# Unravelling trusts: splitting, cloning and umbrella trusts

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Abstract: The need for effective structuring of business and personal assets has been brought into sharp focus for high net worth individuals and business over recent years. The benefits of family trusts are generally still sufficient to make them the preferred structure for asset protection, tax planning and succession purposes. However, the capital gains tax and commercial issues raised in the context of umbrella trusts, trust cloning and trust splitting are significant, and care should be taken when restructuring and establishing discretionary trusts. The author argues that, in this regard, the optimal approach is to methodically follow a tailored checklist. This article provides a starting point for the development of such a list.

## Restructuring a family trust using trust cloning and trust splitting

Trusts have long been the "structure of choice" for achieving a flexible tax efficient vehicle that also protects assets.

Where assets have been built up in one trust, there is often a desire for the assets to be divided among different trusts. This may be for a number of reasons, including:

- to allow some assets to be controlled by certain family members and other assets to be controlled by different family members;
- to separate passive investments or valuable capital assets from the risks associated with carrying on a business; or
- to separate multiple business activities and quarantine the risks associated with each.

Transactions of this nature can have a number of revenue-related consequences, including:

- capital gains tax (CGT) on asset transfers;
- stamp duty (which is outside the scope of this article); and
- trust resettlement due to variations of the trust deed.

Arguably, the three most prevalent forms of separating trust assets are umbrella trusts, trust cloning and trust splitting.

While not historically a popular approach in Australia, the English concept of an "umbrella trust" has informed concepts such as trust cloning and splitting. Each approach can offer pathways to achieve a restructure of trust assets while minimising adverse transaction costs.

Trust "cloning" is synonymous with trust "mirroring". That is, assets of a trust are transferred to a separate identical trust or trusts with no changes to the meaning or effect of the trust deed. This provides for different trust estates.

In contrast, trust splitting is where the assets of the trust are split (within the same trust) so that different trustees are appointed for each part. The ability to split a trust will depend largely on whether the trust deed includes a power to appoint a separate trustee in respect of those assets to be separated from the remaining assets.

## Power to transfer trust assets

Before considering how a trust can be restructured, it is important to ensure the trustee has the necessary powers under the trust deed to create an umbrella trust, split or clone the trust. Further comments in relation to creating an umbrella trust are set out further below.

Before then, broadly, for trust splitting, the trustee must be given the power to appoint another trustee with respect to a particular asset. Where the original deed does not contain such a power, a deed of variation can be prepared. An example provision is set out below:

> "'Asset Sub-Trust' means any Property of the Trust over which a Principal has appointed a separate trustee.
>
> Without limiting the provisions of this clause, the Principal may:
>
> 1. appoint a separate trustee in respect of separate assets of the Trust Fund, including any Asset Sub-Trust;
> 2. remove a trustee appointed and appoint another trustee in their place; and
> 3. appoint one or more additional trustees to any Asset Sub-Trusts in respect of which a separate trustee has been appointed.
>
> The Principal may exercise the power to appoint a new trustee under this clause in favour of themselves."

Similarly, in the context of trust cloning, where no consideration is being provided, trustees must ensure they have adequate powers to transfer trust property. An example provision is set out below:

> "**Power to deal with trust property**
>
> To, in the Trustee's absolute discretion, sell or purchase all or any part of the Trust Fund (including any real or personal property) to or from itself in its capacity as trustee of any trust having the same terms and beneficiaries as the Trust (on such terms as the Trustee thinks fit, including for nominal consideration)."

In a trust cloning situation, generally, a trustee will declare that they cease to hold the assets for the original trust and commence holding them as trustee for the cloned trust. An example provision allowing a trustee to make such a declaration is set out below:

"**Power to hold property for any other trust with the same terms**

The Trustee may:

1. cease to hold any part of the trust fund on the terms of the Trust; and
2. start to hold that part of the trust fund on the terms of any other trust where the Beneficiaries are the same as the Trust,

as the Trustee decides."

## Trust cloning

While the heyday of trust cloning ended with the abolition of the CGT "cloning" exemption (other than in relation to certain forms of fixed trusts) in 2008,[1] trust cloning is still potentially relevant for all forms of trusts. In particular, cloning may be useful if the tax consequences of the transfer can be otherwise managed, for example, if:

- the Subdiv 328-G roll-over provisions of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) are available;[2]
- there has not been a significant increase in the market value of the asset since it was purchased;
- the small business CGT concessions in Div 152 ITAA97 are available; or
- the assets to be transferred are non-CGT assets and the income tax consequences can be managed.

As discussed in more detail below, trust splitting does not provide the same level of asset protection as trust cloning. As a result, trust cloning may still be appropriate in some circumstances if the CGT consequences of cloning can be otherwise managed.

## Trust splitting

The practical uses of trust splitting are broadly the same as those of trust cloning. As there are different mechanisms required for trust splitting, however, the asset protection afforded is not as substantial as for trust cloning.

Trust cloning involves establishing a separate, discrete trust and transferring assets between the two trusts.

Trust splitting, on the other hand, involves establishing a "sub-trust" within the original trust, so there is still only one trust, but different trustees are appointed for different assets held within that trust. The splitting of a trust does not involve a change to the beneficiaries or to the powers conferred on the trustee.

The ability to split a trust will depend on the powers provided in the trust deed to appoint a separate trustee in respect of those assets which have been split.

Trust splitting may not be ideal from a succession planning perspective, as there can be practical difficulties in relation to separating the control of the original trust and the sub-trust. In particular, as a minimum, the following issues would need to be addressed:

- how any principal, appointor or guardian roles are structured under the trust deed;
- the effect of any family trust election (the potential ability to make a one-off change to a family trust election does not generally assist with trust splitting, as only one family trust election can be made for the trust as a whole); and
- the ability (or inability) to obtain separate tax file numbers and goods and services tax registrations for the original trust and the sub-trust, if required.

In some cases, where liability and asset protection issues are not important and some ongoing cooperation among the trustees of the original trust and the sub-trust is feasible, trust splitting can be a useful tool in succession planning.

As the assets are still held in the same trust, albeit with different trustees appointed, this effectively limits the CGT consequences of trust splitting. In particular, while there is a change of legal owner when a new trustee is appointed, the exception under the CGT rules regarding a change of trustee should be available.

For trusts established outside a will, generally, it should be possible to insert the required powers into an existing trust deed without triggering a resettlement. This issue needs to be considered as part of a careful review of the trust deed and in the context of the Australian Taxation Office's (ATO's) position following the withdrawal of its statement of principles on the creation of a new trust.[3]

It should be noted that, in relation to testamentary trusts, the issues in this regard are more problematic because:

- many testamentary trusts have no variation power;
- even if there is a variation power, use of it for any purpose may be invalid on public policy grounds (ie as it allows a willmaker's directions to be changed after death); and
- depending on the underlying assets involved and the terms of the existing trust deed, there may be duty consequences.

## Umbrella trusts

An umbrella trust, while simple in theory, is fraught with difficulty in implementation, at least in Australia. The issues arise first from their creation and second due to their likely adverse CGT consequences.

### Creation of "sub-trusts"

An umbrella trust arrangement is created when a trustee makes a declaration, via a special power of appointment, to hold a particular asset or group of assets on a "sub-trust" for a more limited class of beneficiaries under the "umbrella" of the main trust. Traditionally, under such an appointment, there is no separate entitlement created, rather, it is an entitlement contemplated by the original trust deed itself.

Once a sub-trust or "umbrella" trust is created, it can be managed by a different trustee, while still under the ultimate guise of the head trust. While an umbrella trust is analogous with a splitting arrangement, there are some subtle key differences, as explored further below.

The special power of appointment required to create the "sub-trust" through an umbrella arrangement was originally explained in *Williams v Muir*:[4]

"If, for example, property be settled on trust for A for life and after his death on trust for such of A's children or remoter issue and in such proportions as B shall by deed appoint, B has no interest in the property whatsoever. He has merely been given the power of saying on behalf of the settlor which of the issue of A shall take the property and in what proportions. It is as though the settlor had left a blank in the settlement which B fills up for him if and when the power of appointment is exercised. The appointees' interests come to them under the settlement alone and by virtue of that document. These remarks apply equally well to the case where the donee of the power of appointment has not only the power of saying which of the class shall take under the trust but also the power of saying what interests they shall take."

As further explained by Lord Justice Slade in *Bond (HM Inspector of Taxes) v Pickford*,[5] "when a special power of appointment is exercised, the limitations created under it are treated as written into the original instrument which created the power and not as creating a new settlement for trust purposes".

### Distinction between creating an entitlement and settling a new trust

Lord Wilberforce in *Roome v Edwards (Inspector of Taxes)* (*Roome*),[6] explained

the distinction between a special power to create an entitlement under the existing trust and the settlement of a new trust as:

- in relation to the creation of an entitlement under the existing trust:

  "Many settlements contain powers to appoint a part or a proportion of the trust property to beneficiaries: some may also confer power to appoint separate trustees of the property so appointed … It is established doctrine that the trusts declared by a document exercising a special power of appointment are to be read into the original settlement (*Muir* [or *Williams*] *v. Muir* [1943] AC 468). If such a power is exercised, whether or not separate trustees are appointed, I do not think that it would be natural for such a person as I have presupposed to say that a separate settlement had been created; still less so if it were found that provisions of the original settlement continued to apply to the appointed fund, or that the appointed fund were liable, in certain events, to fall back into the rest of the settled property."

- in relation to the settlement of a new trust:

  "On the other hand, there may be a power to appoint and appropriate a part or portion of the trust property to beneficiaries and to settle it for their benefit. If such a power is exercised, the natural conclusion might be that, a separate settlement was created, all the more so if a complete new set of trusts were declared as to the appropriated property, and if it could be said that the trusts of the original settlement ceased to apply to it."

## Difficulties with umbrella trusts in Australia

The key difficulty in creating an umbrella trust style arrangement in Australia is arguably best evidenced by the Full Federal Court's decision to refuse an appeal in *Oswal v FCT* (*Oswal*).[7] While the decision is generally considered in the context of trust resettlements for tax purposes, the underlying transaction purported to create an umbrella trust style arrangement.

The Oswals created a "separate" fund over certain assets, purporting to rely on the power set out in full below:

> "… the Trustee may from time to time before the Vesting Day whether or not the Trustee has made an appointment under clause 16.1, appoint, apply, or distribute, the whole or any part of the capital of the Fund to or for a General Beneficiary for the Beneficiary's own use and benefit or for the maintenance, education, advancement, or benefit, of a General Beneficiary."

The primary judge considered Lord Wilberforce's abovementioned decision in detail and held that, while the power in *Oswal* was a special power of appointment, there was never any issue in *Roome* that the "sub-trust" was a distinctly new and different trust from the main fund for trust law purposes. Rather, the analysis as to whether the new trust was created by "settlement", or entitlement, was confined to the CGT provisions under English law.

As such, according to the decision in *Oswal*, the distinction set out in Lord Wilberforce's judgment is of no practical consequence in Australia because in either situation, a new trust from a trust law perspective will always be created, even if a special power of appointment is being exercised.[8] This position is crucial in Australia as it means CGT event E1 will be triggered, as explained in more detail below.

## Specific comments on the taxation consequences

As noted above (other than in relation to some forms of fixed trusts), the CGT exemption on trust cloning is no longer available. Furthermore, on the creation of an umbrella trust, no CGT relief is available.

Generally, CGT relief should, however, be available on trust splitting. The basis for this is outlined in more detail below.

## CGT events

The CGT events which may have potential application to a trust split and creation of an umbrella trust are A1, E1 and E2.

CGT event A1 arises on a disposal of an asset. However, where there is a disposal as a result of a new trustee being appointed for particular assets, the exception regarding a mere change of trustee should be available.

CGT event E1 arises if a trust is created over a CGT asset. Splitting does not generally create a new declaration of trust or settlement. A new trust should not arise merely by appointing a new trustee in respect of particular assets already held by the trust. Therefore, CGT event E1 should not apply.

In contrast, in relation to the creation of an umbrella trust arrangement, in *Oswal*, it was held that the creation of an entitlement under an existing trust caused a new trust resulting in CGT event E1 occurring. This was notwithstanding the fact that the power exercised was a special power of appointment.

CGT event E2 occurs where an asset is transferred to a trust. With a trust split, CGT event E2 does not occur as the assets are still held in the same trust, although different trustees are appointed.

In ID 2009/86, it was decided that a trust split did trigger CGT event E1 on the basis that there was "a fundamental change to the rights and obligations attaching to the trust assets". In these particular circumstances, there were a number of factors which gave rise to the ATO's conclusion that a new trust had been created, namely:

- there was a release by the original trustee of its right of indemnity against the assets transferred;
- there was no right of indemnity by the new trustee against the assets which the original trustee retained;
- a separate appointor was nominated for the assets transferred to the split trust; and
- there was a narrowing of the class of beneficiaries who could benefit from the assets transferred to the split trust, by way of a family agreement in which beneficiaries agreed to limit the distributions of the split trust to particular beneficiaries, to the exclusion of others.

In summary, the ATO gave the following reasons for its conclusion that CGT event E1 occurred:

- the trustee's rights were altered by excluding the transferred assets from its right of indemnity; and
- the rights of beneficiaries were altered in that the class of persons who could benefit from the transferred assets had been narrowed.

## Current ATO position

The subsequent PBR 1012921290075 saw the ATO confirm the following key conclusions in relation to trust splitting:

- the insertion of powers into a trust instrument to provide a trustee the ability to create a split trust will not be a resettlement if the power of variation is sufficiently wide;
- a change of trusteeship in relation to certain trust assets will not cause any tax consequences, again subject to the trust deed providing the requisite powers;
- a change to the person nominated as principal or appointor of a split trust will not cause any tax consequences, again subject to the trust deed providing the requisite powers;

- varying a trust deed to limit each trustee's right of indemnity, such that each trustee is only permitted to be indemnified from the assets of the split trust they act as trustee for, will not cause a resettlement; and
- narrowing by deed amendment the class of beneficiaries of each split trust to focus around the family unit intended to control that trust will cause a resettlement.

Arguably, since TD 2012/21, none of the above conclusions are controversial, other than in relation to the narrowing of beneficiaries causing a resettlement. It is important to note, however, that the ability to limit the right of indemnity is a significant change from the previously adopted ATO position. Each of these issues are explored in more detail below.

## Narrowing the right of indemnity

One of the fundamental concerns with trust splitting, as compared with trust cloning, was the asset protection limitations of trust splitting if the trustee of each split trust remained able to be indemnified from assets held by other trustees of assets in a different split trust.

*Trim Perfect Australia v Albrook Constructions*[9] summarised what are generally seen as the key principles of a trustee's right of indemnity as follows:

- a trustee is personally liable for the debts it incurs as trustee, notwithstanding any provision of the trust instrument purporting to relieve it of that liability;
- where a trustee incurs expenses or becomes subject to liability in the course of performing the duties of the trust, it has a right of indemnity out of assets of the trust in respect of those expenses or that liability;
- the right of indemnity is supported by security in favour of the trustee over the trust assets in the form of an equitable lien; and
- the trustee's equitable lien confers on it a proprietary interest in the trust property, which can be asserted in priority to the claims of the cestui que trust.

### ATO's view

As noted above, in ID 2009/86, it was decided that a trust split did trigger CGT event E1 when purporting to narrow the right of indemnity on the basis that there was a "fundamental change to the rights and obligations attaching to the trust assets". However, in PBR 1012921290075, also mentioned above, the ATO confirmed that removing or narrowing the trustee's right of indemnity does not of itself result in the trust estate as originally constituted coming to an end.

Furthermore, the ATO confirmed that altering of the indemnity does not cause any of the assets of a trust to be subject to a new charter of rights or obligations separate to those on which the property was originally settled.

Rather, the restriction of each respective trustee's rights to be indemnified is in fact consistent with the appointment of separate trustees over different assets of a trust. Ultimately, it was considered that the changes concerning trustee indemnity as part of a trust splitting arrangement, without more, did not alter the rights of the beneficiaries to be able to benefit from all of the assets of the trust.

> *"... the three most prevalent forms of separating trust assets are umbrella trusts, trust cloning and trust splitting."*

### Position at law

Limiting a trustee's right of indemnity through the terms of a trust deed has been the subject of some controversy. Despite it being common practice, the ability to do so effectively is far from certain. In this regard, there are a number of competing principles which come into play, including:

- the Trusts Acts in each state and territory which provide a right of indemnity and in some instances, for example, in Queensland, this right cannot be ameliorated by the terms of the trust deed;
- in the context of any pre-splitting liability, the original trustee will still have a right of indemnity against the new trustees in relation to obligations incurred by it while it was trustee. Practically, due to the Limitation of Actions Acts in each state and territory, this exposure period would generally be limited to six years, depending on the cause of action;
- the scope of expenses that are "reasonably incurred" and can thus be covered by the indemnity will differ depending on the role each split trustee has in the trust; and
- where one split trust conducts a comparatively risky activity, such as carrying on a business, public policy considerations may mean that a term in the deed limiting a trustee's right of indemnity may either be:
  - void as a matter of public policy for the purposes of protecting creditors (as was the case in *Moyes v J & L Developments Pty Ltd (No. 2)* (*Moyes*));[10] or
  - where the provision is inserted by way of variation it may be:
  - voidable as a "transaction" designed to defeat creditors under s 121 of the *Bankruptcy Act 1966* (Cth); or
  - an uncommercial, or potentially insolvent, transaction under ss 588FB and 588FC of the *Corporations Act 2001* (Cth).

Where any of these issues arise, the conservative position would be to seek the guidance of the court pursuant to their inherent jurisdiction to provide advice to trustees. Alternatively, before implementing the trust split, the trustees should be fully informed of the uncertainty in the area, such that they can make a fully informed commercial decision.

### Inherent limitation in expenses reasonably incurred

The case law suggests that there may be two inherent limitations with a trustee's right of indemnity that will generally also be relevant in a trust splitting arrangement, namely:

- whether expenses are reasonably incurred such that the trustee is entitled to an indemnity will depend on the scope of the trustee's duty and the proper exercise of that duty; and
- the indemnity is limited to the assets held by the trustee, which it is authorised to use.

*Nolan v Collie & Merlaw Nominees Pty Ltd (in liq)*[11] considered whether expenses were properly and reasonably incurred and opined that:[12]

> "… a trustee is entitled to be indemnified out of the trust estate 'against all his proper costs charges and expenses incident to the execution of the trust'. Starke, J., who approached the matter slightly differently, nevertheless espoused a proposition that a trustee had a right to be recouped as of right all that he had 'expended properly' in that role. Subsequently, in a judgment in which Dixon, J. formed part of the majority, his Honour said in Vacuum Oil Co. that, where an executor has acted under appropriate authority, the executor had a 'right to be indemnified out of the assets in respect of liabilities he has incurred in the proper performance of his duties or exercise of his powers'."

Following this approach, it is arguable that:

- the exercise of a split trustees' powers is limited to the proper management of each asset to which they have been appointed;
- when acting in that capacity, expenses or liabilities incurred are made in the context of the relative quantum of which the split trust assets are worth; and
- any expenses incurred as being reasonably incurred would be judged against:
  - the relative quantum of those assets; and
  - the limited scope of the trustee managing the assets of the split trust.

In relation to the inherent limit of indemnity to assets held by a particular trustee, the majority in *Octavo Investments Pty Ltd v Knight* (*Octavo*)[13] held:

> "The charge is not capable of differential application to certain only of such assets. It applies to the whole range of trust assets in the trustee's possession except for those assets, if any, which under the terms of the trust deed the trustee is not authorised to use for the purposes of carrying on the business."

This is also supported by the English House of Lord's decision of *Dowse v Gorton*[14] where Lord McNaughton confirmed, in the context of a deceased estate, that:

> "If a testator's business is carried [sic] on after his death, in accordance with the provisions of the will, which, I think, is the true view in this case, the indemnity of the executors is only limited by the amount of the assets which the testator has authorised the executors to employ in the business."

By analogy in the context of trust splitting, it could be said that a trustee is only authorised by the trust deed to manage the particular asset or assets appointed to it. Thus, that trustee's right of indemnity is in turn limited to those particular assets.

## Trusts Acts and public policy

The analysis above is subject to the provisions of the Trusts Acts in each state and territory.

As mentioned above, in Queensland, s 71 of the *Trusts Act 1973* provides trustees with a statutory right to be indemnified out of trust property, which (by virtue of s 65) cannot be ameliorated by the trust deed. Other states and territories contain similar provisions, although Queensland is unique in that it is the only state which specifically excludes the indemnity from being removed by the trust deed.

> *"The practical uses of trust splitting are broadly the same as those of trust cloning."*

As also mentioned above, the decision in *Moyes* rendered void on public policy grounds a provision purporting to limit a trustee's right of indemnity to ensure appropriate protection for third party creditors. The decision in *Moyes* has also been followed in the New South Wales Court of Appeal decision of *Agusta Pty Ltd v Provident Capital Ltd*.[15]

## Extension for tort creditors

The limitations on the trustee's indemnity may also be ignored by the courts in situations where the trustee incurs a tort liability, for example where a negligence claim is brought, of which the liability greatly exceeds the value of assets held by that trustee via the split trust.

In this situation, as long as the trustee of the split trust otherwise acted properly, public policy arguments similar to those applied in *Moyes* may apply so that the right of indemnity extends to all the trust assets.

## Personal liability of directors

It is also important to note that s 197 of the *Corporations Act 2001* (Cth) imposes personal liability on directors of trustee companies in situations where the company is unable to meet a liability and there is no indemnity out of the trust assets because of:

- a breach of trust;
- the trustee company acting outside the terms of the trust deed (which would also be a breach of trust); or
- because the trust deed limits the trustee company's right of indemnity.

While outside the scope of this article, commercially, issues that can potentially arise due to the application of this provision would usually be managed by appropriate asset protection planning undertaken by directors.

Critically, s 197 cannot be used to attribute personal liability in situations where the trustee has otherwise complied with their duties under the trust deed, despite the trust having insufficient assets to provide an indemnity to the trustee company.

Interestingly, and in contrast to the conservative view based on case law, s 197 appears to be drafted on the implicit assumption that it is in fact possible to limit a trustee's right of indemnity. Importantly, however, the provision does not itself authorise such a limitation. Rather, it simply provides for the apportioning of liability assuming an indemnity can be limited. This said, there are no recent cases specifically applying the provisions of s 197.

## Summary of position

Conservatively, it appears to be the case that:

- it is not always possible to completely exclude a trustee's right of indemnity; however
- as a matter of practicality, it may be possible to replicate via trust deed the position taken in *Octavo* that the right is inherently limited to the:
  - scope of the trustee's limited duties; and
  - assets the trustee is authorised to use.

An example provision of this effect is set out below:

> "The Trustee is indemnified out of the assets of the Asset Sub-Trust (i.e. the split trust) held by the Trustee against liabilities incurred by it in respect of the Asset Sub-Trust:
>
> (i) in the execution, or attempted execution, of this document or any provision of this document;
>
> (ii) because of the failure to exercise any of the trusts, authorities, powers or discretions of this document; or
>
> (iii) by virtue of being the Trustee,
>
> unless the loss or liability is proved to be caused by any act or omission or fraud or in bad faith, or the wilful misconduct, recklessness or gross negligence of the Trustee.
>
> To the extent allowed by law, the Trustee's right of indemnity under this document or at law is limited solely to the assets of the Asset Sub-Trust held by the Trustee."

Furthermore, additional steps such as a "gift and loan back" arrangement[16] (which is outside the scope of this article) could be implemented to make the position at law concerning trustee indemnity potentially academic in a practical sense.

## Narrowing the class of beneficiaries

Generally, due to the asset protection objectives and estate planning arrangements of the shareholders and directors of the trustee of the original trust, there is a desire in any trust splitting arrangement to narrow the class of potential beneficiaries.

In PBR 1012921290075, the ATO states that any such change will amount to a situation where assets are commenced to be held on trusts different to the original trust. In other words, that CGT event E1 would happen by reason of the changes. In reaching this conclusion, the ATO relies heavily on the decision in *Commissioner of State Revenue v Lam & Kym Pty Ltd* (*Lam & Kym*).[17]

Whether the position adopted by the ATO on this point is correct would need to be considered in light of the following:

- *Lam & Kym* involved an express declaration of trust over specific assets, which does not appear to be the case in the trust splitting factual scenario considered in PBR 1012921290075;
- in any event, *Lam & Kym* was a Victorian Supreme Court case which has been largely superseded by the Full Federal Court in *FCT v Clark* (*Clark*);[18]
- *Clark* confirmed, as acknowledged in TD 2012/21, that a variation of a trust by the trustee in accordance with an express power in the trust instrument will generally not result in the establishment of a new trust; and
- the narrowing of a beneficiary class is analogous to *Clark* and TD 2012/21, which confirm that no resettlement arises from a variation of beneficiaries where the variation is permitted by the trust deed and there is continuity of the trust estate.

## Resettlement

Trust resettlement is an area that continues to be important for trust splitting, especially where the original trust needs to be varied before the splitting takes place. The consequences of a resettlement include:

- all assets are treated as having been disposed of by the original trust and settled on the new trust (ie CGT event E1 occurs); and
- any losses in the trust are trapped and cannot be carried forward to offset income in the "new" trust.

The perceived risks of triggering a trust resettlement have varied substantially over recent years as a result of case law and ATO publications.

Following the court's decision in *Clark* and the subsequent removal of the ATO's statement of principles, the risk of a resettlement when amending a trust deed is substantially reduced.

When structuring a splitting transaction, with reference to the resettlement risks, it is arguably still the case that:

- no steps should be taken towards limiting the range of beneficiaries entitled to the assets of the trust, and in particular:
  - no steps should be taken by particular beneficiaries to renounce their entitlements in respect of the assets held in the split trust or the original trust; and
  - no agreements should be made in respect of future distributions from the split trust or the original trust (ie the trustee of each trust should retain full discretion as to distributions in each year); and
- the trust deed should contain an express power permitting a separate trustee to be appointed to particular trust assets. For testamentary trusts, this aspect may be particularly difficult to address, unless the relevant powers are in the will before the willmaker dies.

## Conclusion

The benefits of family trusts, even those that need to undergo some form of rearrangement, are generally still sufficient to make them the preferred structure for asset protection, tax planning and succession purposes. That said, the CGT and commercial issues raised in the context of umbrella trusts, trust cloning and trust splitting are significant and care should be taken when restructuring and establishing discretionary trusts.

In this regard, arguably the optimal approach is to methodically follow a tailored checklist, and this article provides a starting point for the development of such a list.

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