

# Discretionary trust deed health check review

*Trust name:*

*Date reviewed:*

## Overview

To understand what issues in a Trust Deed (**Deed**) are required to be reviewed, it is important to appreciate the reasons why a trust is commonly utilised.

Broadly, these reasons are as follows:

- 1 tax planning flexibility;
- 2 succession planning flexibility; and
- 3 asset protection drivers.

In conducting a health check of the Deed, it is necessary to consider if the current terms of the Deed continue to achieve the above objectives.

This is particularly necessary given various changes to the law relating to trusts, such as (but not limited to):

- 1 cases relating to the distribution of income from the trust to beneficiaries and the subsequent changes to the tax legislation as a result;
- 2 cases relating to the lack of provisions in a trust deed confirming the appropriate controller of the trust on the death of a controller; and
- 3 the continued potential for 'sham' and 'alter-ego' arguments to be made in relation to trusts from a bankruptcy perspective.

The terms of the Deed should also be reviewed to:

- 1 ensure there are no historical errors requiring rectifying;
- 2 consider if any vesting date can be lengthened or clarified;
- 3 consider if there are any issues in relation to the beneficiaries of the Trust;
- 4 whether there are unusually burdensome or restrictive terms.

## Health check review

This health check lists the issues that should be considered in relation to the following aspects of the Deed:

- 1 establishment and historical errors;
- 2 vesting date;
- 3 beneficiaries of the Trust;
- 4 trust distribution and tax related provisions;

- 5 succession planning provisions;
- 6 asset protection provisions;
- 7 miscellaneous provisions and structuring concerns.

### **Establishment and historical errors**

Although uncommon, trust deeds may have been executed incorrectly.

A consequence of failing to execute a trust deed correctly could result in the Trust having never been established.

Further any subsequent changes to the Deed, if improperly made, could be deemed invalid.

As such, the terms in relation to the establishment of the Trust must be reviewed to ensure there were no issues on establishment. Any purported changes to the Trust must also be reviewed to ensure any subsequent documentation entered into has been effective.

If any errors are identified in relation to the establishment or changes to the Deed, then a document fixing the errors should be prepared to reduce any potential for a dispute in the future regarding the terms of the Deed, between parties to the Deed. Conservatively, such a 'fix' in the errors should be sought by the Courts, however, a self-correcting document has been considered by the Courts to be effective if prepared correctly. That said, it has also been accepted that third parties such as revenue authorities are not bound to accept such self-correcting documents, and that they are only bound by Court-corrected orders.

<b><i>Issue</i></b>	<b><i>Comments</i></b>
Has the Deed been executed correctly (including witnessing requirements)?	
Has the Deed been dated?	
Has the Deed been stamped, if required?	
Are there any missing pages to the Deed?	
What is the jurisdiction of the Trust?	
Are there any relevant documents affecting the terms of the Deed (e.g. deeds of variations, trustee minutes appointing beneficiaries)?	
If so, have the relevant documents been properly executed and a trustee's power validly exercised?	
Is there any discrepancy between the date of the Deed and the establishment of the Trust and if so, does the Deed reconcile this difference?	
What was the settlement sum?	

Are there are incomplete definitions or 'Schedule' items? If so, what is the impact on the Deed?	
Is there inconsistent spelling of roles throughout the Deed?	
Who was the original trustee?	
Who is the current trustee?	
Have there been other trustees appointed?	
Have any of the change of trustees been ineffective? If so, what is the impact on the Deed?	
Are there any other roles in the trust (e.g. appointor, principal, guardian, nominee etc)	
What power do these roles have?	
Who was the original person in the relevant role/s?	
Who is the current person in the relevant role/s?	
Have there been other persons appointed in the role/s?	
Have any of the change of persons in the relevant role/s been ineffective? If so, what is the impact on the Deed?	
<b>Recommendation</b>	

## Vesting Date

Is it critical to understand when the Trust will end and the consequences of such an ending (e.g. who is entitled to the assets of the Trust).

Whilst it is common for Trusts to last up to 80 years from being established, there are providers that may include a shorter term (even as low as only lasting 20 years from establishment).

The Deed should therefore be reviewed to confirm when the Trust ends and if possible, whether the ending date (also known as the vesting date or perpetuity date) can be extended as far into the future as possible under law.

<i>Issue</i>	<i>Comments</i>
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What is the vesting date or perpetuity date of the Trust?	
Does the trustee have the power to change the vesting date for the Trust?	
What happens to the Trust assets on vesting?	
<b>Recommendation</b>	

## Beneficiaries of the Trust

Understanding who may benefit from the Trust is important in that the Trust cannot distribute the income generated, or underlying assets of the Trust to someone who is not a beneficiary of the Trust.

This is important as trust deeds can vary in terms of who are defined as beneficiaries and who are explicitly excluded.

Further, given changes to various tax legislation across the Country, it may be preferable in certain circumstances to restrict the potential beneficiaries of the Trust to 'non-foreigners'.

Who are considered beneficiaries for the Trust and who are explicitly excluded from benefitting should be properly understood.

Steps can then be taken at a later date to decide whether beneficiaries should be added or removed from the class.

<i>Issue</i>	<i>Comments</i>
Who are the named beneficiaries (also commonly called the 'Primary Beneficiaries')?	
Does the definition for beneficiaries include wider family?	
Does the definition for beneficiaries include trusts and companies?	
Does the definition for beneficiaries include charities, DRG recipients, not-for-profits and/or public benevolent institutes?	
Are there limits in relation to who can be beneficiaries of the Trust?	
Can beneficiaries be added?	
Can beneficiaries be removed?	
Is there a definition for spouse (if applicable)? If so, is the definition broad enough to include 'same-sex' couples?	

Is there a definition for children? If so, does the definition include 'step-children' or 'adopted children'?	
Is the term 'issue' or 'remoter issue' used? If so, is such a term defined?	
Has a family trust election been made, or an interposed entity election been made?	
Who is the settlor?	
Is it obvious whether the settlor is related to the beneficiaries?	
Has the settlor been excluded from being a beneficiary?	
Are there other persons excluded from being a beneficiary (e.g. the trustee, persons who have contributed to the trust fund, trusts which lasts longer than the reviewed trust)?	
Consider whether an excluded person has received a benefit?	
Does the Trust hold assets that could have surcharges imposed on the Trust? For example, real property may impose additional stamp duty or land tax in certain States if the beneficiary class could include 'foreigners'.	
Who are the persons who receive the income if no trust distribution is made and some income are undealt with (known as the 'default income beneficiary')?	
Who are the persons who receive the capital on vesting if no trust distribution is made by the end date of the trust (known as the 'default capital beneficiary')?	
<b>Recommendation</b>	

## Trust distribution and tax related provisions

Just as it is important to understand who can benefit from the Trust, it is critical to ensure the Trust contains sufficient powers to enable assets or income of the Trust to be distributed to a beneficiary in a tax effective manner.

Whilst there are many ways that income and assets of a trust can be distributed out, it is important to appreciate some of the methodology must be tailored according to the strict rules of the trust deed when drafting the trust distribution resolution.

This is not always considered, and therefore having broad flexible provisions allows for a more relaxed approach in making trust distribution resolutions.

The health check considered if there are sufficient powers to enable various trust distribution resolutions to be prepared, and if additional powers should be introduced to enable a broad flexible approach.

Please note that the laws in relation to the taxation of trusts may change in the future (as well as all aspects of law), however, we note that the Government has not made any movement to amend such rules since their announced intentions.

<i>Issue</i>	<i>Comments</i>
What 'income' can be distributed from the Trust (E.g. what is distributable income)?	
Is there sufficient power to determine what distributable income is?	
Is there sufficient power to categorise trust receipts on revenue or capital account?	
Is there sufficient power to categorise trust expenses on revenue or capital account?	
Is there discretion to categorise and account income received as separate classes of income, specifically capital gains or franked distributions?	
Is there discretion to categorise and account expenses against separate classes of income?	
Can classes of income be grouped (E.g. can all franked distributions be grouped under one class)?	
Is there a power to accumulate income?	
Is there a discretion to distribute income of the trust in such a manner as the trustee determines?	
Is there discretion to enable separate classes of income to be and distributed to different beneficiaries in such proportion as the trustee decides?	

Is the trustee's power to distribute income broad enough to allow beneficiaries to be presently entitled, but not paid?	
Are there limitations on how the trustee may distribute income (e.g. a 39% cap on distributions)?	
Is consent or notice required when making income distributions?	
When must income distributions be made by? If not stated in the Deed, the Australian Taxation Office has adopted the practice that distributions must be made by 30 June.	
Can distributions be orally recorded? It is best practice, regardless of whether the Deed allows it, to subsequently document oral distributions in writing.	
Is there a power to carry forward losses (e.g. the trustee is not required to utilise losses if not suitable)?	
Is there a power to offset income with previous year losses?	
How are unpaid present entitlements treated?	
Are unpaid present entitlements automatically converted into a loan?	
Are Division 7A sub trusts automatically created?	
Can unpaid present entitlements be mingled with the trust fund?	
Can unpaid present entitlements be placed on a sub-trust for the relevant beneficiary?	
Can the trustee make capital distributions prior to vesting?	
Are there restrictions on making capital distributions?	
<b>Recommendations</b>	

## Succession planning provisions

Assets and activities conducted through your Trust can not directly be governed under your Will.

This is because assets forming part of a trust are not considered yours to deal with as part of your Will.

As such, it is important to understand who takes control of the Trust on certain events occurring to people in control.

It is common for a trust deed to outline what happens to certain roles, as well as allow for the relevant person in control to also (subject to there being sufficient power) nominate successors.

Having these powers are important in a robust estate plan, and any amendments to update the provisions will provide the flexibility for you to nominate (through a separate document or Will) a successor controller for the Trust on events such as death and loss of capacity.

<i>Issue</i>	<i>Comments</i>
Can the trustee retire and appoint their own successor?	
Are there any conditions before a trustee can retire and appoint their successor?	
Are certain persons excluded from being the trustee?	
Are there other restrictions on how the trustee can appoint their own successor?	
Is the trustee automatically retired on certain events occurring?	
Who replaces the trustee if they are automatically removed?	
Is there an explicit power to appoint a successor trustee by Will?	
Is there flexibility to outline the conditions on appointing a successor trustee?	
Can separate trustees be appointed over particular assets of the trust?	
Are there any restrictions on how a trustee may retire (e.g. other consent required, or there needs to be a minimum of at least two individual trustees)?	
Can the trustee explicitly be a sole individual or corporation?	



Is there anyone else who may replace the trustee (e.g. the <b>controller</b> )? If so, what is the term used for that role.	
Are there any conditions before the trustee can be replaced by the controller?	
Is the controller automatically retired on certain events occurring? If so, what events are these?	
Who replaces the controller if they are automatically removed?	
Is there an explicit power to appoint a successor controller by Will?	
Is there flexibility to outline the conditions on appoint a successor controller?	
Can separate controllers be appointed over particular assets of the trust? It is not recommended to exercise such a power, if available, or to at least obtain specialist tax advice prior to doing so.	
<b>Recommendations</b>	

## Asset protection provisions

*Australian Securities and Investments Commission In the Matter of Richstar Enterprises Pty Ltd v Carey (No 6)* [2006] FCA 814 remains as a reminder that arguments to ignore the trust structure for asset protection has been held by the Court as valid. The argument relies on the notion that a trust is the 'alter-ego' of the 'controller' and therefore assets of the trust should be deemed to be assets of the controller.

Despite various cases since deciding to the contrary, it would be prudent for a trust deed to include provisions automatically removing persons in control in the event of bankruptcy.

A similar rationale as also been considered in relation to family law breakdowns, however, the Courts in those circumstances are more likely to ignore such a clause in the trust deed and consider trust assets as forming part of property able to be split pursuant to a subsequent Court order.

This health check considers whether bankruptcy triggers an automatic change of trustee or controller, which we recommend it should.

<b>Issue</b>	<b>Comments</b>
Is the trustee automatically removed on bankruptcy/insolvency?	
Who replaces the trustee if they are automatically removed?	

Is the controller automatically removed on bankruptcy/insolvency?	
Who replaces the controller if they are automatically removed?	
<b>Recommendations</b>	

## Miscellaneous provisions

In addition to considering the above issues, a general review of the Deed should be undertaken to identify whether there are any clauses that may cause the trustee (or other persons) to fail in complying with the terms of the Deed.

Such clauses can include unusual or special restrictions on the decisions the trustee may make, or limitations. Examples could include clauses:

- 1 requiring the trustee to provide 7 days notice to an 'appointor' of the trust before a trust distribution can be made;
- 2 excluding persons on Centrelink from being able to receive trust distributions (in addition to their 'Associates'); and
- 3 appointing an unrelated person as a successor to the trustee or appointor role.

Thought should also be had as to the structuring of the trust deed, including (but not limited to):

- 1 whether a company trustee should be used;
- 2 whether the structure of the company trustee is suitable;
- 3 whether there are potential land tax or payroll tax issues with the structure of the trust; and
- 4 whether multiple persons should act jointly in an 'appointor' or 'principal' role.

<i>Issue</i>	<i>Comments</i>
Are there any 'non-standard' provisions identified in the Trust?	
Are there any structuring concerns identified based on the information currently known?	
<b>Recommendations</b>	

## Variation power

If issues have been identified and the terms of the Trust are to be updated, it is important to review the clause enabling such a change.

Whilst it is common for most clauses to be broad in power, the precise nature of the wording may cause complications and impose restrictions on how a document may vary the Trust.

This health check considers whether there are any restrictions that may prevent a valid update being made.

<b><i>Issue</i></b>	<b><i>Comments</i></b>
Is there a power to vary the trust deed?	
What is the extent of the variation power?	
Are there restrictions or limits on what can be amended?	
Is anyone's consent required for the trustee to exercise the power to vary?	
Can the deed be varied orally, or does it need to be varied in writing?	
<b>Recommendations</b>	