What is a discretionary trust?

A discretionary trust is generally a trust under which the distribution of income or capital to beneficiaries is made at the discretion of the trustee. Until the trustee exercises its discretion, the beneficiaries generally have no interest in the property of the trust. A discretionary trust is sometimes called a "family trust" (for tax reasons, however, a family trust means a trust that has made a family trust election).

What are the benefits of a discretionary trust?

The benefits of a discretionary trust include the following:

- Potential asset protection;
- The trustee has flexibility regarding the distribution of income and capital;
- Less regulation than a company;
- The trust deed can be tailored to the needs of principals and beneficiaries;
- Easier to wind up than a company.

When does a discretionary trust start?

A discretionary trust is created when a person known as the "settlor" gives the trustee money or property for the benefit of the beneficiaries. The "settled sum" is the original trust fund. The settlor is normally a family friend and should not be a beneficiary of the trust, nor should they be the client's accountants or anyone else who could be seen to benefit or receive money from the trust. No other legal obligations arise for the settlor, who is not responsible in any way for the trustee's actions.

A trust deed is usually subject to stamp duty. The stamp duty varies from one state to another.

Explanation of other terms in the trust deed

The trustee

The trustee is the legal owner of the trust property, although not the beneficial owner, and is responsible for managing the trust fund.

The trustee's overriding duty is to obey the terms of the trust deed. The trustee also has a duty to act in the best interests of the beneficiaries. There are many other duties imposed on the trustee by law.

As the trustee is personally liable for the debts and transactions they undertake on behalf of the trust, best practice is to use a company as trustee, for the following reasons:

- it is easier to effect changes of control;
- a company never dies; this saves the expense of transferring assets to new trustees on the death or retirement of the existing trustees; and
- the company will have no significant assets of its own (if its only role is to act as corporate trustee) which could be exposed to the creditors of the trust (however, the directors may be personally liable in certain circumstances).

It is generally preferable for different trusts to have separate trustees.

The appointor

The appointors (or appointor) of a trust have the real power and control of the assets of a trust. The appointors have the power to appoint and remove trustees. In most cases, the original appointors are the parties for whose benefit the trust is established.

Generally, having a number of joint appointors, possibly including an independent appointor, provides greater asset protection and succession planning benefits, so it is preferable to avoid having a sole appointor. Alternatively, a company could be made the appointor.

The beneficiaries

The beneficiaries are the people (including entities) for whose benefit the trustee holds the property.

Features of NTAA Corporate's Trust Deed

The following are some of the features of NTAA Corporate's Discretionary Trust Deed. However, the deed should be read in full to fully ascertain the relationship between the trustee(s) and the beneficiaries.

- The general beneficiary clause is very wide, basically including almost anyone related by blood or marriage to the Primary Beneficiaries, as well as trusts and companies in which they may have an interest.
- If no determination is made to distribute the income of the trust for a particular income year, the income will be held on trust for equal distribution amongst the Primary Beneficiaries (unless any of them have died, in which case their share will be distributed equally to their children).
- When the trust is wound up (which will be 80 years after the trust commences, unless the trustee decides to wind it up earlier) the trustee can distribute the assets of the trust fund as it thinks fit and, if it does not make a determination, they will be distributed to the Primary Beneficiaries (unless any of them have died, in which case their share will be distributed equally to their children) or, if none of them are alive, equally to the general beneficiaries.
- The above default clauses ensure that the income and capital of the trust can be distributed in the relevant circumstances even if no determination is made to that effect (and, in the case of the income of the trust, ensures that someone will always be presently entitled to the income for taxation purposes). However, it should be noted that adverse tax consequences may arise if a "default" beneficiary "renounces" their interest in the trust fund for any reason – such a beneficiary should seek advice before doing so.
- The trustee's powers have been drafted as broadly as possible, also allowing the trustee to act as if it is the sole and beneficial owner of the assets of the trust fund, and should include most situations that a trustee will encounter (although note that banks are notorious for requiring very specific powers to be inserted, and may still insist on this despite the trustee having very broad power to act under the deed).
- The trust deed allows income derived from the investment of property received from a deceased estate (and similar property) to be distributed to minor beneficiaries such that they retain their preferential tax status (i.e. for the income to be taxed at adult rates).
- There is a dispute resolving mechanism when there is more than one trustee (or appointor) and they can't reach an agreement.
- If the trustee receives a testamentary gift (i.e. under the will of a deceased person) and there may be a problem with a technical legal rule known as "the rule against the delegation of testamentary power" (or any other such legal rule or law) then that gift is considered to be held on trust for the beneficiaries existing at the time the trustee receives the gift. New beneficiaries can be added but if any such technical rules apply, they cannot share in that gift. Note that this rule is still contentious in Australia, but the clause has been inserted to remove doubt.
- It is possible for the trustee to resettle this trust (i.e. the trustee is not prohibited from doing so and may, for example, add new beneficiaries) but utmost care should be taken when resettling the trust (or in doing anything that may resettle the trust), due to the adverse tax consequence that may result. Resettling the trust basically results in a totally new trust arising, and the assets of the old trust being deemed to be sold to the new trust, potentially triggering income tax, capital gains, GST and stamp duty issues. Expert advice should be obtained before doing anything that may resettle the trust.

Disclaimer

These notes are intended to be a guide only. You should not act solely on the basis of the information contained in these notes because many aspects of the material have been generalised and the tax laws apply differently to different people in different circumstances. Further, as tax laws change frequently, there may have been changes to the law since the notes were written.

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