How to best apply your family trust to your business succession plans

What are the problems?

- Control
- CGT
- Time and money
- Stamp duty

A trust consists of:

- Trustee
- Trust property
- Beneficiaries
- Trustee equitable obligations

Selling shares in the corporate trustee

- Arguably easiest
- Shares are $1 each - no CGT
- Shareholders control the board
- No duty on shares since 1 July 2016?

Changing shareholders in the corporate trustee

Consider stamp duty for landholder corporate trustees: If the corporate trustee is also a beneficiary of the trust and the trust holds land is NSW worth $2m or more, then the corporate trustee is treated as a landholder for the purpose of landholder duty and if a person or their associates comes to acquire at least 50% or more of the shares, then the transfer of the shares is dutiable at landholder rates.

Answer: exclude the corporate trustee from benefiting under the trust before the transfer or issue of shares.

Bear in mind that the Chief Commissioner of State Revenue has a discretion under section 163H of the Duties Act to grant a full or partial exemption where is it not just to impose landholder duty in the circumstances.

Changing trustees

Bob and Bernadette are trustees and beneficiaries of their family trust. They want to retire. Their son James has a company he wants to use as the new corporate trustee. If Bob and Bernadette are replaced by James' corporate trustee then section 54 of the Duties Act says that because they continue to be beneficiaries of the trust, ad valorem duty is imposed.

So you change the trust deed so that Bob and Bernadette cannot be beneficiaries and this is done before changing trustees.

But make sure the change is stated to be irrevocable!

Trust Splitting

The trust deed remains as the governing deed of the trust. A new trustee is appointed as trustee of certain assets under the trust. The existing trustee remains trustee of the remaining trust assets. Those controlling the new trustee are different to those controlling the existing trustee. The broad class of beneficiaries is the same and has not changed. There is technically still a single trust fund.

TD 2018/D3 says the ATO considers that this will give rise to CGT event E1.

Changing beneficiaries

Clark's case provides that so long as the trustee, trust property, beneficiaries and the trust obligations remain, even though they may change over time and from time to time, the trust continues as one trust.

If it does not continue to exist as one trust then there is a "resettlement" and under the Duties Act, ad valorem duty (up to 5.5%) will apply on the then current value.

What about the sub-stratum of the trust?

This has been argued in Australian Courts since 1968.

The classic case is in relation to a family trust established for the benefit of the Smith family where the Smith family beneficiaries are removed and replaced with the Jones family beneficiaries.

It could well be argued that the trust was established for the purpose of benefiting the Smith family but now that fundamental purpose and the fundamental nature of the trust has changed, the sub-stratum has changed and ad valorem duty ought to apply.

Appointors

They can sack or appoint trustees.

The removal or appointment of an appointor must be done in accordance with the power of removal and appointment found within the trust deed.

Variations to the Trust Deed

What does the trust deed say? If there is a deficiency in the appointment of a trustee, then any subsequent deed of amendment or action by the purported new trustee will be invalid.

Vesting date

The best way to extend it without the ATO getting involved is to understand the Perpetuities Act. It only applies to trust deeds dated on and after 31 October 1984.

For those dated before this, the perpetuity period could be: *21 years after the death of the last survivor of the descendants of King George VI living at the date of this deed*.

Distributions to Corporate beneficiaries

Distributions to a corporate beneficiary where the trustee is a shareholder of the corporate beneficiary or an associate of a shareholder, can be treated as unfranked dividends if a Division 7A loan agreement is not in place.

If the trustee declares a distribution to that corporate beneficiary but never pays it, then the distribution can be taken to be an unpaid present entitlement: a UPE. This can also be treated as an unfranked dividend unless invested as required in PSLA 2010/4.

Loans from beneficiaries

Was it a loan or was it a contribution of capital? Disputes arise if the arrangement is not documented.

But we are ‘family’, you say! All the more reason to clarify the arrangement.

This is nothing to do with trust but everything to do with communication. If the loan is not documented, then the right to recover is statute barred after 6 years.

Winding up a Corporate Trustee

Directors can be liable for losses suffered by the trust. Mr Ryan was 10% liable for the losses suffered by his self managed super fund where it was the fund’s auditor who failed to warn of the risk attached to a particular unsecured investment.

Who is a director? They can be an active director or a de facto director - people who take an active role in directing the affairs of the company, notwithstanding the lack of formal appointment. They can also be a shadow director - who is someone in accordance with whose directions, the directors are accustomed to act.

Directors can be liable for insolvent trading: S588G Corporations Act – deals with incurring a debt when the director suspects the company is insolvent at the time.

Under S588FGA Corporations Act, directors must indemnify the Commissioner of Taxation if tax payments are set aside as a preference.

What if the director transfers his own assets to the family trust to avoid his own creditors? Section 121 Bankruptcy Act provides that the payment can be reversed and there is no limitation period which applies to the application to reverse the payment. Ask your parents about their history with the trust before you take it over.

Under common law, trustees have a right of indemnity out of the trust assets in respect to liabilities incurred in the course of carrying out the trustee duties. This general right is secured by an equitable charge, but the equitable charge does not, of itself, confer a right to sell trust assets. So make sure your trust deed gives the trustee a power of sale.

The indemnity is personal to the trustee and passes to the liquidator or bankruptcy trustee in the event of insolvency.

But it will be lost if the trustee is guilty of misconduct or acts in a way which is not authorised by the terms of the trust.

It is in the beneficiaries' interest to allege a loss of the indemnity: it preserves the trust property for the beneficiaries to the exclusion of the trustee's creditors.

S197 of the Corporations Act

This section imposes personal liability on the corporate trustee's directors where the corporate trustee's right of indemnity is lost or if the trust deed denies or limits the right of indemnity.

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