

Checklist: Unit Trusts

Failing to effectively establish and operate a trust can lead to poor outcomes for you and your clients.

We get it.

It's important to appreciate the need for the effective establishment and operation of a trust, and to remember that the primary reasons for establishing trusts are:

- **Asset protection** – protecting assets from creditors of the trustee and beneficiaries.
- **Tax planning** – achieving the best possible tax outcomes.
- **Estate planning** – achieving an intergenerational change of control of assets.

Getting this wrong may mean the trust's assets are exposed to personal creditor's claims, and/or more tax is payable than would otherwise be the case.

We've developed a simple diagnostic tool so you can:

- **Quickly identify any gaps in trust structures** – some of which may be easily addressed with a trust deed amendment;
- **Review trust deeds** – this should be done regularly to ensure they reflect changing circumstances and are continuing to provide for effective trust distributions; and
- **Understand the benefits of standardised terms** – this reduces the time you'll need to review your trusts.

Please call us on 1800 773 477 if you have questions while completing the checklist or identify anything that needs action.

Unit Trust Checklist

Please refer to the FAQs attached for a more detailed explanation of these issues.

1. Trust Establishment and Continuity FAQ 1

Has the deed been properly and validly executed? (FAQ 1.1) ▶CLICK HERE	Yes	No/Unsure
Has the perpetuity date of the trust already passed? (FAQ 1.2) ▶CLICK HERE	Yes	No/Unsure
Does the trustee hold a fully executed copy of the trust deed? (FAQ 1.3) ▶CLICK HERE	Yes	No/Unsure
Is the trust dormant and/or should the trust be terminated? (FAQ 1.4) ▶CLICK HERE	Yes	No/Unsure

2. Fixed Trusts FAQ 2

Is the trust required to be fixed under Sch 2F ITAA 1997? (FAQ 2.1) ▶CLICK HERE	Yes	No/Unsure
Does the deed require issue and redemption at market value? (FAQ 2.1) ▶CLICK HERE	Yes	No/Unsure
Do the unit holders require access to franking credits? (FAQ 2.2) ▶CLICK HERE	Yes	No/Unsure
Does the deed permit the issue of partly paid units? (FAQ 2.3) ▶CLICK HERE	Yes	No/Unsure
Is income and capital distributed proportionately? (FAQ 2.4) ▶CLICK HERE	Yes	No/Unsure
Can income/capital be distributed other than to unit holders? (FAQ 2.4) ▶CLICK HERE	Yes	No/Unsure
Can the trustee issue or reclassify different classes of units? (FAQ 2.5) ▶CLICK HERE	Yes	No/Unsure
Can the trustee amend the deed? (FAQ 2.6) ▶CLICK HERE	Yes	No/Unsure
If so, is unanimous consent of unit holders required? (FAQ 2.6) ▶CLICK HERE	Yes	No/Unsure
Can the trustee accumulate income rather than distribute? (FAQ 2.7) ▶CLICK HERE	Yes	No/Unsure
If so, is unanimous consent of unit holders required? (FAQ 2.7) ▶CLICK HERE	Yes	No/Unsure
Does the trustee have power to make gifts? (FAQ 2.8) ▶CLICK HERE	Yes	No/Unsure
Has a Family Trust Election been made? (FAQ 2.9) ▶CLICK HERE	Yes	No/Unsure
Does the trust hold land in NSW? (FAQ 2.10) ▶CLICK HERE	Yes	No/Unsure
Does any SMSF hold units in the trust? (FAQ 2.11) ▶CLICK HERE	Yes	No/Unsure

3. Income and Capital FAQ 3

Does the deed contain a definition of income? (FAQ 3.1) ▶CLICK HERE	Yes	No/Unsure
Is income defined as S95 income or some other method? (FAQ 3.2) ▶CLICK HERE	Yes	No/Unsure
Can the trustee adopt different definitions or methods? (FAQ 3.3) ▶CLICK HERE	Yes	No/Unsure
Can the trustee record amounts as income or capital? (FAQ 3.4) ▶CLICK HERE	Yes	No/Unsure
Can the trustee record income in specific categories? (FAQ 3.5) ▶CLICK HERE	Yes	No/Unsure
Can the trustee stream different classes of income? (FAQ 3.6) ▶CLICK HERE	Yes	No/Unsure
Can the trustee accumulate income rather than distribute? (FAQ 3.7) ▶CLICK HERE	Yes	No/Unsure
Can the trustee treat accumulated income as income? (FAQ 3.8) ▶CLICK HERE	Yes	No/Unsure

Unit Trust Checklist

Can the trustee distribute capital gains before the trust ends? (FAQ 3.9) ▶CLICK HERE	Yes	No/Unsure
Can the trustee make in specie distributions? (FAQ 3.10) ▶CLICK HERE	Yes	No/Unsure

4. Current Provisions and Positions in the Trust FAQ 4

Does the deed contain an indemnity to the trustee? (FAQ 4.1) ▶CLICK HERE	Yes	No/Unsure
Does the deed permit a conflict of interest? (FAQ 4.2) ▶CLICK HERE	Yes	No/Unsure
Are all of the trustee's powers up to date/bank compliant? (FAQ 4.3) ▶CLICK HERE	Yes	No/Unsure
Can the trustee amend the deed? (FAQ 4.4) ▶CLICK HERE	Yes	No/Unsure
Can this be done without consent of any other person? (FAQ 4.5) ▶CLICK HERE	Yes	No/Unsure
Are any schedules part of the deed? (FAQ 4.6) ▶CLICK HERE	Yes	No/Unsure
Does the trust deed allow appointment/removal of trustees? (FAQ 6.4) ▶CLICK HERE	Yes	No/Unsure

5. Unpaid Entitlements FAQ 5

Do unpaid entitlements remain as UPEs and not loans? (FAQ 5.1) ▶CLICK HERE	Yes	No/Unsure
Does the deed contain a sub-trust provision? (FAQ 5.2) ▶CLICK HERE	Yes	No/Unsure
Are there any unpaid entitlements to companies? (FAQ 5.2) ▶CLICK HERE	Yes	No/Unsure

6. The Trust & Asset Protection FAQ 6

Does the deed provide effective asset protection? (FAQ 6.1) ▶CLICK HERE	Yes	No/Unsure
Has the trustee considered the powers of the Family Court? (FAQ 6.2) ▶CLICK HERE	Yes	No/Unsure
Is the trustee a company? (FAQ 6.3) ▶CLICK HERE	Yes	No/Unsure

7. Small Business Concessions FAQ 7

Has the trustee considered small business tax concessions? (FAQ 7.1) ▶CLICK HERE	Yes	No/Unsure
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8. Resettlement FAQ 8

Is there a resettlement risk, CGT risk or stamp duty risk? (FAQ 8.1) ▶CLICK HERE	Yes	No/Unsure
Does the trust have any carry forward losses? (FAQ 8.1) ▶CLICK HERE	Yes	No/Unsure
Does the trust have any dutiable assets or capital gain assets? (FAQ 8.1) ▶CLICK HERE	Yes	No/Unsure

Other significant issues specific to the trust?

FAQ 1 – Trust Establishment and Continuity

- 1.1 Where, by oversight or otherwise, a trust deed is not validly executed, this may raise significant validity issues – at worst, the trust may not exist. If so, any distributions made will be invalid and may result in notices of re-assessment being issued by the ATO in relation to purported distributions.

Some trust deeds may be signed by using electronic signatures relying on Commonwealth and state/territory legislation that permits some documents to be signed that way.

The Corporations Act 2001 provides a method for the execution of trust deeds by companies, and state/territory legislation applies for the execution of deeds by individuals. The legislation imposes the following conditions on electronic signatures:

- a method is used to identify the person and to indicate the person's intention; and
- the method used is either:
 - as reliable as appropriate for the purpose, in the light of all the circumstances; or
 - proven to have fulfilled those functions; and
- the person to whom the signature is given consents to that requirement being met by electronic communication.

The Corporations Act 2001 provides a method for the execution of documents (including trust deeds) by companies – section 127 (the primary method relied upon) requires signature by company officers. The Commonwealth Electronic Transactions Act 1999 however, excludes the whole of the Corporations Act from its operation. Therefore, electronic signatures do not constitute "signing" under the Corporations Act (at least as far as section 127 is concerned).

In each state/territory, legislation applies which deals with the execution of deeds by individuals. Usually these require an individual's signature to be witnessed by a third party. In most states, the electronic transactions legislation doesn't exclude the execution of deeds. However, this may not extend to witnessing. Therefore, an electronic signature must be witnessed by the written signature of the witness – meaning the electronic signature could not work, in practice, for trust deeds.

► **BACK TO QUESTION 1**

- 1.2 If the trust's vesting day has already passed, the trust has ceased to exist. If so, any distributions made after that date, whether of income or capital, may be invalid and may result in notices of re-assessment being issued by the ATO in relation to purported distributions of income or taxable capital gains. ► **BACK TO QUESTION 1**

- 1.3 If a trust deed is lost, it will need to be replaced to ensure it's continued existence and proper operation. In practice, where you can show that the trust has been established, this can be done by:
- (a) adopting a replacement trust deed; and/or
 - (b) seeking a declaration from a court of the validity and terms of the trust.

In each case, the trustee must be able to show that the trust was validly established and prove the terms of the trust as they existed at the date of establishment. It's generally recommended that the trustee contact the firm that prepared the trust and obtain a copy of the trust deed.

If that's not possible, the trustee may obtain a copy of the form of trust deed generally in use at the time by the firm that prepared it. The trustee must then establish, as closely as is possible, the terms of the trust as they existed at its establishment. If the trust deed was prepared by Acis after August 2006, we have an exact copy in our records. If prior to August 2006, we are likely to have all the relevant details and a pro forma deed that would have been used for the trust. If the trust deed was not prepared by Acis, we may still be able to provide a replacement trust deed.

Practitioners should be aware however, that there are limitations as to what can be done to replace a lost deed. The trustee must be in a position to produce evidence of:

- (a) the valid creation of a trust; and
- (b) the original terms of the trust as contained in the original trust deed.

Without these there will always be some question as to whether the replacement truly represents the terms of the trust. ► **BACK TO QUESTION 1**

- 1.4** Trusts usually have a specific life – usually the statutory period of 80 years. At the end of the term of the trust, it will expire or terminate, by operation of law. This is unlike a company, which will continue to exist indefinitely, until it is wound up or deregistered. However, a trust will not end or cease to exist simply because it is dormant. Like a company, overt steps must be taken by the trustee to formally terminate the trust. Ideally this will be done by a vesting deed. Prior to vesting (terminating) the trust, all of the trust's assets must be distributed and all liabilities discharged. Some care is needed as there may be capital gains tax or commercial debt forgiveness issues to consider.

Prior to vesting (terminating) the trust, all of the trust's assets must be distributed and all liabilities discharged. The steps to winding up include:

- prepare the vesting deed;
- discharge or set aside funds as a provision for trust liabilities;
- make provision for any contingent or other liability of the trust for income tax;
- lodge all outstanding returns and ensure the ATO cancels the trust's ABN/TFN.

► **BACK TO QUESTION 1**

FAQ 2 – Fixed Trust

- 2.1** Section 272-65 of Sch 2F defines a fixed trust as one in which "persons have fixed entitlements to all of the income and capital of the trust". A non-fixed trust is defined in s 272-70 of Sch 2F as a trust that is "not a fixed trust". ► **BACK TO QUESTION 2**

According to section 272-5(1) of Sch 2F, beneficiaries have a fixed entitlement to the income and capital of the trust where they have a vested and indefeasible interest in a share of the income or capital. Section 272-5(2) of Sch 2F requires that units can only be issued or redeemed on the basis of the net asset value, according to Australian accounting principles, of the unit trust at the time of the redemption or issue in order to constitute a "fixed entitlement to the income and capital of a trust".

Schedule 2F deals with the recoupment of trust tax losses. A number of tests which will permit the carry forward of trust losses, are prescribed - some apply to "fixed trusts" and others to "non-fixed trusts". They are:

Fixed trust rules (Subdivision 266-B of Sch 2F)

- 50% stake test (similar to the continuity of ownership test for companies), and
- non-fixed trust stake test (applicable where fixed entitlements to the trust's income or capital are held by non-fixed trusts, like discretionary trusts).

Fixed trust rules (Subdivision 266-B of Sch 2F)

- Pattern of distributions test
- Control test, and
- 50% stake test (only applicable if some of the beneficiary entitlements are fixed (more than 50%) and some are not fixed, which rarely happens in practice. If, for example, the trust is 100% non-fixed, then this test does not apply).

From a trust loss perspective, it is preferable that the relevant trust be a fixed trust since the fixed trust rules are simpler to satisfy and the non-fixed rules (the pattern of distribution test and the control test) can be difficult or virtually impossible to apply in practice.

Very few (particularly older) unit trust deeds qualify as fixed trusts because most allow the issue and redemption of units at a price which is determined at the discretion of the trustee. Classification as a fixed trust is now, less likely following the Federal Court decision in Colonial First State Investments Ltd v Commissioner of Taxation. The Court decided that due to the presence of a power of amendment in the trust deed, the interests of the unit holders could not be said to be indefeasible. Since virtually all deeds contain a power of amendment, almost none will therefore qualify.

Since that decision was handed down the Commissioner has taken the general view that no trusts are fixed trusts for the purposes of Sch 2F. Trustees have relied since that time on the exercise of the Commissioner's discretion in section 272-5(2) of Sch 2F to treat the trust as "fixed" in appropriate circumstances.

► **BACK TO QUESTION 2**

2.2 Where a trust is non-fixed, difficulties arise under the dividend imputation system.

To claim the benefit of franking credits, section 207-145 ITAA 1997 requires a taxpayer to be a "qualifying person" i.e. the person must hold the relevant shares or interests "at risk" for a continuous period of 45 days.

To work out if shares are held "at risk", special rules apply to a person who holds an interest in shares as the beneficiary of a trust. Generally, a beneficiary is taken not to hold their shares at risk. Effectively, where a unit holder receives a franked dividend from, then that unit holder will not gain the benefit of any franking credits. 2 main exceptions are available:

- a family trust election has been made in relation to the trust and the franked distribution is paid to a beneficiary (unit holder) who falls within the family group;
- the beneficiary (unit holder) has a fixed interest in the trust.

Just like the trust loss rules, the imputation rules specify that, beneficiaries have a fixed interest where they have a vested and indefeasible interest in a share of the income or capital. Similarly also, units can only be issued or redeemed on the basis of the net asset value, according to Australian accounting principles, of the unit trust at the time of the redemption or issue.

Accordingly, if the unit trust is not fixed for the purposes of Schedule 2F loss rules, a unit holder's interest in that trust will not be fixed for imputation purposes.

► **BACK TO QUESTION 2**

2.3 Since section 272-5(2) of Sch 2F requires that units can only be issued or redeemed on the basis of the net asset value, according to Australian accounting principles, the issue of partly paid units causes difficulty where unit holders are entitled to a full distribution whether or not they have fully paid for the units. In effect, where that occurs, the unit holder acquires a proportional interest in the income and capital of the trust for less than net asset value and so therefore the trust cannot be considered as "fixed".

► **BACK TO QUESTION 2**

2.4 Where income and capital can be distributed other than in strict proportion to the number of units held by each unit holder, or to persons other than unit holders, the unit holders do not have fixed entitlements.

► **BACK TO QUESTION 2**

2.5 Where the trustee has the power to issue different classes of units or to reclassify different classes of units the rights of the unit holders cannot be considered to be fixed as:

- their rights may be affected by a subsequent exercise of the trustee's right to reclassify;
- their rights may be affected by a subsequent allotment of different classes of units having competing or different rights. ► **BACK TO QUESTION 2**

2.6 See FAQ 2.1. The Federal Court decision in Colonial First State Investments Ltd v Commissioner of Taxation resulted in almost no trusts being considered to be fixed where the trust deed contains a power of amendment. The Commissioner seems to accept that provided that the amendment power is limited so that the unanimous consent of the unit holders is required for a valid exercise of the power, that the discretion in section 272-5(2) of Sch 2F is more likely to be exercised in the trustee's favour.

► **BACK TO QUESTION 2**

2.7 Where income can be accumulated at the trustee's discretion, the unit holders may be considered not to have fixed entitlements to income. This is generally considered to be rectified by requiring the unit holders' direction. ► **BACK TO QUESTION 2**

2.8 Where the trustee is able to dissipate the assets of the trust for less than full consideration, the unit holders may not have fixed entitlements. ► **BACK TO QUESTION 2**

2.9 Has a Family Trust Election (FTE) been made which might restrict distributions? Making a FTE may prevent a trustee from making distributions to certain persons/entities and may deny access to franking credits. ► **BACK TO QUESTION 2**

A FTE is an election that is made in order to make the trust a family trust for taxation purposes. The election must specify a year of income from which it is to take effect. It must also specify one individual whose family group is to be taken into account. Where a trust makes a FTE, distributions may only be made to unit holders who are within the family group. Any distributions outside the family group will be taxed at the highest marginal rate applying to individuals plus Medicare levy. ► **BACK TO QUESTION 2**

2.10 The Land Tax Management Act 1956 (NSW) treats trusts which hold taxable land in NSW as "special trusts" unless it is a "fixed trust" for the purposes of that Act. The definition of "fixed trust" differs from the one in Sch 2F of ITAA 1936. Special trusts cannot access the land tax free threshold in NSW whereas fixed trusts can. Accordingly, additional specific provisions are required in a land holding unit trust in NSW to ensure it is a fixed trust for land tax purposes. If these are not present in the trust deed the trust will be taxed on the full unencumbered value of its NSW land holdings. ► **BACK TO QUESTION 2**

- 2.11 Section 295-550(4) of the ITAA 1997 states that income derived by a SMSF as a beneficiary of a trust, other than because of holding a fixed entitlement to the income, is non-arm's length income. Non-arm's length income of the SMSF is taxed at the highest marginal rate. The expression "fixed entitlement" is also used in Sch 2F of ITAA 1936.

In 2012, the Administrative Appeals Tribunal handed down its decision in *The Trustee for MH Ghali Superannuation Fund v Commissioner of Taxation*. The Tribunal decided, in that case, that the test for fixed entitlement in S295-550 is the same as in Sch 2F, meaning that if the trust fails to qualify as a fixed trust under the tests described above, the SMSF's income derived from the unit trust will be non-arm's length income for section 295-550. However, the Commissioner of Taxation's views differ as to the correct test for S295-550. Taxation Ruling TR 2006/7, which has been affirmed as the Commissioner's view in the Decision Impact Statement following the Ghali case, suggests the test, which will be applied for S295-550 purposes, is that the SMSF's entitlement to income must not rely on the exercise of any discretion by the trustee. Provided the trust deed mandates that the trust income must be distributed or set aside for the benefit of the unit holders, the Commissioner will treat this as a fixed entitlement as far as the SMSF is concerned. This is a much simpler test to satisfy. ► **BACK TO QUESTION 2**

FAQ 3 – Income and Capital

- 3.1 If there is no definition of income in the trust deed, the trustee is only permitted to deal with trust law income as the income of the trust – that is income which would be treated as income under trust law. All other amounts would be classified as trust capital. Capital gains are not trust law income, for example, and cannot be distributed as income by the trustee, in the absence of a definition which permits this. Distributions of taxable capital gains in such circumstances may be ineffective and may result in the trustee being taxed on such gains or may result in a different tax outcome to the one intended ► **BACK TO QUESTION 3**
- 3.2 For the purposes of the trust deed, is income defined as accounting/distributable income, S95 income, a combination of these or some other method? Ideally the trust deed will permit all or any of these and permit the trustee to use whichever method of determining income to achieves the best tax position for the trust and the unit holders. Without such flexibility, distributions may be ineffective and may result in the trustee being taxed on such gains or may result in a different tax outcome to the one intended. ► **BACK TO QUESTION 3**
- 3.3 Does the trust deed contain discretion for the trustee to adopt different definitions or methods of calculating income in different years? Ideally, the trust deed will permit the trustee to use different methods of determining income in different years to achieve the best tax position for the trust and the unit holders each year. ► **BACK TO QUESTION 3**
- 3.4 Does the trust deed permit the trustee to record any receipts/outgoings or revaluations as income or capital? Ideally, the trust deed will confer a discretion on the trustee to account for all or any amounts received, or paid, by it as income or capital. This permits the trustee to manage the effective distributable income of the trust ensuring the trustee is able to fully distribute all income and to prevent accumulations to achieve the best tax position for the trust and the unit holders. ► **BACK TO QUESTION 3**

- 3.5** Does the trust deed allow the trustee to record income in specific categories and from specific sources? In order to effectively stream different types of income, the trustee must be permitted by the trust deed to account separately for different types of income. **▶ BACK TO QUESTION 3**
- 3.6** Does the trust deed allow the trustee to stream different classes of income to different unit holders? In order to effectively stream income, the trustee must be permitted by the trust deed to separately distribute different classes of income to different unit holders. **▶ BACK TO QUESTION 3**
- 3.7** Does the trust deed permit the trustee to accumulate income rather than distribute it? It may be advantageous or desirable for the trustee to retain income within the trust, from time to time. **▶ BACK TO QUESTION 3**
- 3.8** Does the trust deed allow the trustee to treat accumulated income as income in future years rather than adding it to capital? In the absence of such a provision, any distribution of accumulated income will be a deemed distribution of capital. **▶ BACK TO QUESTION 3**
- 3.9** Does the trust deed permit the trustee to distribute capital and/or capital gains before the trust ends? Where the trust deed does not allow the trustee to distribute capital prior to the vesting day of the trust, capital and capital gains may be trapped in the trust and not distributable. **▶ BACK TO QUESTION 3**
- 3.10** Does the trust deed permit the trustee to make distributions of income or capital by an in specie transfer of trust assets? It may be desirable for the trustee to transfer trust assets to a unit holder in satisfaction of an entitlement to income or capital. In the absence of such a provision, the trustee may be required to convert trust assets to cash (by sale for instance) in order to make a distribution. This may have capital gains tax consequences and will usually present timing issues for the trustee to consider. **▶ BACK TO QUESTION 3**

FAQ 4 – Current Provisions and Positions in the Trust

- 4.1** Does the trust deed contain an indemnity in favour of the trustee? Trustees are personally liable for all of the liabilities of the trust and incurred in the capacity as trustee. While the law implies an indemnity that allows the trustee to be reimbursed for any such liabilities incurred by the trustee, it is limited. Ideally, the trust deed will contain a provision that significantly extends the indemnity on which the trustee may claim. **▶ BACK TO QUESTION 4**
- 4.2** Does the trust deed permit the trustee to have a personal interest/conflict of interest in transactions involving the trust and is the trustee permitted to be a unit holder and to receive trust income/capital? Where the trustee acts and the trustee has a conflict of interest, a breach of trust may result and void the relevant transaction. Similarly, if the trustee is not a unit holder, any distribution may be invalid and may result in notices of re-assessment being issued by the ATO. **▶ BACK TO QUESTION 4**
- 4.3** Are all of the trustee's powers up to date/bank compliant? The trustee is only permitted to act in accordance with powers specified in the trust deed. Any transaction that is not supported by an express power may be invalid, resulting in a breach of trust. Banks and other institutions regularly find trust powers to be insufficient for their purposes and require amendments to ensure the efficacy of a transaction and/or to ensure no breach of trust arises. **▶ BACK TO QUESTION 4**

- 4.4 Does the trust deed contain a power for the trustee to amend the trust deed in order to resolve any deficiencies in any relevant provision referred to in this checklist? The trustee cannot amend the trust deed to address any deficiencies or to improve the efficacy of the trust deed in the absence of a power to amend. Not all amendment provisions are sufficiently broad to permit all amendments. Clark's case and TD 2012/21 confirm that, in the ATO's view, any amendment carried out in the valid exercise of a power of amendment contained in the trust deed would be effective and should not result in CGT event E1 or E2 occurring. ► **BACK TO QUESTION 4**
- 4.5 Is the consent of any person required before the trustee can validly amend the trust deed? Failure to obtain any consent required by the trust deed may invalidate any attempted amendment of the trust deed. ► **BACK TO QUESTION 4**
- 4.6 Are all schedules in the trust deed actually part of the trust deed and can they be amended in accordance with the trust deed's amendment powers? If the trust deed does not make any schedules or other annexures to the trust deed, a part of the trust deed, an amendment power may not authorise the amendment of provisions appearing in schedules/annexures. Any attempted amendment of such provisions may be invalid. ► **BACK TO QUESTION 4**

FAQ 5 – Unpaid Entitlements

- 5.1 Does the trust deed convert unpaid entitlements to loans? Where a trust deed creates a loan from an unpaid entitlement, the loan may be subject to Div 7A of ITAA 1936 by virtue of TR 2010/3, where the unit holder is a company. Failure to comply with Div 7A may result in a deemed dividend paid by the company to the trust. Tax will usually become payable at the highest marginal rate without the benefit of a franking credit. ► **BACK TO QUESTION 5**
- 5.2 Does the trust deed contain a sub trust provision that states that distribution amounts set aside as unpaid entitlements of unit holders are held in a separate or sub trust? If it does it may be possible to treat unpaid distributions to companies as not subject to Div 7A. ► **BACK TO QUESTION 5**

FAQ 6 – The Trustee & Asset Protection

- 6.1 Does the trust deed work effectively for asset protection of trust and/or personal assets? In order to achieve effective asset protection using a trust, the overriding principle is to separate risk from assets. The trust should not be established in such a way that any "at risk" person has sole control of trust assets – some commentators suggest that such a person should have no direct control of trust assets at all following recent court decisions (e.g. Richstar). The courts consider that where the trustee of the trust is the "alter ego" of the "person at risk", then the assets of the trust may be treated as that person's assets. ► **BACK TO QUESTION 6**
- 6.2 Has the trustee considered the effect of Family Court jurisdiction on the issue of asset protection? The Family Court has extremely broad jurisdiction to make orders regarding the distribution of assets in marital matters. In some cases the Family Court may disregard a trust and make orders that trust assets be transferred to specific parties to a marital dispute. ► **BACK TO QUESTION 6**
- 6.3 Ideally, the trustee should be a company. The primary concern around using a corporate trustee is one of asset protection. The overriding principle is to separate risk from assets.

Because trusts are not considered to be legal entities, when trusts operate there must be a person or other legal entity that becomes primarily liable for the debts of the trust and who can act on behalf of the trust. This is the trustee. Trustees incur personal liability for the debts of the trust. The trustee is entitled to be indemnified for any personal liability by recouping any such amount out of the assets of the trust. However, if the trust does not have sufficient assets to pay that liability for the trustee, the trustee is personally responsible for the payment of the trust's debts. The trustee is responsible for those liabilities whether or not the trust has sufficient assets. Any trustee who cannot claim against the indemnity has his or her personal assets exposed to the claims of creditors of the trust.

A number of recent cases (e.g. Richstar) have highlighted the need for separation of the "at-risk" person in a trust situation from trust assets. The use of a company as the trustee of a trust can provide a greater level of asset protection than the appointment of an individual as trustee, because doing so separates risk from assets. Also, most banks prefer lending to trusts with corporate trustees.

Most trust deeds also prohibit certain individuals from being trustees. For example, the settlor is commonly excluded. However, some trusts also prohibit a beneficiary from being a trustee. In addition some jurisdictions (for example, NSW) impose stamp duty on a transfer of assets from one trustee to another when the trustee is changed. Using a corporate trustee will usually avoid these problems. ► **BACK TO QUESTION 6**

- 6.4 Does the trust deed contain up to date provisions for the appointment and/or removal of trustees? Where the trust deed does not contain an effective mechanism for the replacement of trustees, the trust deed may lose flexibility and may make it difficult or impossible to change the trustee. This may adversely affect asset protection and estate planning measures. ► **BACK TO QUESTION 6**

FAQ 7 – Small Business Concessions

- 7.1 Has the trustee considered the application or availability of small business tax concessions to the trust in the event of the sale of a significant trust asset? Various threshold tests must be satisfied before small business tax concessions become available to the trust under Div 152 of ITAA 1997. Great care needs to be exercised in determining the timing of the relevant CGT event, the identity of affiliates/connected entities of the trust and the maximum net asset value of assets for the application of the tests. ► **BACK TO QUESTION 7**

FAQ 8 – Resettlement

- 8.1 Is there a resettlement risk, CGT risk or stamp duty risk in making changes to the trust deed to address any of the issues identified above? Resettlement means that, by some action on the part of the trustee, a new trust is created. Primarily, resettlement occurs when a change is made to the trust, which fundamentally changes the relationship of the trustee and the unit holders. The change in question is sufficiently significant to terminate the trust, and create a new one. If that occurs, there is a notional disposal of all of the trust assets. This may result in CGT or stamp duty liabilities.

The resettlement issue presents a difficulty where the existing trust has substantial assets or carry forward losses. Resettling the trust in those circumstances will trigger CGT and/or stamp duty liabilities, and any carry forward losses will be lost.

In some jurisdictions, some changes to trusts may trigger a stamp duty liability even where there is no resettlement of the trust. ► **BACK TO QUESTION 8**