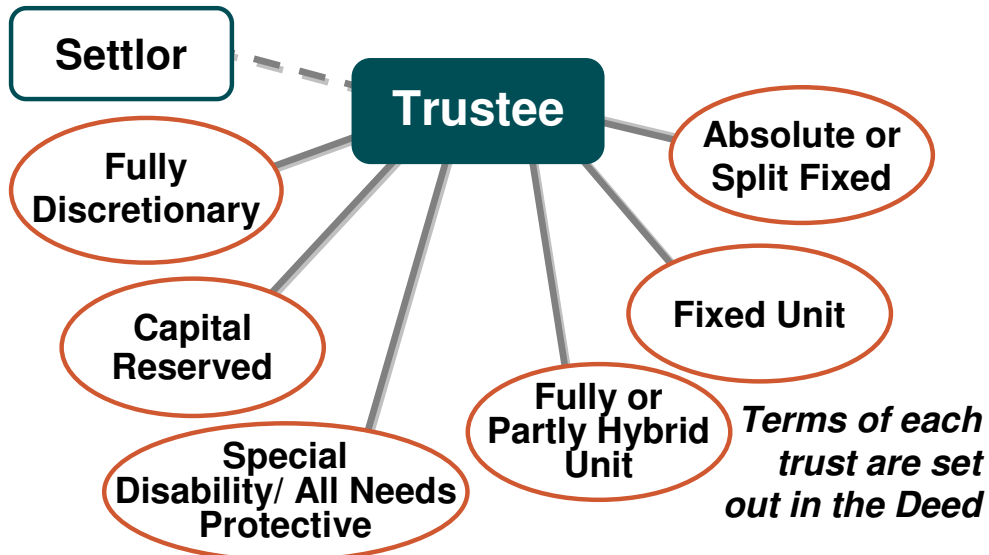


# Types of Trusts Established by Deed

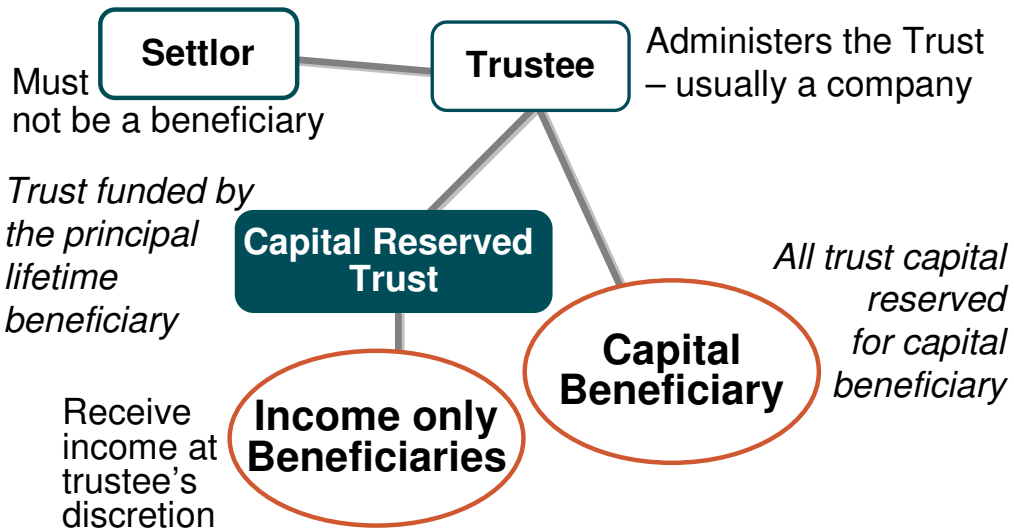


## ***Personal Trusts Established by Deed in Australia***

Personal trusts can be mandatory or optional, fixed or non-fixed, flexible or protective and can have beneficiaries or unitholders:

- **Absolute entitlement** trusts have beneficiaries who are absolutely entitled to the income and capital of the trust – these trusts can be general absolute trusts with no trustee discretion or can be priority trusts, eg prioritising education or childhood welfare. Employer funded death benefits trusts for the children of a deceased employee and injury compensation trusts are usually absolute entitlement trusts.
- **Special disability** and **all needs protective** trusts are established for vulnerable beneficiaries, with a lifetime principal beneficiary and residual capital beneficiaries.
- **Capital reserved** trusts have a fixed entitlement to trust capital when the trust ends, but give the trustee discretion as to which members of the class of discretionary beneficiaries are to receive the trust income from year to year. Capital reserved trusts are often established prior to the commencement of a new domestic relationship so that the party to the relationship enters the relationship with no potential capital entitlement to the assets in the trust. Alternatively they may be established to qualify for income tax concessions, eg a child support trust.
- **Fully discretionary** trusts give the trustee discretion as to distributions of both trust income and capital, the latter usually requiring the appointor's consent. The class of potential beneficiaries usually includes family members (usually excluding any means tested pensioners), associated entities (eg associated companies and trusts) and charities. Fully discretionary trusts include family trusts, descendants only family trusts, farm transfer trusts and sole purpose – insurance bond trusts.
- **Unit** trusts, often operating as fixed unit trusts within regulation 13.22C of the *SIS Regs* to enable the unitholders to include trustees of SMSFs. Personal unit trusts can also be fixed or can be hybrid trusts, ie with terms that are partly discretionary.

## Capital Reserved Trust



### **Major Reasons for an Australian “Fixed” Capital Reserved Trust (established by Deed)**

# Significant creditor asset protection. # Family law and estate planning, eg to prevent a claim on the deceased estate/notional estate of a surviving parent (or child) by a new partner – in NSW it may be necessary for the surviving parent to have relinquished any lifetime control. # Flexibility (income/benefits only) – each year the trustee can decide which family members or associated entities benefit. # Accumulation of income – 30% (rather than 46.5%) if “parked” with a corporate beneficiary. *Note:* Income tax concessions apply to particular types of fully reserved trusts, eg child support/estate proceeds trusts.

#### **Trustee/Control**

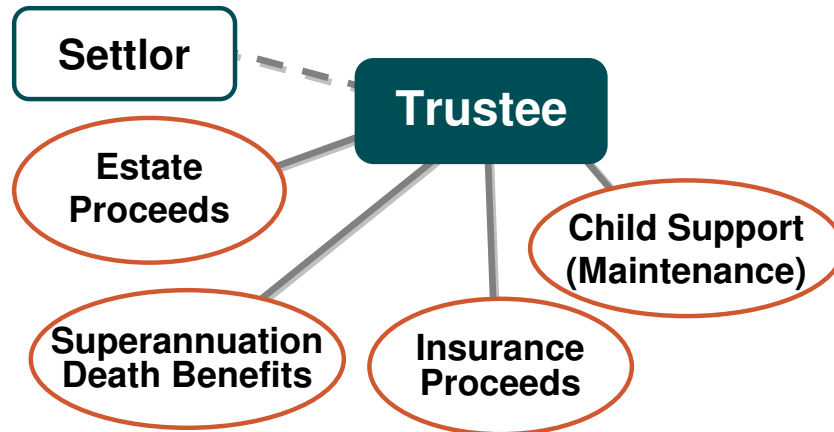
Frequently a person other than the capital beneficiary controls the trust for either an initial period or for the lifetime of the trust.

#### **Trust Income and Capital**

While trust income is usually defined as accounting income, income beneficiaries are taxed by reference to the proportion and type of taxable income (including net capital gains) spent on or allocated or paid to them, with credit for any tax already paid, eg dividend franking credits. The trustee is usually expressly empowered to reimburse beneficiaries for any CGT liabilities. Capital profits (usually subject to a 50% discount) are taxed both when trust assets are disposed to 3<sup>rd</sup> parties and on winding up of the trust. Loans to the trust usually need to be on arm's length terms.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and non-excluded beneficiaries of the trust.

## Special Purpose Capital Reserved Trusts



**Key Australian excepted income provisions  
–paragraphs 102AG(2)(c) & (d) of ITAA 1936**

### **Paragraphs 102AG (2) (c) & (d)**

Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:.....

(c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary:.....

#### **[Insurance Proceeds Trust]**

(iv) directly as the result of the death of a person and under the terms of a policy of life insurance;

#### **[Superannuation Death Benefits Trust]**

(v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;.....

#### **[Child Support Trust]**

(viii) as the result of a family breakdown (see section 102AGA);

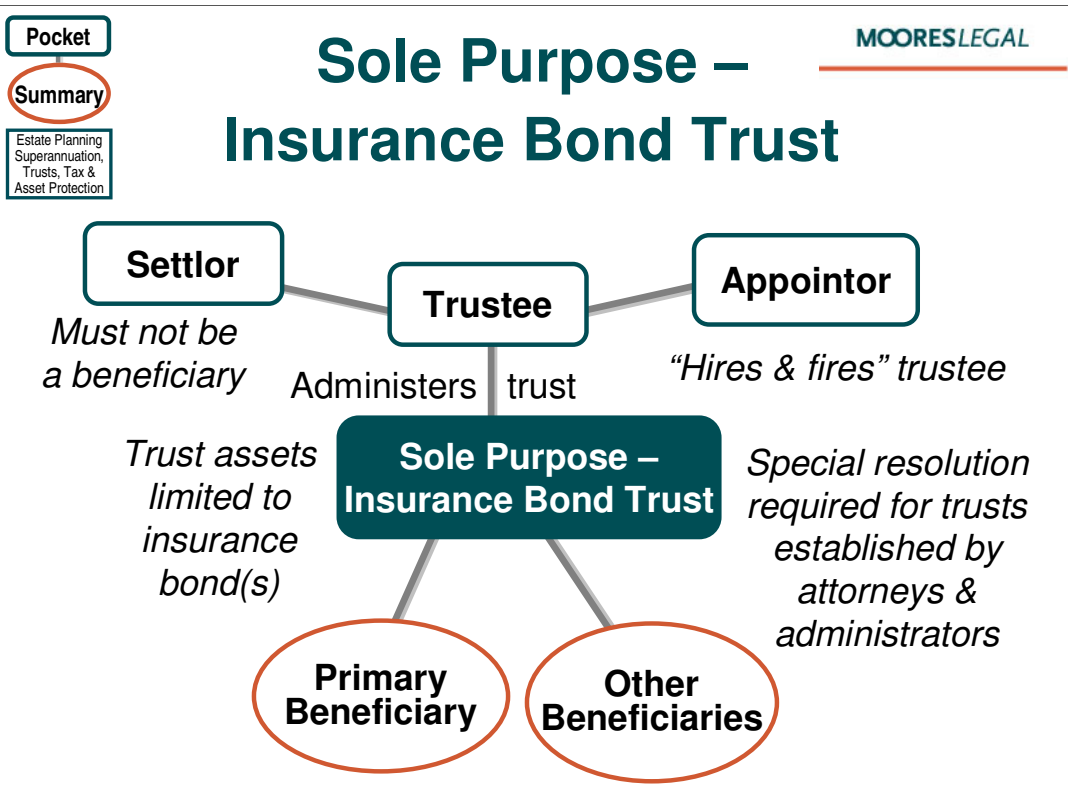
(d) is derived by the trustee of the trust estate from the investment of any property:

#### **[Estate Proceeds Trust – subject to the intestacy limit in subsection 102AG(2)(7)]**

(ii) that was transferred to the trustee for the benefit of the beneficiary by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the date of the death of the deceased person;.....

### **Subsection 102AG (2A)**

Paragraph (2)(c) or subparagraph (2)(d)(ii) does not apply unless the beneficiary of the trust concerned will, under the terms of the trust, acquire the trust property (other than as a trustee) when the trust ends.



***Reasons for an Australian Sole Purpose – Insurance Bond Trust***

When assets are held in a family trust, Centrelink and Veterans’ Affairs are able to deem the assets in the trust and the income from the trust as being personal assets or income of a means tested pensioner who is considered to have a sufficiently close connection to the trust. Where, however, the assets of the trust are limited purely to one (or more) insurance bonds taken out on the life of the pensioner, the assets are still deemed to be the pensioner. The income of insurance bond, however, does not form part of the deemed income of the insured if it is accumulated for either the balance of the lifetime of the insured or 10 years, whichever is the lesser.

Sole purpose trusts are established where a means tested pensioner sells and does not replace a family home and the net sale proceeds would adversely affect eligibility for the pensioner’s health card and other pension benefits.

***Attorneys and Administrators and Sole Purpose – Insurance Bond Trusts***

Where the pensioner is represented by an attorney appointed by a financial enduring power of attorney or by an administrator, it is important that the attorney only acts in the best interests of the pensioner. In these situations, an irrevocable resolution is usually also prepared, ensuring that the proceeds of the insurance bond (other than an amount equal to the settled sum) are to be paid into the deceased estate of the pensioner.

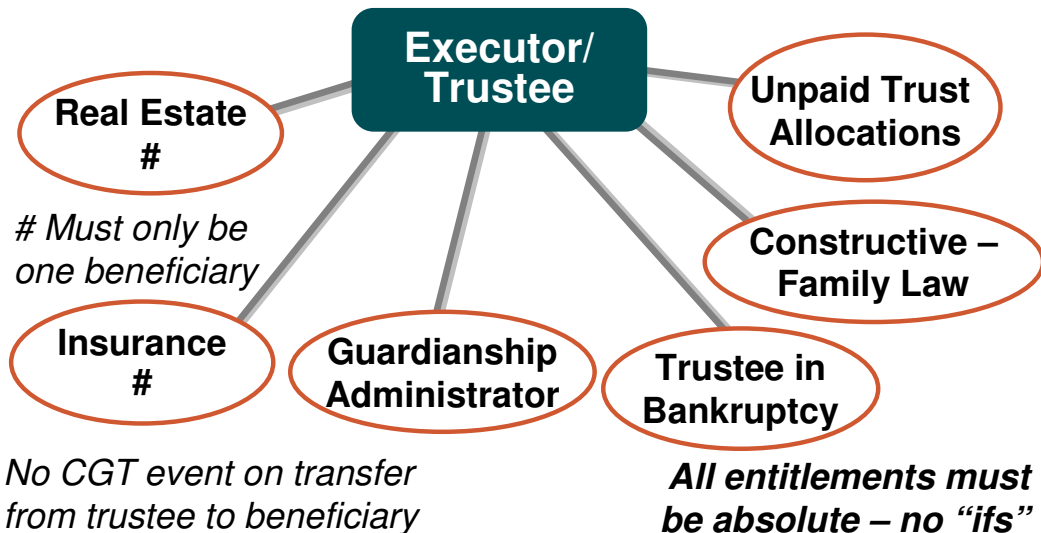
***Trustee***

The trustee is usually a relative or friend of the primary beneficiary, the primary beneficiary’s attorney or administrator or a professional trustee.

***Ultimate Control by Primary Beneficiary***

The appointor (usually the primary beneficiary or the primary beneficiary’s attorney or administrator) has effective control via the power to appoint the trustee.

## Types of Absolute Entitlement Trusts



### **“Absolute Entitlement” Trusts in Australia**

“Absolute entitlement” trusts, ie trusts that fall within the specific requirements of section 106-50 of the *Income Tax Assessment Act 1997*, can be:

- “Bare” trusts where the trustee administered the trust for an absolutely entitled beneficiary; or
- “Blind” trusts where the trust has been established so that either the beneficiary or third parties (or both) are not aware of the decision of, and transactions undertaken by, the trustee in administering the trust.
- Trusts where the entitlement of the beneficiary is still absolute, but the trustee, under the terms of the trust, is required to prioritise certain expenditure on behalf of the beneficiary, eg education or accommodation expenses.

A lack of decision making capacity, eg because of age, health or bankruptcy, is not an obstacle to an absolute entitlement trust. Assets in an absolute entitlement trust form part of the personal estate of the beneficiary. The beneficiary is able to include those trusts assets in the beneficiary’s Will. The trust assets also form part of the beneficiary’s divisible assets for bankruptcy and family law purposes.

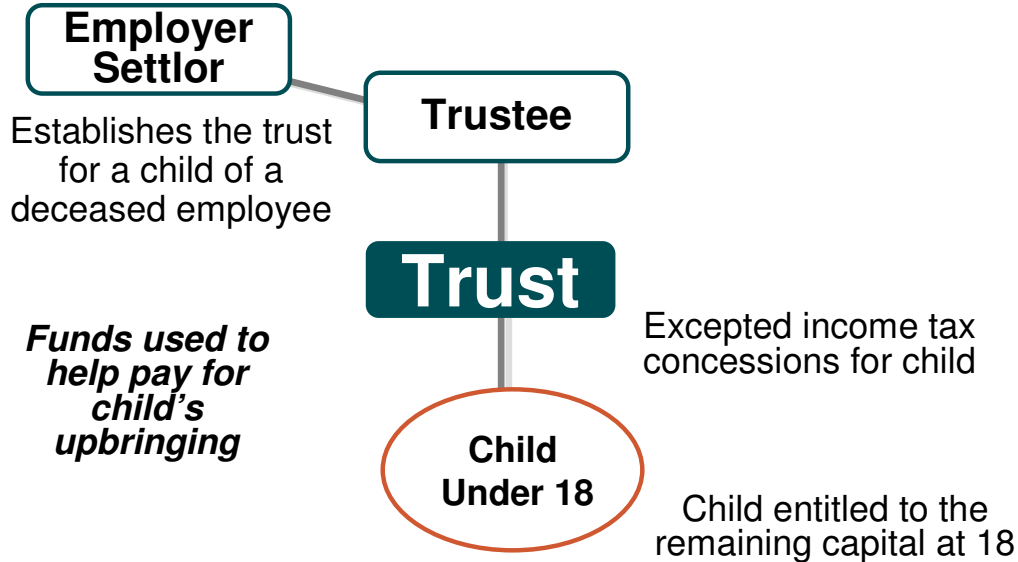
### **“Absolute Entitlement” Trusts and CGT**

When assets of the absolute entitlement trust are transferred from the trustee to the beneficiary, the transfer does not trigger a CGT event (because section 106-50 specifically exempts such transfers). In most cases, these transfers would not be dutiable transaction or taxable supplies for State duty and GST purposes either.

### **Trusts not meeting the 106-50 requirements (see TR 2004/D25)**

Among the trusts that the Australian Taxation Office does not consider to be absolute entitlements trusts are defeasible (“if”) trusts and trusts with 2 or more beneficiaries holding non-fungible assets such as real estate and insurance policies.

# Employer Funded Death Benefits Trust



## **Major Reasons for an Australian Employer Funded Death Benefits Trust**

# To enable an employer to fund a trust to help pay for the cost of the upbringing of a child of a deceased employee. # To achieve that funding in a tax effective manner by ensuring that the income of the trust will be concessionally taxed income pursuant to subparagraph 102AG(2)(c)(vi) of the *Income Tax Assessment Act 1936*. # To ensure that the remaining trust assets will pass to the absolutely entitled child without a CGT event occurring when the trust ends.

### **Trustee**

Chosen by the employer – may be the child's surviving parent (if appropriate and if the surviving parent is not a means tested pensioner. Separate trust needed (usually within a single trust deed) where the employee has more than one child.

### **Rights of Child**

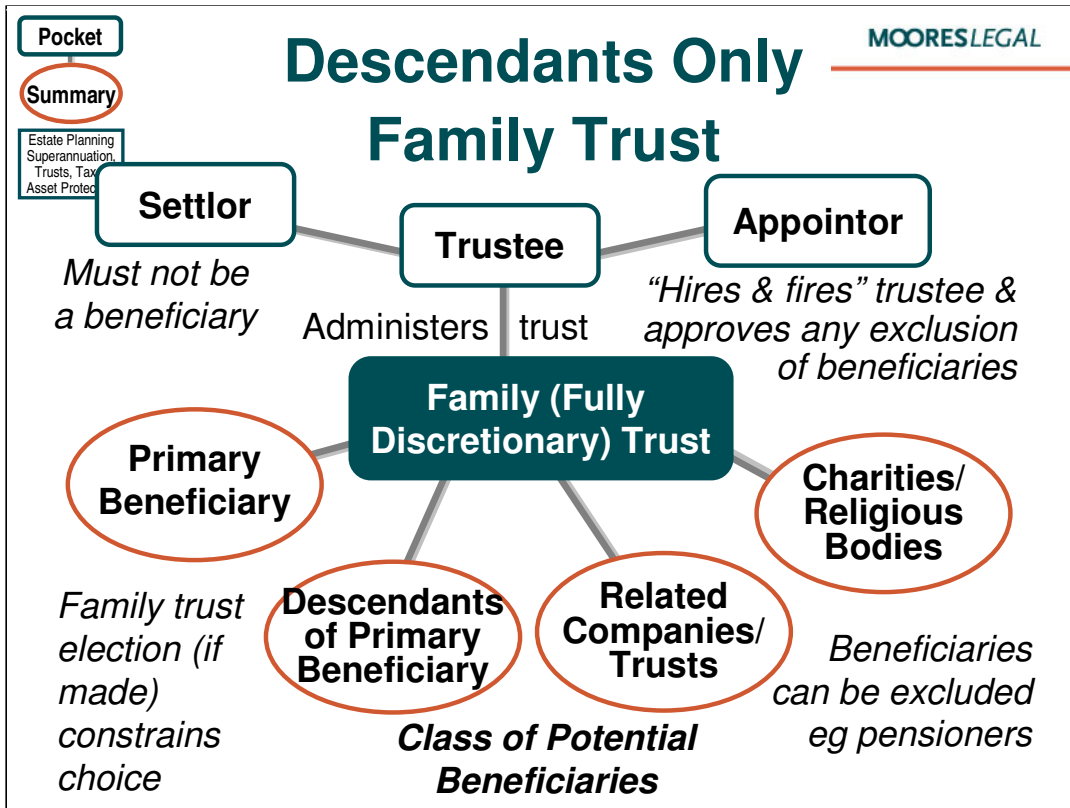
The child is entitled to prudential administration of the trust. On attaining 18 years of age, the child is entitled to demand payment of all of the trust capital remaining at that time.

### **Income**

The child is taxed on all income spent on or allocated or paid to the child, with credit for any tax already paid, eg dividend franking credits.

### **Capital Profits**

Taxed as a capital gain for the child (usually subject to a 50% discount). Unlike the non-fixed alternative, a CGT event does not occur when the trust ends and the capital is distributed to the child.



### **Limitations of an Australian Descendants Only Family Trust**

A descendants only family trust prevents the trustee allocating income or capital to the domestic partners or stepchildren of the descendants. At first instance this often appears to be an attractive option for an individual contemplating establishing such a trust.

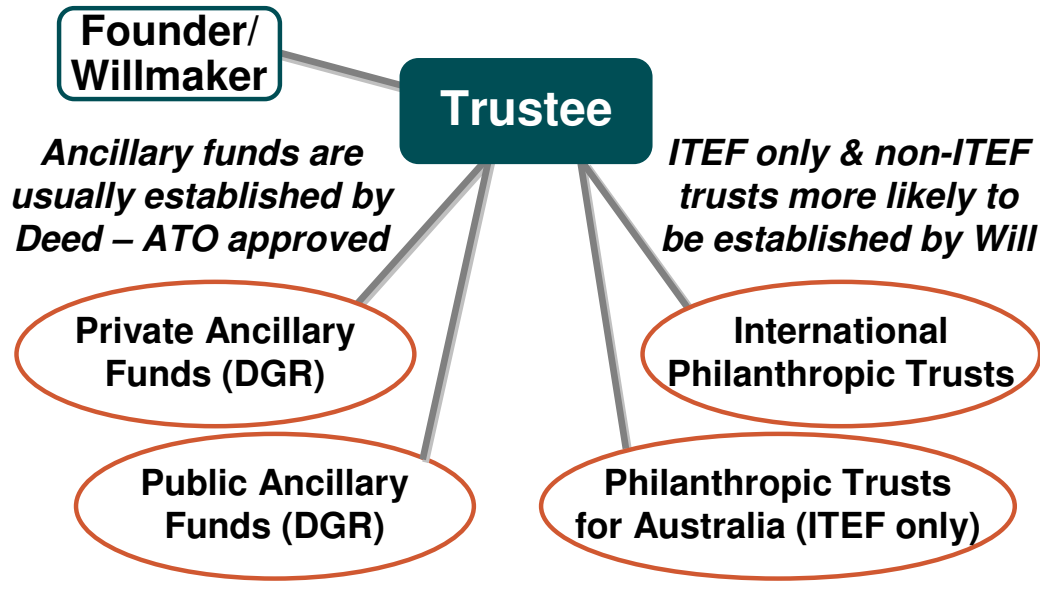
In practice, however, there are 2 major drawbacks to having a narrower class of beneficiaries than is usual for a family trust, ie:

- higher rates of income tax are often paid by the beneficiaries as the opportunity to split income with domestic partners is blocked; and
- the Family Court has the power to order that a payment be made by the trustee of the descendants only family trust to a beneficiary and then from the beneficiary to the beneficiary's domestic partner.

Subject to the narrower class of income beneficiaries, a descendants only family trust is administered in the same way as a standard fully discretionary family trust.

Related companies and trusts are usually included in the class of income beneficiaries, provided that the beneficial ownership of those companies is confined to income beneficiaries of the descendants only family trust.

# Types of Philanthropic Trusts



## ***Philanthropic Trusts in Australia – 3 Tax Categories***

- “DGR” – the trust, typically a private ancillary fund or a public ancillary fund, is a trust that has been endorsed by the ATO as a “deductible gift recipient” under Division 30 of ITAA 1997 (and also as ITEF – see below) . A DGR trust provides donors to the trust with an income tax deduction and can be useful for people starting philanthropic trusts during their lifetime. The most commonly established philanthropic trusts established are the 2 forms of ancillary funds.

- “ITEF” only – the trust itself is endorsed by the ATO as an “income tax exempt fund” under Division 50 of ITAA 1997, but the trustee is not able to provide an income tax deduction under Division 30 to a donor to the trust. An ITEF may well be sufficient for an individual funding a philanthropic trust via a Will bequest or a distribution from a family trust. In addition, philanthropic trusts established for Australian religious purposes are often established as ITEFs.

- Non-ITEF – while the trust itself is not able to be endorsed as being ITEF, that lack of eligibility for endorsement often means that the establishment and administration of the trust can be streamlined and the potential beneficiaries of trust can be widened to include international charitable purposes.

A non-ITEF philanthropic trust is only subject to Australian income tax to the extent that the trust income and any net capital gains are:

- Accumulated as an addition to the trust capital.
- Allocated to an ITEF beneficiary by the end of the financial year, but the trustee fails to notify the beneficiary within 2 months of the end of the financial year.
- Allocated to a non-ITEF beneficiary, eg most ex-Australian beneficiaries.

Via [www.treasury.gov.au](http://www.treasury.gov.au), the Australian government provides guidelines regarding the establishment and operation of both private and public ancillary funds.

# Types of Trusts – Further Reading

**Australian Master Estate  
Planning Guide –  
Chapter 10**

**You Can't Take It  
With You –  
Part 3**

The latest version of this Pocket Summary is at  
[www.mooreslegal.com.au/services/estateplanning/pocketsummaries](http://www.mooreslegal.com.au/services/estateplanning/pocketsummaries)

## **Further Reading**

- *Australian Master Estate Planning Guide* – Allan Swan, to be published (in both a Standard and Premium Edition) by **CCH** in 2012.
  - *Estate Planning Documents* – Allan Swan, **MOORESLEGAL** (includes many of the Pocket Summary series).
  - *You Can't Take It With You* – Andrew Simpson, **Wrightbooks**.
  - *Tax Issues in Family Law Property Settlements* – Peter Szabo, **MOORESLEGAL**.
- Australia-wide Seminar, Workshop & other Presentations – Allan Swan**

**EPSTTAP Introductory:** • Estate Planning – The A-Z • Superannuation – The A-Z  
• Trusts – The A-Z (includes all pages of this Pocket Summary).

**EPSTTAP Advanced:** • Estate Planning – Case Studies • Estate Planning Masterclass (4 & 6) • Superannuation – Death Benefits & Binding Nominations  
• Testamentary Trusts – Drafting the 6 Major Types • Trusts & Deceased Estates – Income & Capital Distributions (1-3) • AMEPG Chapter Workshops.

Allan's local **MOORESLEGAL** client, community & discussion group topics are:

- Estate Planning – Protecting & Enhancing Wealth • Estate Planning – Vulnerable Family Members • Family Trusts – Income & Capital Overview • Farm Succession – Avoiding Tax Pitfalls & Anticipating Disputes • Providing an Estate Planning Service for Clients • SMSFs – Instalment Warrants, Pensions & Binding Death Benefit Nominations • Tax & Business Structures Overview • Update – Estate Planning, Superannuation, Trusts, Tax & Asset Protection.

To book Allan for any of these topics, contact Lilian Bruère on 03 9843 2153. All Pocket Summaries are copyright and are for general information purposes only and should not be relied on as (or in substitution for) legal or other professional advice.