

# TRUSTS

## Excellent Private Wealth Investment Vehicles

AUSTRALIAN INVESTORS ASSOCIATION

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# Introduction

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Trusts hold the greatest portion of private wealth in Australia outside home ownership and superannuation.

Benefits include:

- Flexibility
- Asset protection
- Succession
- Taxation – 50% CGT exemption and access to franking credits.



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# Types of Trusts

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In Australia – types of trusts (per ATO):

- 78% Discretionary trusts
- 11% Unit Trusts
- 6% Deceased estates
- 6% Other – e.g. Hybrid

Bare trusts

- Very common and simple e.g. where a parent opens a bank account on a child's behalf
- Tax return is not required.



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# Brief History

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Trust law began many hundreds of years ago in England

Based on practical needs, for example:

- King requests a Knight to conquer foreign lands
- Knight has large estate and a family requiring care
- Knight asks trusted neighbour to manage estate and provide for family



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# Key Elements of Trusts

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Trustee - Neighbour

Trust property – The Knight's Estate

Beneficiaries – Knight's wife and children

Trust Deed – Rules applying to the management of the trust

Note: Unlike a company a trust is not a separate legal entity



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# Discretionary Trusts

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The most popular form of Trust in Australia

Additional key roles in discretionary trusts

- Settlor –provides initial capital for the trust (nominal)
- Appointor/s – Hold the real power – Can replace the trustee with another trustee

Key benefits:

- Flexibility
- Asset protection
- Succession
- Tax Efficiency



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# Flexibility – Discretionary Trusts

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Trustee distributes Income and Capital annually on a discretionary basis

There are no “owners” of discretionary trusts = no fixed entitlements

- Differs from companies and unit trusts
  - Shareholders own companies
  - Unitholders typically own trusts (subject to specific rights)

Beneficiaries are merely named as potential beneficiaries in the trust deed.



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# Discretionary Trust Example

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## Family and related entities

- Mr and Mrs Hancock
- Three children
  - Johnny – Age 21, Uni student working part time
  - Charity – Age 19, full time Uni student
  - Hope – Age 16
- Reliable Pty Ltd trustee for Hancock Family Trust
  - Investments – Australian shares.
  - Net income (after expenses) - \$100,000 pa
- Hancock Investments Pty Ltd – corporate beneficiary



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# Discretionary Trust Example (Con't)

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Annually the trustee should distribute the net income of \$100,000

Examples of Income Distribution Options:

A. Distribute the income to each parent equally

- \$50,000 Mr Hancock
- \$50,000 Mrs Hancock, or

B. One parent and one adult child

- Mr Hancock \$90,000
- Johnny \$10,000



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# Discretionary Trust Example (Con't)

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## Distribution options (con't)

### C. One parent and all children

- Mrs Hancock \$70,000
- Charity \$20,000
- Johnny \$9,584 (other income \$10,400)
- Hope \$416

### D. All to the related company

- Hancock Investments Pty Ltd \$100,000



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# Asset Protection - Discretionary Trusts

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No fixed ownership by beneficiaries provides additional asset protection

Assets are more exposed to creditors where:

- They own assets in their personal name directly
- This includes:
  - Shares in private companies
  - Units in Unit Trusts

Discretionary beneficiaries only right is for “due administration” of the trust.



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# Succession - Discretionary Trusts

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Life of a trust may exceed the founders

May be passed on from generation to generation subject to the vesting date chosen or the “rule against perpetuities”

- In NSW the rule against perpetuities is a maximum of 80 years
- Other states have different periods

Trust assets “vest” (distribute the assets) on the vesting date

- CGT may be payable on gains realised at the time of vesting



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# Other tax issues – Discretionary Trusts

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If a trustee does not distribute all the net income each year it pays tax at the top marginal rate of tax – 45%.

Family Trust Election – should be made to allow franking credits to flow through to beneficiaries and trust losses to be carried forward.

- Need to nominate a “test individual” around which the family group is measured.

Trust losses cannot be claimed by beneficiaries personally

- Can only be offset against future trust income



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# Other tax issues – Discretionary trusts

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Bill Shorten's announcement regarding Labor policy – 1 August 2017

- Very limited detail provided

Assuming Labor wins the next election and the announcement is legislated:

- Discretionary trust distributions will be taxed at a minimum of 30%
- Farm trusts, special disability trusts and charitable trusts are not affected

This would be a major change to decades of tax treatment.



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# Other tax issues - Discretionary trusts

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## Labor policy (con't)

Tax implications assuming no other income and distributions are made to adults up to the tax free threshold each year:

- Additional tax payable per annum:
  - Single Adult (not a senior) - \$6,162
  - Single Senior - \$9,683
  - Single Senior (couple) - \$8,692 each (combined threshold is \$57,948).

If becomes law there may be strategies to reduce this tax

- Pay commercial salaries to individuals
- Distribute income to a company which pays dividends to shareholders.



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# Other tax issues - Discretionary trusts

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NSW Land Tax - Payable on the unimproved land value (excluding home and primary production land)

- No tax free threshold for discretionary trusts - currently \$549,000 (2017).
- Rate is 1.6% +\$100
- Discretionary trusts can therefore pay \$8,884 p.a. more land tax than individuals
  - Land tax is deductible for income tax purposes where the property is income producing

CGT – 50% exemption is available for investments held for more than 12 months.



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# Unit Trusts

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Common examples: REITs and Managed Funds are public unit trusts

Private unit trusts are typically used to pool investments between families or within a family group e.g. SMSF and individuals.

Key differences from discretionary trusts:

- Beneficiaries hold units and become unit holders
- Unitholders have specific rights specified in the trust deed
- Net income generally distributed based on the % of units held (subject to the deed).
- Trust deed can be drafted so that there are fixed and discretionary aspects (known as Hybrid Trusts).

# Unit Trusts

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## Taxation

- Similar to discretionary trusts except:
  - Beneficiaries hold an asset for CGT purposes being the unit
    - can be sold for a gain or loss
  - If trust law income exceeds taxable income the CGT cost base of the units will be adjusted down – can cause CGT issues.
- If the units are fixed the unit trust may be entitled to the NSW land tax free threshold.
  - Beneficiaries will also be assessed for land tax – credit received

# Conclusion

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Trusts remain a very important vehicle for holding private wealth in Australia

As discussed today; they provide benefits such as:

- Flexibility
- Asset Protection
- Succession
- Taxation savings

It is critical you seek specific professional taxation and legal advice before deciding whether a trust is appropriate for you and the terms of your trust.



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# Contact us

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