

What is a Trust?

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## Purpose of this document

The purpose of this document is to outline the nature of a trust, the parties to a trust and some important considerations that are relevant to trusts generally.

This document does not represent an exhaustive treatment of the legal and taxation issues associated with trusts. However it will be useful introduction to those considering establishing a trust. Further advice should be obtained from a legal practitioner.

## 1. What is a trust?

In essence a trust is simply a relationship where one person (the trustee) is under an obligation and holds or uses assets (trust property) for the benefit of another person (a beneficiary) for some object or purpose.

Thus, any trust has four essential elements:

Trustee;  
Trust Property;  
Equitable Obligation;  
Beneficiaries;

To restate the above in slightly more legalistic terms "a trust is a fiduciary relationship where one person, a trustee, holds an interest in property but has an equitable obligation to use or keep that property for the benefit of another person(s) (beneficiaries) for some committed object or purpose.

There are many types of trusts, however the common ones are:

Express Trusts;  
Settled Trust;  
Discretionary Trusts;  
Unit Trust;  
Will Trust;

**Express Trusts** - are trusts created by the express and intentional declaration of the settlor. Trusts dealt with in practice usually evidence this declaration by way of a formal trust deed.

**Settled Trust** - one form of an express trust is a settled trust created by settlor (or director). The settlor will intentionally create a trust by gifting the initial trust property to be held on trust by a trustee under an equitable obligation.

The most common trusts we implement are a discretionary trust, unit trust and a will trust (or deceased estate).

**Discretionary Trust** - a common settled trust dealt with in practice is a discretionary trust. A discretionary trust, which may also be known as a family trust, allows the trustee (who is usually the head of the family) to exercise discretion on an annual basis as to which beneficiaries will receive a distribution and to what extent each beneficiary shall benefit.

**Unit Trust** - Unit trusts are commonly used when arms length parties wish to enter into a commercial undertaking together.

Each party's entitlement to income and capital from the trust is proportionate to the units held.

**Will Trust** - A will trust or a deceased estate arises on the death of a person. Upon death, property of the deceased passes to his or her estate.

The fiduciary obligation to administer the estate and the assets therefore falls upon the executor or administrator who assumes the role of trustee in respect of the property of the deceased estate.

The beneficiaries of a deceased are those nominated in the Will of the deceased.

## 2. Why choose a trust?

Issues to be considered when choosing a trust are as follows;

- Control
- Simplicity/complexity
- Liability limitation
- Costs - establishment and maintenance
- Life span
- Formalities/adherence to rules
- Reporting and disclosure requirements
- Acceptability to financiers
- Admission of new investors
- Selling out/winding up
- Family disharmony/asset - sheltering
- Retirement planning
- Ease of future restructure

Should the concept of a trust satisfy your commercial objectives, the following taxation issues will need to be considered:

### **Taxation issues:**

- Overall level of tax;
- Acceptability by authorities;
- Double taxation;
- Restructuring tax consequences;
- Employee on costs;
- Tax payments/tax rate;
- Flexibility of distributions;
- Tax losses trapped;
- Dividend streaming;
- Type of business to be carried on;

## 3. How do you set up a trust?

If you have made the decision that a trust is an appropriate structure the next step is to establish a trust.

### **Approaching a Solicitor**

Prior to approaching a solicitor you should not only have considered the commercial and taxation issues noted previously, but you should also have determined:

- The purpose and activities of the trust;
- Nominated beneficiaries and future beneficiaries;
- Who is to be the trustee and settlor;

### **Review and Understanding**

The solicitor will draft the trust deed in accordance with the client's requirement and at this stage it is critical that a thorough review is done to ensure that the trust deed (or governing rules) reflects your commercial and legal requirements and allows flexibility for future contingencies.

If a solicitor who specialises in trust law is consulted you will often receive an information booklet setting a basic outline of a trust for administration purposes.

At this stage also it is critical that you read through the draft deed and that questions are addressed prior to creating the trust. In this regard the family or business solicitor (if he or she did not draft the deed) may be used to add his/her comments and to provide a different perspective and extra level of comfort to both the client and accountant.

## **4. Parties to a trust**

### **The Creator or Settlor**

The Creator or settlor is the person who brings the trust into being.

Typically the settlor is a family friend or business associate who will contribute initial capital of up to \$100 to create or settle the trust.

It is important that there is not any reimbursement by the trustee in respect of distributions made for children under 18 years old if a parent, who will usually act as trustee or a director of the trustee company of a family trust, settles or creates the trust.

It is also advisable that the advisers to the trust are not the settlor for the reason that many trust deeds contain clauses that the settlor is excluded from any benefit or income under the trust.

### **The Trustee**

A Trustee is the person who holds an interest in trust property for a committed trust object or purpose.

In a discretionary trust situation the trustee exercises control over trust property so the trustee can deal with it on behalf of beneficiaries.

The choice of a trustee is worth proper consideration for the reason that the trustee's powers and duties are significant. In that regard the person who is appointed to the position must understand his/her role and responsibilities.

Trustees may be individuals but more commonly will be companies to limit liability. In a family trust a parent or both parents will usually act as directors of a corporate trustee.

### **The Appointor**

The Appointor is the person who has the authority under the trust deed to appoint or remove the trustee of the trust. As such the appointor is often said to be the **controller** of the trust.

Many trust deeds empower the appointor to remove the trustee and appoint a new trustee at any time in writing.

Unless specified in the trust deed or in the will of the Appointor, on the death of the Appointor, the legal personal representative of the deceased Appointor will become the Appointor.

### **Income Beneficiaries**

These are beneficiaries who may at the discretion of the trustee receive entitlement to trust income. Most modern trust deeds are drafted very widely in this area to give the trustee very wide discretionary powers for the advantage of flexibility of distribution for taxation purposes. Common classes of beneficiaries are:

Family members, including children;

Unborn children of family members such as direct lineal descendants;

Eligible entities in which the abovementioned beneficiaries of the trust itself has an interest (such as a corporate beneficiary)

### **Capital beneficiaries**

These are beneficiaries who are entitled to the corpus of the trust or the capital in the trust.

This entitlement does not usually arise until vesting day, or the day the trust is to be wound up, but entitlements to capital or corpus of the trust may occur earlier if permitted by the trust deed or agreed to by all beneficiaries.

## **Default Beneficiaries**

A default beneficiary is simply the beneficiary to whom a distribution may default to in the absence of any other nominated beneficiary.

For example should an amended assessment be raised increasing assessable income that income will be distributed primarily in accordance with the relevant trustee's distribution minute.

However in the absence of any guidance contained therein or in the event the resolution or minute cannot be located or was not made for the reason there was considered to be no income, the distribution may revert to the default beneficiary rather than be assessed in the hands of the trustee at the top marginal rate.

There are very few restrictions on who may be a beneficiary. A beneficiary may be a resident or non-resident natural person or any legal entity.

Further, persons who have not yet been born or legal entities that have not yet come into existence may subsequently become beneficiaries. However it is important to nominate who will be and who can become a beneficiary on drafting of the deed.

A trust, as stated above, is a fiduciary relationship.

The adding of unanticipated beneficiaries at a later stage may, in a worst case scenario, lead to a resettlement of a trust or the ceasing of the former relationship and creation of a new relationship, being the creation of a new trust.

Should there be considered to be cessation of one trust and the creation of a new trust, a myriad of unwelcome income tax, capital tax and stamp duty issues may arise.

Thus, upon reviewing the deed detailed consideration must be given to who and who might potentially become income, capital and/or default beneficiaries.

## Contact us

Should you be interested in discussing further how a trust may suit your purposes please do not hesitate to contact us at our office in Sydney.

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We have the technical and industry knowledge to provide professional advice and practical solutions to our clients in the complex area of international tax.

We are a wholly independent company with an affiliate office in Singapore.

For more information about us please visit our website - [www.marcarian.com.au](http://www.marcarian.com.au)

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