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Protecting the assets in your family tree

Article on changing discretionary trusts

Discretionary trusts are a misunderstood beast!

In our experience, most people do not know what their trust deed says – or even where it is!

We get it – who wants to read things like that when there are more interesting and pressing things to do?

CS587990



"It builds trust."

In the olden days, if you did read the deed and wanted to change it there was a fear that you would incur huge capital gains tax and / or stamp duty because it would amount to a resettlement of the trust. Changes to the beneficiaries were seen as a sneaky way to pass control of assets to the new beneficiaries without paying capital gains tax and / or stamp duty.

Then the Full Federal Court in *F.C. of T v. Commercial Nominees of Australia*¹ and the High Court opened the door to certain amendments being acceptable in superannuation funds.

Then *Clark's case*² came along which said that in certain situations unit trust deeds could be amended.

¹ (1999) 167 ALR 147 and (2001) 75 ALJR 1172

² Commissioner of Taxation v Clark [2011] FCAFC 5

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Then, the ATO released Tax Determination 2021/12 which broadened this to discretionary trusts³ - “. . . as a general proposition, it would seem that the approach adopted by the Full Federal Court in Commercial Nominees, as explained by Edmonds and Gordon JJ in Clark, is authority for the proposition that assuming there is some continuity of property and membership of the trust, an amendment to the trust that is made in proper exercise of a power of amendment contained under the deed will not have the result of terminating the trust, irrespective of the extent of the amendments so made so long as the amendments are properly supported by the power.”

Practitioners were still very cautious despite the numerous examples in the TD and sought private binding rulings to be absolutely sure.

Those rulings pointed out that the variation power needed to be appropriate so there was a rush to amend such powers or create new trusts.

In more recent times, we have seen the ATO agree that certain changes to tighten up discretionary trusts have been acceptable.⁴ The ATO has extended that view to unit trusts.⁵

With the wind behind our backs, practitioners are getting more brave and asking for what clients really want which is some certainty around discretionary powers.

What we mean is that discretionary trusts are one of the most common structures for owning privately owned businesses in Australia – disclosure, the author uses them this way and assists our clients to do the same. This is fine while Mum and Dad are around and means no capital gains tax because of the death of them both. However, when the next generation take control of the trust, they realise that they do not have a share of the trust to leave to their own families. I point out that if a second generation member dies, the surviving members will decide where the income and capital goes and it may not be to the children of the deceased sibling.

More and more, we are helping clients get more certainty and control over these assets in otherwise discretionary trusts.⁶ In this scenario, the applicant explained their reasons for proposing the amendment which was intended to:

- remove the trustee's discretionary powers
- ensure that all future income and capital distributions flow to Trust D

³ <https://www.ato.gov.au/law/view/document?docid=TXD/TD201221/NAT/ATO/00001>

⁴ Authorisation Number: 1012802358976, 1012771064638, 1012516972522, 1051478663638
Authorisation Number: 1051756641581, 1052127445736,

⁵ Authorisation Number: 1052113998591

⁶ Authorisation Number: 1052077248394 - the structure for this one is set out in the Appendix.



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- allow Trust D to invest its funds by equity investments in or loans to other trusts in the family group to give it the capital to expand and operate
- require Trust D to split income and capital distributions so that there's a clear structure and division of assets across entities in the family group which have been established for different purposes.

We have also received positive private binding rulings confirming that neither CGT Event A1, E1, E2 or other CGT Events have occurred in certain situations. This gives us confidence but as good lawyers we know that such rulings are based on their specific facts.

Trusts can be great structures to share assets and income among family members. But when control moves from the parents to the adult children, it can be like the change from a monarchy to a democracy. Without good planning, it can turn into a revolutionary situation. In particular, decision-making can be difficult when each sibling has a partner and a different financial needs and different risk tolerances.

If the difficulties make the use of the trust untenable, the parties have the pleasure of having to agree a valuation for the assets (often privately owned companies or real estate whose value is arguable) and if that fails, a trip to Court to sue their siblings. But who has raised this sub-optimal and highly predictable situation with the family and offered a solution?

If your adviser says nothing can be done other than to vest the trust with large tax consequences, you may have the wrong adviser!

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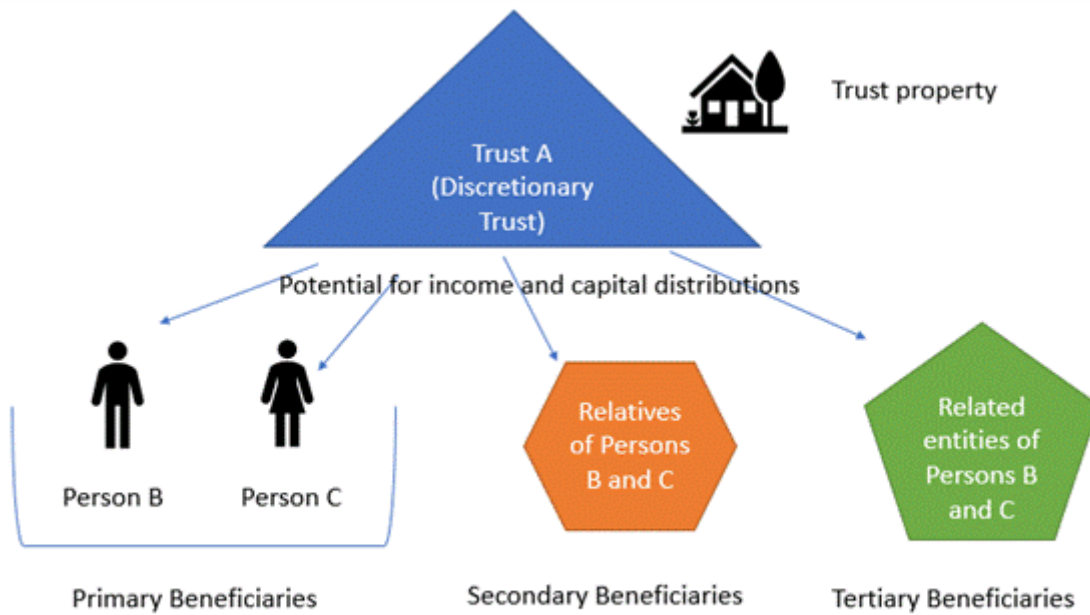


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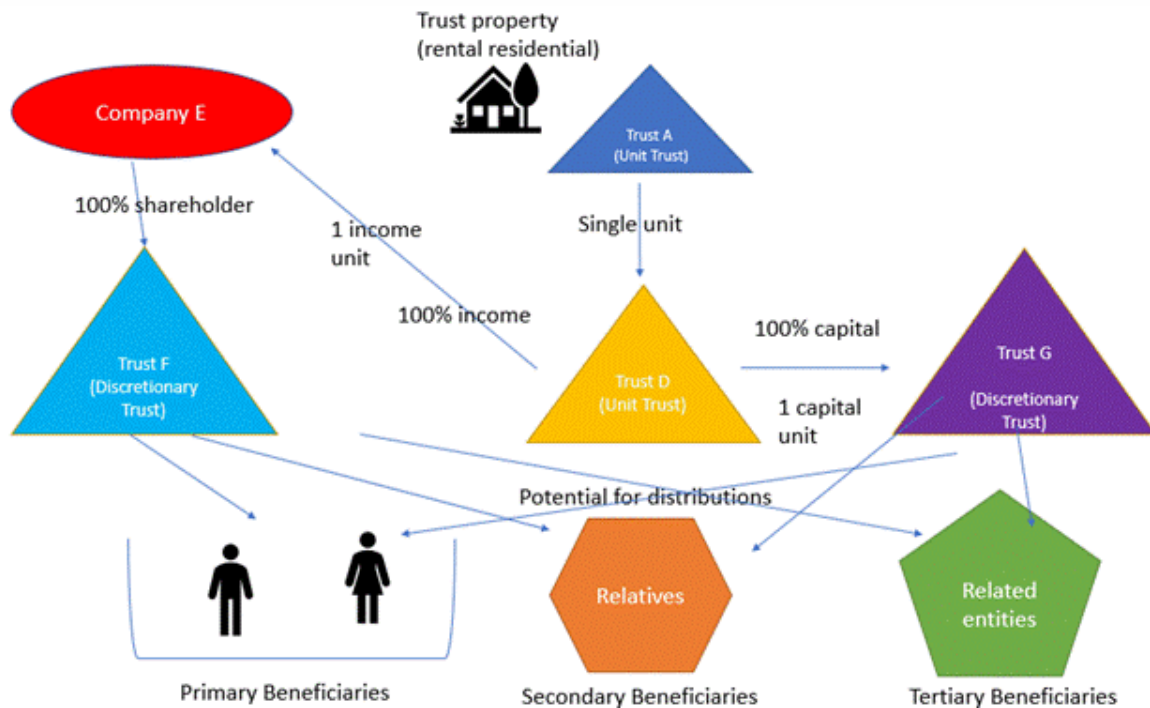
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Appendix

Pre restructure



Post restructure



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