Factor 1
Accountants & Advisers

Is a family trust right for you?

Establishing a family trust is a popular way for people to hold assets for the benefit of their family as well as potentially minimise their tax burden. If you are considering setting up a family trust you should be aware of both the benefits and pitfalls of this legal structure.

What is a family trust?

A family trust is a type of discretionary trust established by a person for the benefit of their family members (the beneficiaries). The assets of the trust are controlled by a trustee in accordance with the terms set out in the trust deed. The trustee has the discretion to distribute the trust's income and capital to various beneficiaries and in varying amounts. This is generally done with the aim of accumulating wealth more effectively than if the person was to own their assets directly.

A family trust has many similarities to a testamentary trust. However, a key difference is that a family trust can be set up at any time and come into effect on a chosen date. In contrast, testamentary trusts are written into wills and only come into effect when the will maker passes away.

The key benefits of establishing a family trust are set out below.

Tax minimisation

By establishing a family trust instead of a testamentary trust, a person may have the immediate benefit of minimising their tax burden. The trust's income and capital can be distributed to beneficiaries in such a way as to reduce the amount of tax that must be paid. This is because tax is not applied to the trust itself and instead is applied to each beneficiary individually. Consequently, a large portion of the income coming into the trust could be distributed to a beneficiary who is on a lower tax bracket than other members of the family.

Additionally, in some cases money from the family trust can be loaned to someone for investment purposes. The interest from this loan is paid to the family trust, with the beneficiaries potentially having very low (or nil) tax to pay on it.

Asset protection

A family trust can be an effective way of protecting assets from creditors, or beneficiaries who may not be responsible enough to deal sensibly with the assets. This is because the trust owns the assets while the beneficiary only has the expectation of receiving the assets.

A family trust may also protect assets in cases where a beneficiary's will is contested or a marital breakdown occurs. A family trust is considered a separate entity from a person's estate and personal assets, with the assets in the trust generally being protected from anyone contesting a will. This however is on a case-by-case basis and should not be considered a fool proof method of asset protection.

Assist with succession planning

Family trusts can be a good option for passing wealth on to the next generation in a tax effective way. This is primarily because ownership of assets does not need to pass from one individual to another in the event of the death of one of the beneficiaries, reducing the likelihood of tax being paid at that time.

Potential pitfalls of family trusts

With the popularity of family trusts being due in most part to tax minimisation, there have been recent changes in the law to crack down on what the ATO perceives as tax avoidance.

For example, the amount of income that can be distributed to minors on a tax-free threshold has been significantly reduced, and undistributed income in the trust is taxed at a high rate.

Additionally, trusts cannot distribute tax losses and do not receive the same advantageous land tax threshold that individuals can receive.

There is also a risk that the trustee of the family trust will not perform their role adequately, creating resentment or suspicion among family members.

Finally, the time and money required to administer the family trust may be a greater burden than if the assets were held personally.

Overall, it may be worth considering the establishment of a family trust if you are accumulating assets and wondering how to best maintain your wealth for yourself and future generations.