FACT SHEET

Business Structures:
How a Trust structure works in Australia

In Australia, there are several types of business structures that you can choose from when setting up your business operations. The choice of business structure depends on factors such as the nature of the business, the number of owners, liability considerations, and tax implications.

The following information is a simplified explanation of how a Trust structure works in Australia.

What is a Trust?

A trust is a legal structure where a trustee carries out the business on behalf of the trust's members (or beneficiaries). A trust allows a trustee to hold and manage assets for the benefit of beneficiaries

Here are the key components and roles involved in the structure of a trust:

- Settlor: The settlor is the individual who creates the trust. The settlor's role is typically completed at the establishment of the trust, and they have no further involvement in its operation. The settlor should be independent and must not be a beneficiary, trustee or appointor.

- Trustee: The trustee is the legal owner and manager of the trust's assets. They hold the assets in trust for the beneficiaries and are responsible for managing and administering the trust in accordance with its terms. The trustee has a fiduciary duty to act in the best interests of the beneficiaries. A trustee can be a company or one or more individuals.

- Beneficiaries: Beneficiaries are individuals or entities who are entitled to benefit from the trust. They can include individuals, companies, or even other trusts. Beneficiaries may be specifically named in the trust deed, or they can be determined by a class description (e.g., "children/spouse of some specific beneficiary").

  Most Trust Deeds name one or more Primary Beneficiaries - these are typically the people that subsequent beneficiaries are drawn from.

  Whilst it is possible under many Trust Deeds to add or remove Beneficiaries, before doing so, it is important to keep in mind that this may result in stamp duty and Capital Gains Tax liabilities. Please do not attempt this without seeking professional legal advice as adding and removing Beneficiaries may constitute the transfer of a "trust interest"

- Appointor or Principal: This role can be taken on by one or more people, the Appointor is responsible for appointing the Trustee and so effectively controls the Trust.

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What is a Trust cont.

- Trust Deed: The trust deed is a legally binding document that sets out the terms and conditions of the trust. It outlines the powers and responsibilities of the trustee, the rights and entitlements of the beneficiaries, and the rules for distributing trust income and assets. The trust deed may also include provisions regarding the appointment and removal of trustees and other operational matters.

- Distribution of Income and Capital: The trustee has the discretion to distribute income and capital of the trust to the beneficiaries based on the terms of the trust deed. The income earned by the trust is typically distributed to beneficiaries in proportion to their entitlements as specified in the trust deed.

Types of Trusts

There are several different types of trusts that serve various purposes and have distinct characteristics. Here are some of the most common types of trusts:

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- Discretionary Trust: A discretionary trust provides the trustee with discretion in distributing income and assets to the beneficiaries. The beneficiaries and the amount of money beneficiaries receive under a discretionary trust is not fixed as the trustee has the power to decide the amount and timing of distributions, considering the individual circumstances and needs of the beneficiaries. Discretionary trusts offer flexibility and tax planning opportunities.

- Family Trust: Family trusts are discretionary trusts that are set up to hold a family's assets, which may include a family business. Usually, one or more family members manage the trust for their family. Trustees can choose the beneficiaries; however, beneficiaries will be limited to family members.

- Unit Trust (Fixed Trust): A unit trust is a trust where the beneficial interests are divided into units, similar to the shares in a company. Each unit represents a proportionate share of the trust's assets and income. Unit holders, also known as unitholders, are entitled to a fixed percentage of the trust's income and capital.

- Hybrid Trust: A hybrid trust combines elements of both discretionary and unit trusts. It allows for both fixed interests (units) and discretionary distributions. Hybrid trusts offer a degree of flexibility while also providing certainty in the entitlements of certain unitholders.

- Bare Trust (Nominee Trust): A bare trust, also known as a nominee trust, is a simple trust where the trustee holds assets on behalf of the beneficiary. The trustee has limited discretion and typically acts according to the instructions of the beneficiary. Bare trusts are commonly used in property transactions, where the legal ownership is held by the trustee for the ultimate beneficiary.

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How is trust taxed in Australia?

Generally, a trust is a "flow-through" entity for tax purposes, meaning the trust itself does not pay tax on its income. Instead, the income of the trust is distributed to the beneficiaries, who are then responsible for paying tax on their share of the trust's income.

The trustee of the trust is responsible for lodging an annual tax return for the trust. This return includes details of the trust's income and deductions. The trustee must pay tax on any income kept within the trust at the highest marginal tax rate (known as the "trustee tax rate").

If a trust incurs losses, these losses can generally be carried forward to offset against future income of the trust. However, restrictions apply to the use of these losses, and they cannot be distributed to beneficiaries.

How to access the funds from a trust?

Beneficiaries can access the trust funds via trust distributions. The trustee will decide based on the trust deed and other relevant factors while finalising the distributions.

Other considerations when operating through a Trust

- Trustees must execute their discretion and declare to whom and how any trust income will be distributed prior to 30 June of each year. Failure to do this can result in the trustee paying tax at the top marginal tax rate. You may wish to consider a Default Beneficiary clause in your trust deed to guard against this.
  - Beneficiaries under 18 years of age can also attract higher tax rates

- There is a requirement that funds distributed are actually paid to beneficiaries
  - This includes minor beneficiaries or adult children, the ATO (Australian Taxation Office) has been clear that they expect any distributions to be physically paid and the beneficiary to have ultimate control over the funds paid.
  - This requirement can cause cashflow considerations for a trading entity as cash generated from business operations are usually tied up in stock holdings, aged creditors and working capital of the business.

- If you're running a business through a Trust where the income is primarily derived from one person's personal exertion, this may be considered PSI and the ATO may not accept that the income belongs to the Trust and may seek to assess the income to the specified individual instead.

- Particularly where a Trust is Discretionary there is no ultimate underlying ownership interest – therefore it is uncommon for the assets of the Trust to make up any individual's estate on death. It is therefore important to consider who acts in the role of Appointor to ensure ongoing management of the Trust.