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Vesting a trust can have revenue-related consequences

By Keeli Cambourne, Deputy Editor, SMSF Adviser and Matthew Burgess, Director, View Legal

One of the most responsible decisions for a trustee to make if a trust deed cannot be found is to wind up the trust, but it can also trigger a range of tax and stamp duty consequences, says an SMSF legal expert.

Matthew Burgess, director of View Legal, said commercially it makes more sense to wind up a trust if the deed cannot be found and that it could be a case of the trustee being forced to take this action due to “disgruntled” beneficiaries or third parties.

But vesting a trust brings with it a range of revenue consequences especially around taxation and stamp duty he warned.

“These revenue consequences normally arise where a positive determination is made by the trustee to vest a trust,” he said.

“The trustee will usually resolve to make one or more beneficiaries absolutely entitled to the assets (or specific assets) of the trust.”

A trust will need to be terminated or wound up when it naturally reaches the end of its life and ‘vests’.

There are several circumstances that may arise where the trustee and beneficiaries want to bring the relationship to an end and seek to wind up the trust early. These can include where the trust is no longer needed, or the purpose of the trust has been fulfilled; the trustee no longer holds any assets; the beneficiaries are old enough to take care of their own assets; administrative costs of running the trust are too high; or there are court orders that the trust be wound up.

According to the ATO, on vesting, the beneficial interests in the property of the trust become fixed. This is to avoid breaching the “rule against perpetuities”. The regulator said the trust deed should be checked so the trustee is aware of when the trust will vest.

What happens when a trust vests will depend on the terms of the trust. For example, the trust deed may direct that, on the vesting day, the trustee is to end the trust by distributing the trust property to particular beneficiaries or it may provide that the trustee continues to hold the trust property on trust from this date for certain beneficiaries.

Whether the trustee has the power to vest the trust early will depend on the rules and powers of the trustee set out in the trust deed.

The trust deed may provide that the trustee needs the consent of the appointer or the beneficiaries or in some cases, the trustee may have the unilateral right to wind up the trust.

The vesting of the trust does not always end the trust or create a new trust. If the trustee is permitted by the trust deed to hold trust property for specified beneficiaries after the vesting date, the same underlying trust relationship continues although the duties of the trustee will have changed.

The ATO also states that there may be income tax implications of the trust vesting depending on the trust deed, including capital gains tax (CGT) consequences.

Mr Burgess said there is an exhaustive list of the revenue-related ramifications of a trust vesting including a capital gains tax being payable on the increase in the value of any assets being transferred since the date they were acquired.

Additionally, income tax may be payable on non-capital assets, such as plant and equipment and trading stock, or stamp duty may be payable on the transfer of the assets, to the extent they comprise dutiable property in the relevant jurisdiction.

“There is also the chance of additional tax, stamp duty and commercial costs being incurred to subsequently transfer the assets out of the name of the recipient beneficiary if they want the assets then re-routed to a trust environment,” he said.

“As well, there could be asset protection exposure for the beneficiary receiving the assets in the event they subsequently commit an act of bankruptcy, considering the impact of the rule against perpetuities, which effectively prevents a distribution to another trust if this causes the assets to remain within a trust environment for more than 80 years.

“Finally, there could be revenue-related consequences where an individual receives the assets, and there is the need to update their estate plan to reflect the additional assets owned in their personal name.”

However, many of these consequences can be more easily managed if appropriate planning is put in place, he said.

If a trust has to be wound up, Mr Burgess said there are a number of considerations a trustee should consider.

“Questions should be asked around ‘should the trust property be sold with the net proceeds of sale and then distributed to the beneficiaries, or what level of certainty does the trustee have that they have identified all potential beneficiaries and adequately discharged their obligations to all such beneficiaries?’”

“The trustee should also consider if assets should be transferred to beneficiaries as they are and what are the alternatives to revenue consequences, particularly tax and stamp duty, of each distribution,” he said.

Trustees should also know if all loan accounts and unpaid present entitlements with beneficiaries have been satisfied and which beneficiaries will receive the distributions.

Storing the records of the trust after vesting should also be considered as the trustee should ascertain all the beneficiaries will indemnify the trustee for the actions taken in historically administering the trust and for the wind up itself.