Trusts - Discretionary

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What is a Discretionary Trust?

A trust is a fiduciary relationship in which one party, the trustee, is the holder of an interest in property, but is subject to an equitable obligation to use or keep the property for the benefit of another person (the beneficiary) or for some commitment object or purpose.

In a discretionary trust, the trustee is able to exercise discretion as to the entitlement of each beneficiary or class of beneficiaries to the trust fund or trust income and the proportion to which they are entitled.

Set up Procedure

- Create by a settlor with a Trust deed. (Discretionary).
- Establish a trustee.
- Have trust deed stamped where necessary.
- Register ABN.
- Register for GST (if applicable).
- Register for PAYG (if applicable).

Advantages of a Discretionary Trust

- With a corporate trustee – limited liability;
- Asset protection – Assets sheltered within the trust may be protected from creditors;
- Flexible tax planning with ability to distribute income and profits to family and other entities;
- Distributions from trust do not generally attract workers' compensation except in certain circumstances, e.g. when distribution is made to a worker in lieu of wages;
- Distributions from trust do not require superannuation guarantee to be paid;
- Capital gains income flows through to beneficiaries where it may be discounted;
- Can distribute to a Company utilising the Company tax rate with operation of a subtrust.
- Family Trust Loss rules available.
- Business income distributed to beneficiaries may be eligible for a tax discount worth up to $1000/annum from FY 2016 under the small business tax offset.

Disadvantages of a Discretionary Trust

- Cost of maintenance of structure;
- Interest paid on loans where money is on lent to a discretionary trust cannot be claimed as a tax deduction;

- Tax losses generated by the trust cannot be distributed to beneficiaries;
- Changing legislation may require ongoing updates to the trust deed;
- Beneficiaries unpaid present entitlements are treated as assets by Centrelink;
- Income tax is generally paid by the beneficiaries at their marginal tax rates;
- Profits retained by the trust are taxed at 47% (49% for FY2015, 2016 & 2017);
- Any unused franking credits received are lost.
- Alienation of Personnel Services Income rules may limit deductions and reduce effectiveness of structure;
- Does not receive the land tax exemption threshold in NSW if it owns real property.

Compliance Requirements.

- ASIC annual return & annual fee (approx $249/annum) payable to ASIC where a corporate trustee is used.
- Any changes in Directors/Shareholders details of the corporate trustee must be reported to ASIC within 28 days.
- ABN registration.
- Tax File Number application.
- GST registration (if applicable).
- BAS – monthly or quarterly (if applicable).
- Income Tax Return – Yearly.
- Fringe Benefits Tax Return – Yearly (if applicable).
- Financial Statements must be prepared annually in required format.
- Trust Distribution Minutes must be made each year prior to 30 June.

General Comments

This type of structure is generally used as an asset holding structure for asset protection purposes but may also be used as a trading structure.

When creating a discretionary trust you may elect to have a company as the trustee of the trust. This ensures that the trust is not owned or dictated by one individual but rather it is overseen by all of the directors of the company. This also provides a level of asset protection for the trust and its assets as should any individual trustees or beneficiaries come into financial trouble, the assets of the trust are secure and unable to be touched by any debtors.

You may also require a corporate beneficiary, colloquially known as a “bucket company”. The role of the corporate beneficiary is to receive trust distributions where the other beneficiaries are in high marginal tax brackets.