

# Trusts

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## What is a trust?

A trust is not a separate legal entity. Rather, a trust is a relationship where a person or company (the trustee) is under a legal obligation to deal with property owned by the trust (trust property) for the benefit of some other person or persons (beneficiaries) or for some specific purpose or purposes (objects). The terms of the obligations are normally defined by the trust deed.

### Key trust concepts

A trust requires three essential elements, namely:

1. A trustee who or which is the legal owner of the trust property but not the beneficial owner. The trustee is usually a company which owns the assets of the trust, not in its own right, but as trustee of the trust. The trustee is responsible for the financial "health" of the trust, and makes decisions about investments, distributing income, borrowing money etc;
2. Trust property, also known as the trust fund. This comprises all the property of the trust, including accumulated income and any other money and property held by the trustee under the terms of the trust deed; and
3. Beneficiaries who are the people and/or entities for whose benefit the trustee holds the trust property. The beneficiaries themselves do not have a separate interest in the trust assets under a discretionary trust. They merely have the right to be considered when the trustee makes a distribution. In discretionary trusts, beneficiaries often include children (including as yet unborn children). Some trusts (e.g. trust for charitable purposes) have objects rather than beneficiaries.

Other persons required for a discretionary trust are:

4. the appointor who is the person who has power under the trust deed to remove the trustee and appoint another trustee; and
5. the settlor who is the person who provides the initial funds to establish the trust (we usually recommend an initial settlement of at least \$550.00 to at least cover the stamp duty involved).

### Discretionary Trusts

In a discretionary trust, the trustee has discretion when distributing funds to the beneficiaries. The income and/or capital of the trust can be distributed wholly or partially to any one or more of the beneficiaries, as the trustee determines in the trustee's discretion. Often the beneficiaries consist of a wide class of people and/or corporations. Among other things, this may allow for income streaming, often in a tax advantageous manner.

### Unit trusts

In a unit trust, each of the beneficiaries has units in the trust representing a right to a share or

portion of the income and capital of the trust. In some ways, this is similar to shares in a company. A unit trust may have hundreds of units, each with the same or different rights to income and/or capital. In some cases it is advisable to have different classes of units.

### **Family trusts**

Often investments are made, or businesses are conducted by family trusts. These are usually discretionary trusts controlled by the senior member or members of the family or a corporate trustee whose directors are senior family members. They are usually designed to protect assets and/or to enable tax effective income distributions among family members.

### **Trusts and businesses**

Trusts including discretionary trusts are often used in connection with running business, particularly for taxation and asset protection purposes. The trust is not a separate legal entity in the same way that a company is. Essentially, it is a business structure where a trustee carries on the business on behalf of the beneficiaries.

### **Trusts and investments**

Discretionary trusts are also often used as investment vehicles. The assets (e.g. real property, equities, managed funds etc) are held in the name of the trustee. Income from the investments can usually be distributed among the beneficiaries in a tax effective manner or in such proportion as may be advised (e.g. to limit or increase a particular beneficiary's income) from time to time.

### **Advantages and disadvantages of trusts**

#### Advantages of a trust include:

- there may be considerable taxation advantages although this depends on current tax law;
- a trust allows for income streaming; and
- limited liability.

#### Disadvantages of a trust include:

- possible capital gains tax implications;
- inability to distribute tax losses; and
- establishment and administration costs.

### **Frequently Asked Questions**

#### **1. Does the trust have to be in writing?**

Normally the terms of the trust should be contained in a deed which sets out such matters as the powers and duties of the trustee, the names of various parties, how the trustee can be removed, who the beneficiaries are, how income and capital should be dealt with and what the rights and powers of the beneficiaries are, particularly in the case of a unit trust. However, a trust does not have to be created in writing; a trust can arise by virtue of an oral declaration or through conduct in some circumstances.

## **2. Can the trustee also be a beneficiary?**

Although the law allows for a trustee to also be a beneficiary, the trustee cannot be the only beneficiary since, otherwise, both the legal and beneficial ownership would vest in one and the same person or company. In that case, the trust property would no longer be held on trust. Nevertheless, in order to avoid conflicts of interest and possible stamp duty consequences on removal of a trustee, the trustee should generally not be capable of being a beneficiary. This also avoids a conflict of interest situation arising.

## **3. Can the settlor also be a beneficiary?**

Again, from a legal point of view, a settlor can be a beneficiary or even the trustee of the trust. However, tax and stamp duty considerations as well as avoiding the possibility of conflicts of interest make it preferable that the trust deed stipulate that the settlor cannot be a beneficiary or a trustee of the trust.

## **4. Who can the beneficiaries be?**

The beneficiaries of a trust, particularly a discretionary trust, can be almost unlimited. They can be natural persons, corporations and other legal entities including other trusts and charities. The persons or corporations who can be beneficiaries of a trust do not even have to be in existence at the time that the trust is created. The beneficiaries of a family trust can include current and future spouses, future children and future grandchildren. They can also include corporations or other trusts in which named or specified beneficiaries or future beneficiaries hold an interest.

## **5. What is an appointor of a trust?**

The term "appointor" is the term most often used to describe the person with the power to remove a current trustee and appoint a new trustee. A trust can have more than one appointor so that, for example, if the initial appointor dies, another person takes his or her place. Being the appointor gives the named person a degree of control over the trust, particularly in the event of a threat of a claim by a "predator" or "creditor" against a trustee or one of the people involved in the control of a corporate trustee.

## **6. Is the trustee liable for the debts of the trust?**

A trustee is usually personally liable for the debts that the trustee incurs while acting as trustee of the trust. If the trustee has acted in a legitimate manner then the trustee is entitled to be indemnified out of the assets of the trust for any debt incurred. If, on the other hand, the trustee has acted fraudulently or dishonestly then the trustee may not have the right to be indemnified out of the assets of the trust. If a creditor wishes to make a claim on the trust, the claim cannot be made directly on the trust assets but must be made against the trustee and rely on the trustee's right of indemnity out of the assets of the trust.

## **7. Are beneficiaries liable for the debts of the trust?**

Usually beneficiaries are not liable for any debts of the trust or for any improper or fraudulent actions of the trustee. While a trustee is usually entitled to be indemnified out of the assets of the trust, the trustee is not normally entitled to be indemnified by the beneficiaries personally unless there is a specific provision to the contrary in the trust deed. If, however, a beneficiary has

authorised or directed a trustee to act in a particular manner then a claim may in certain circumstances be brought against the beneficiary as the principal on whose behalf the trustee has acted in a fiduciary capacity.

#### **8. What are the duties of a trustee?**

The trust deed usually sets out the duties of the trustee in relation to the trust property. These duties generally include the following:

- 8.1. to carry out the terms of the trust deed;
- 8.2. to act in good faith;
- 8.3. to act in the best interests of the beneficiaries;
- 8.4. to preserve trust property;
- 8.5. to insure trust property;
- 8.6. to properly invest trust funds;
- 8.7. to keep accounts;
- 8.8. to supply information to beneficiaries when required; and
- 8.9. in the case of a discretionary trust, to exercise discretion properly. This normally allows the trustee significant leeway in how the discretion is exercised and, accordingly, how income and capital is distributed.

#### **9. What are the rights of beneficiaries?**

Beneficiaries of a discretionary trust do not have a right to, or interest in any part of the income or capital of the trust fund. They merely have a right to ensure that the trustee does not breach his or her duties. If the trustee has acted improperly, they may be entitled to bring proceedings for the trustee to reinstate the trust fund to the position it would have been in if the breach had not occurred. Beneficiaries of a unit trust are normally entitled to the income and capital of the trust fund in proportion to their respective units and/or in accordance with the terms of the units as described in the unit trust deed.

#### **10. What are the trustee's powers over the trust fund?**

The powers of a trustee in relation to the assets in the trust fund are normally described in the trust deed. Usually trust deeds enable the trustee to invest the assets in almost the same way as an individual can do as if the trustee were the beneficial owner. In addition, the laws in the various States and Territories and court decisions also control how a trustee may act in relation to trust property.

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