*Compiled by Stuart Wemyss*

# It's all about TRUST!

**Many dentists use** family trusts to protect assets and build wealth. However, have you ever considered if your trust structure is optimal? There's a lot to consider when setting up a trust structure. One mistake can render a trust structure useless. Let's take a closer look at some commonly overlooked matters.

## WHAT IS A TRUST AND HOW DOES IT WORK?

A trust is not a legal entity in itself. Instead, it's simply an agreement to hold assets for the benefit of certain people (beneficiaries). Assets are held in trust until they are distributed to beneficiaries. Many trusts will have the following attributes:

- Trust deed – a written document setting out the terms and conditions of the trust, i.e., how the trust is to be operated.
- Beneficiaries – the people that can benefit from the trust, i.e., receive a distribution. Beneficiaries can be named, i.e., the persons' name is included in the Deed or unnamed the person is described, such as 'all blood children' of a certain person.
- Trustee – the legal entity that holds the assets in trust. A trustee can be a natural person/s or a company. Often, it is best to have a company – more on this later.
- Appointer – this is the person that can hire and fire the trustee. This is quite an important party.
- Settler – this is the person that starts the trust with a gift.

There are three types of trust. Firstly, a discretionary trust (often referred to as a family trust) is a trust where the Trustee has full discretion on how income and capital is distributed. Second is a unit trust. A unit trust is a fixed trust in that the beneficiaries' entitlement is fixed depending on the amount and type of units held (much like shares in a company). Lastly, a Hybrid Discretionary Trust (HDT) which is a combination of both. A HDT can issue units to create a fixed entitlement or, if no units are on issue, the Trustee can have complete discretion over how distributions are made.

As a trust is not a legal entity, it must distribute all profit at the end of the year. If a trust does retain undistributed profit, the profit is taxed at the penalty rate of 46.5%.

## SOME IMPORTANT CONSIDERATIONS MANY PEOPLE OVERLOOK

If you're an investor who uses negative gearing, i.e., borrowing a proportionally high amount to fund investments, one of the biggest downsides to using a discretionary trust is that you will not be able to benefit from the negative gearing benefits. The reason for this is that a trust cannot distribute a loss, only a profit. Therefore, if you own an investment property in a trust and that property produces a loss, i.e., the interest cost is more than the rental income received, the loss will have to remain in the trust and carried forward. This loss can be offset against future profitable years. If structured correctly, a unit or HDT can shift the negative gearing benefits into a person's name. Also, if you operate your private practice via a trust, you may be able to distribute profit into your property investment trust to soak up the annual loss (which is tax effective).

Discretionary trusts provide the best asset protection (compared to unit trust and HDT) as assets are held in trust and a beneficiary doesn't have claim to ownership of any trust property until it is distributed. Be careful with providing loans to a trust, as this will significantly weaken asset protection. A recent court case suggests the court may 'look through' a trust structure to determine who controls the trust, so it's not bullet proof. In this circumstance, be careful with who is appointed Trustee or directors of the Trustee company. We would prefer not to see any 'at risk' people, i.e., dentists being a Trustee or director.

A unit trust can be an effective way of transferring property and avoiding stamp duty. For example, the highest income earner within a family can purchase an investment property using a unit trust. They can possibly benefit from the negative gearing benefits (which are normally enjoyed in the first 5 to 7 years of ownership) by personally owning all the units in the trust. Once the property produces a taxable profit, the highest income earner can sell the units to the lowest (or non) income earner. It's likely that Capital Gains Tax will be payable, but stamp duty should be avoided in most States. (Note: keep in mind land rich stamp duty provisions. This strategy will not work for high value properties.) The additional benefit of this transaction is that the investors can potentially 're-gear' the investment and pull out some cash to use for a non-deductible purpose. Whilst it may not suit everyone, our numbers suggest this can often be better than the same person owning the asset for its entire life.

The ATO has scrutinized the use of HDT by property investors, particularly in relation to investors generating negative gearing benefits. Therefore, we advise all clients considering using a HDT to obtain a Private Ruling from the ATO to eliminate this potential tax compliance risk.

The Appointer of a trust holds a very powerful position and must be carefully considered. Specifically, the death of an Appointer must be considered in the Appointer's Will and Trust Deed. This is often identified by estate planning lawyers. However, disablement is often overlooked. What if the Appointer becomes mentally or physically disabled and unable to execute their responsibilities? The trust deed needs to provide for these circumstances.

The Settler of a trust should be an unrelated party. The reason for this is that it might be difficult for a Settler to ever receive a distribution from a trust. Therefore, make sure the Settler is a person you will never want to distribute money to.

We strongly advise all clients to use a corporate trustee instead of acting as individual trustees. The reason for this is to ensure it is clear (to the ATO and State Revenue Office) that the property is an asset of the trust, not a personal asset. Confusion can be created because property titles only record the Trustee's details and they don't mention the entity is acting as trustee for a particular trust. For example, a Contrct of Sale is often signed as 'Trustee Company Pty Ltd ATF The Family Trust', whereas the title is simply registered in the name of Trustee Company Pty Ltd.

Also, using a company provides greater asset protection.

If you establish a trust and then become a non-resident for tax purposes, e.g., you decide to work overseas for a few years, the taxing of distributions may not work effectively for you (and therefore a trust may not be appropriate). The reason for this is that the trustee must pay tax on distributions paid to any non-resident at 46.5%. The beneficiary obtains a tax credit so, if they lodge an Australian tax return, it will all wash out in the end. However, if the beneficiary chooses not to lodge an Australian tax return, then this could cause problems.

## THE COST

Trusts are reasonably cost-effective to establish. You can purchase a trust deed for $200 to $500. If you want to appoint a corporate trustee, you will need to establish a company which normally costs $600 to $800. The ongoing costs of a trust depend on the nature and size of investments and accounting requirements. A company needs to pay an annual fee to ASIC of $212.

## REVIEW YOUR STRUCTURE

It is a good idea to review your structure every one to three years. You need to take into account any changes in income structure and asset ownership. It's critical that your investments and personal assets are structured correctly to ensure you have as much protection as possible.

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