Estate Planning – Family trusts

The term family trust refers to a discretionary trust set up to hold a family's assets or to conduct a family business. The ability to effectively manage tax between family members, protect assets from creditors, and help with succession planning could make them a useful tool in wealth creation. For tax purposes though, a trust is not considered a “family” trust until a “Family Trust Election” is made. While a family trust is generally just a discretionary trust, there are certain tax concessions available when the trust is a ‘family trust’.

Benefits

- Asset protection. Assets held in a family trust can generally not be accessed by creditors in the event of bankruptcy. In many cases, assets in a trust are also protected in the event of relationship breakdown. Therefore, they can be useful in protecting assets from business or personal disputes.
  A family trust can also facilitate the transfer of assets from generation to generation tax efficiently, and help ensure that particular assets are maintained for the benefit of the family and don’t leave the family bloodline.
  A family trust can also be helpful in managing and protecting investments for children without having the investment legally owned by the child for them to access at their will.

- Tax planning. Subject to the trust deed and the power this document provides the trustee, it may be possible for trust income to be distributed tax effectively to beneficiaries on lower marginal tax rates. It is generally possible for the trustee to review this on a year-on-year basis to maintain tax effectiveness as beneficiary’s circumstances change.

- Flexibility and estate planning. Most family trust deeds are flexible in their operation and can provide for good estate management, allowing for assets to benefit generations without the need for ownership to change from one individual to the next.

How it works

To be eligible to make a ‘family trust election’ there are specific requirements that must be met.
Given the taxation and legal issues that need to be considered and addressed, it’s important to seek tax and legal advice from suitably qualified professionals.

An Australian family trust:

- is generally established by a family member for the benefit of members of the 'family group'
- can be the subject of a family trust election which provides it with certain tax advantages, provided that the trust passes the family control test and makes distributions of trust income only to beneficiaries of the trust who are within the 'family group'
- can assist in protecting the family group's assets from the liabilities of one or more of the family members (for instance, in the event of a family member's bankruptcy or insolvency)
- provides a mechanism to pass family assets to future generations, and
- can provide a means of accessing favourable taxation treatment by ensuring all family members use their income tax "tax-free thresholds".

The terms and conditions under which a family trust is established and maintained are set out in its deed.

The trust is established by the trust's settlor and trustee (or trustees) signing the trust deed, and the settlor giving the trust property (the "settled sum") to the trustee.

The settlor's function is to give the assets to the trustee to maintain for the benefit of the trust's beneficiaries on the terms and conditions set out in the trust deed. The settlor executes the trust deed and then, generally, has no further involvement in the trust.

The trustee is responsible for the trust and its assets. The trustee has broad powers to conduct the trust, and manage its assets.

Subject to the terms of the trust deed, the trustee may be free to distribute trust income to any beneficiaries as deemed appropriate, and in proportions that take best advantage of those beneficiaries' personal marginal tax rates. Distributions received by a beneficiary from a trust form part of a beneficiary's assessable income. The beneficiaries then pay the tax on distributions made to them. Undistributed income is taxed in the hands of the trustee at the top marginal tax rate, which may be an incentive to fully distribute the trust's income before the end of each financial year.

Distributions must be made only to people who qualify under the terms of the trust deed to be beneficiaries of the trust and who are within 'the family group'. If a family trust makes a family trust election and then makes a distribution to someone who is not a member of the family group, they will be taxed at the top marginal tax rate, plus Medicare levy. The trustee should also take care in relation to which beneficiaries are chosen to receive distributions, as penalty tax rates can apply to distributions made to minors.

Risks and Consequences

It's important to seek tax and legal advice from suitably qualified professionals before establishing a family trust. This will help to understand whether a family trust is right for you, and some important things to consider.

Some considerations include:

- When trust income is not distributed, tax is payable on the undistributed income at the top marginal rate which may be higher than if the income were distributed to a beneficiary.
- It is always important that distributions are made in accordance with the trust deed and that proper records are kept regarding distributions.
- It is important to consider any social security implications as a result of having involvement in a trust in any capacity, including as trustee or a beneficiary. In some cases, Centrelink may attribute assets or income of the trust to an individual when determining the benefit to which they are entitled under means-testing arrangements.
- A family trust will need to satisfy certain requirements, such as completing annual tax returns. The trustees may need to seek professional advice (eg legal, accounting or financial planning) and the costs paid by the trust should be compared to the benefits of maintaining the trust. Additional requirements apply if the trustee is a corporate trustee.

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