the property of the trust for the benefit of certain Beneficiaries. The terms of this obligation are defined by the trust deed between the Trustee and Settlor. The Settlor creates the trust by giving ('settling') property on the Trustee to be held on trust.

The trust involves the separation of legal and beneficial ownership. The Trustee is the legal owner and controller of the trust property that is held by them for the ultimate benefit of the Beneficiaries who are identified by the trust deed. Importantly, the Appointor can appoint and remove trustees and thus the Appointor can control the trust by changing the trustees.

In a discretionary trust, the trustees have the power to determine which beneficiaries (and in what proportions) receive the income and capital of the trust property. The beneficiaries do not have a fixed interest or entitlement to any trust property, only the hope of receiving a benefit. In contrast, a beneficiary of a fixed trust has a fixed entitlement and the trustee must apply the trust property for their benefit.

Liability of Trustees

Discretionary trusts are often used for asset protection. There is a common misconception that trustees are only liable for trust debts to the extent of trust property. This is not correct (except where there is an express agreement to this effect). A trustee is personally liable for trust debts they incur. However, section 59 *Trustee Act 1925* (NSW) provides a trustee with a right of indemnity from trust property for expenses properly incurred.

I recently acted for two doctors (Dr Jill and Dr Jack) who had large business assets within a trust (presumably for asset protection and to stream income). Dr Jack and Dr Jill were the individual trustees of the trust. As the trustees are personally liable for trust debts, if a claim was made against the businesses and there were insufficient trust assets, Dr Jill and Dr Jack would be personally liable for payment.

Hence, the importance of a corporate trustee. This situation could have been avoided by appointing a company as trustee with Dr Jack and Dr Jill as the directors. As the liability of a company is limited to the assets of the company, personal assets of the doctors are protected. To make matters worse, this trust also held Dr Jill and Dr Jack's personal investments. Even with a corporate trustee, the trustee would still need to use the investments to settle claims.

Amending this trust was not easy. With Barrister advice, we were able to split this trust into two separate trusts, one with the businesses and one with the investment assets. This way, investment assets could not be called on to settle business debts of the other trust. A corporate trustee was appointed to each trust, removing Dr Jill and Dr Jack's personal liability for trust debts. A private ruling was obtained from the Commissioner of the Office of State Revenue as there are strict rules with successor trustees and benefits, while also ensuring we did not cause a resettlement of the trust (creation of a new trust) which would have triggered a large stamp duty liability and CFT. This is a complex area of law that requires planning. We recommend your clients seek legal advice and never pull trust deeds off the internet!

Where is the original deed?

Do you know where the original stamped trust deed is located? Some time ago, I acted for Dr Dan who could not locate his original trust deed, which the bank required. Without the trust deed, we had to make an application to the Supreme Court with sufficient evidence to prove the trust existed and the terms of the trust. Without that order, consider the possible tax and stamp duty penalties if a valid trust was never established! We suggest obtaining three stamped copies of the trust deed, with at least one in safe custody.

Bamford v FC of T

The decision in *Bamford v FC of T* did little but restate the law. The terms of the trust deed must be followed. In order to properly steam income to beneficiaries, create categories of income, treat amounts as capital/income, change the method of determining income etc. then the trust deed must provide for this. Many older trust deeds to do not provide these broad powers and often need to be updated. However, these trusts are often treated as though the powers existed. If such a trust was audited by the ATO, this could create large tax liabilities. Reviewing trust deed for these simple powers is frequently overlooked. We recommend reviewing all trust deeds and updating where necessary by a qualified lawyer.

- Lindsay Stoddart, Director