

Understanding Discretionary Trusts and Second-Generation Estate Planning

Discretionary trusts, also commonly known as family trusts, are one of the most common legal vehicles in Australia to run businesses and build assets across generations. A trust is a fiduciary relationship between a trustee, who is entrusted to hold and invest trust assets for the benefit of the beneficiaries. Discretionary trusts offer many advantages, such as asset protection, income distribution flexibility and tax minimisation.

A trust “lives on” even after the death of the individuals who have control of the trust. It is important to note that the assets of the trust do not form a part of the estate of the trustee upon their death.

Succession planning simply refers to the process of passing on the control of the trusts to a different group of people, be it during the lifetime of the original appointor/trustee, or upon the original appointor/trustee suffering from an incapacity, or upon their death.

Succession planning of trusts requires careful consideration to ensure that an appropriate structure is set up for the trust to be functional and the distribution of income and assets of the trust are in line with the wishes of the original controller.

Control

There are two distinct roles in a trust:

- **A trustee** has the power to decide the day-to-day management of the trust;
- **An appointor** generally has the power to remove and appoint trustees, which in essence, has the effective control of the trust.

It is crucial that the Trust Deed as well as the constitution of the corporate trustee (if any) are thoroughly examined so that the successor trustee or successor appointor can be effectively appointed via Deed or via Wills.

Issues to Consider

A common issue in succession planning to the second generation is the passing of the control of the trust to multiple family members, generally, the children of the original controller. If a Trust has multiple trustees, or if the corporate trustee has multiple shareholders and directors, often a dilemma arises when the parties cannot reach an agreement on the investment of trust or the distribution of income or assets of the trust.

If the Deed or the constitution of the trustee company requires that all trustees or all directors of the trustee company reach a unanimous decision, there is a potential of parties encountering a deadlock, requiring the Court's advice and direction, which can be time-consuming and costly to obtain.

Alternatively, if a decision can be made by the majority, there is a significant risk of outvoting and unfair decisions being made against the minority in the family.

Families who have discretionary trusts are encouraged to seek tailored advice, considering the investments in the trust as well as the dynamics of the family.

Some possible strategies include:

- appointing an independent party in deadlock situation
- establishing family agreements
- seeking approval of a third party when major decisions, such as vesting of the trust, is made.

Another issue in succession planning to the second generation is the potential tax consequences in setting up the relevant structures within the trust. Some of the potential strategies, including amending the trust deed or the constitution of the corporate trustee, might trigger Capital Gains Tax. Careful examination of the current structures and advice is required to ensure that the changes to the structure does not "resettle" the trust.

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If you have any questions on succession planning for trusts, please contact Andersons Solicitors experienced estate planning team.