# Types of trusts

**Factsheet**
**July 2020**

**There are different types of trusts, each with their own specific obligations, benefits and taxation implications. This factsheet outlines some of these types of trusts.**

For most doctors at some stage, one or more types of trusts will likely form part of their overall financial strategy; to help meet their objectives during their career, to ensure assets are protected and managed tax effectively, and that the beneficial use of assets is passed to their intended beneficiaries during their life or on their passing. Your financial adviser, accountant or lawyer may discuss and strategise with you about the benefits of using certain types of trusts from a tax, asset protection and estate planning perspective.

For an introduction to trusts, see our separate factsheet 'Trusts: know the basics'.

To help you understand the different types of trusts, here are some of the more common ones.

## Discretionary trust (or family trust)

The standard discretionary trust (also known as a 'family trust' because it is often established for the benefit of the members of a particular family) is the most common type of trust. It can have a wide range of beneficiaries and while it can be structured in different ways, typically the beneficiaries consist of named individual/s and their relatives, trusts and companies in which they have an interest and in some cases, charities.

The standard discretionary trust may provide income distribution flexibility, asset protection, access to capital gains tax concessions and estate planning advantages.

## Unit trust

A unit trust is a trust where the entitlements of the beneficiaries (known as unitholders) are divided into units (although some unit trusts have different classes of units which have differing rights attached to them). Income and capital are distributed to unitholders in proportion to the number of units held. Therefore, the distributions can be viewed as being 'fixed'. This is similar to the manner in which shareholders of a company receive dividends. Units can be transferred or redeemed (subject to the terms of the trust deed or any unitholders' agreement) in a similar manner to shares in a company.

A unit trust differs from a standard discretionary trust, where the trustee has the absolute discretion to distribute income and capital to such beneficiaries and in such proportions as the trustee sees fit.

### Considerations:

- Unit trusts can be a popular vehicle for holding business real property such as a medical practice premises. Units are often owned by a doctor and their family's self-managed super fund (SMSF). As units in a unit trust are transferable, unit trusts can be a useful structure where there are multiple doctors in a practice and changes in doctor staff, who may wish to acquire or dispose of the holding in the practice premises.

## Special disability trust

Immediate family members and carers can set up a special disability trust (SDT) to provide for the future care and accommodation needs of a person with a disability, who must be the only beneficiary of the SDT (the beneficiary).

An SDT can provide taxation and social security concessions for both the beneficiary and donors to the SDT.

The tax rules for SDTs are designed so the net income of the trust is taxed at the beneficiary's individual income tax rate, rather than some or all of it being assessed to the trustee at the highest individual income tax rate plus Medicare levy.

Unlike other trusts, where taxation of net income depends on a beneficiary being presently entitled to trust income, the beneficiary of an SDT is deemed to be presently entitled to all of the income of the SDT (even if there is none). The beneficiary is also taken to be under a legal disability, which means the entire net income of the SDT is assessed to the trustee on behalf of the beneficiary.

SDT assets up to the concessional limit ($681,750 from 1 July 2019) are exempt from the social security assets test. Where the primary residence of the beneficiary is held by the SDT, it is excluded from the assets test. In addition, income or distributions from the SDT are not assessable under the social security income test.

A gifting concession limit of $500,000 is available to immediate family members (combined) who contribute to an SDT on behalf of the beneficiary. The effect of the concession is that any gift is ignored for the purposes of the donor's social security means testing. To be eligible for the concession, immediate family members must be at or over age pension or service pension age and receiving a social security pension.

### Considerations:

- SDTs are not available to all people with disabilities as an assessment is required to determine if the person qualifies.
- SDTs can provide significant benefits from a financial or tax perspective and can also protect the assets for the benefit of the beneficiary through the appointment of a trustee and monitoring by Centrelink.
- They can also be an important estate planning tool for elderly parents with adult children with disabilities.

## Testamentary trust

A will can establish a trust known as a testamentary trust, which can be a tax-effective way to administer your estate. A testamentary trust is, in essence, a discretionary trust (discussed above) created by the will of the deceased, whereby a trustee holds specified assets of the deceased on trust for a class of beneficiaries and has the discretion as to which of the beneficiaries receive income and capital of the trust. Although the terms of a testamentary trust are contained in a person's will, the trust is only established after a person's death.

Generally, subject to the terms of the will, the trustee has total flexibility to invest in whatever assets they wish and can draw on capital or income at any time.

As set out in our separate factsheet 'Trusts: know the basics', minor beneficiaries receive the benefit of the adult tax-free threshold in respect of income they receive from testamentary trusts (whereas they are taxed at punitive rates on passive income received from standard discretionary trusts). For example, effective 1 July 2019, the tax-free threshold for adults is $18,200 and for minors it is $416. This, coupled with the ability of the trustee to stream income to different beneficiaries in different proportions in its absolute discretion, makes it possible to stream income in a tax-effective manner by taking advantage of the lower marginal tax rates of minor children and making distributions to them rather than to their parents who may be on a higher individual income tax rate. This means that a trustee can take into account the other income of beneficiaries prior to distribution, to minimise tax and maximise distribution to individual beneficiaries or a family group.

As set out in our separate factsheet 'Trusts: know the basics', like discretionary trusts, testamentary trusts may have asset protection benefits.

However, there are some issues to consider when deciding whether a testamentary trust is appropriate. These include:

- if you incorporate a trust arrangement into a will, it is difficult to perceive what the needs and requirements of beneficiaries will be in 10 or 20 years' time
- the costs of administering the trust
- whether there should be one testamentary trust or multiple testamentary trusts (e.g. one for each child)
- in the case of beneficiaries who are in receipt of social security benefits, assets held in a testamentary trust for their benefit are no longer treated as exempt assets. This may result in a reduction of social security entitlements.

### Considerations:

- Testamentary trusts can be an invaluable estate planning tool, not just for accessing adult rates of taxation for minors, but also asset protection for beneficiaries. Adult children may have their own business or have credit issues and face the risk of bankruptcy. A testamentary trust may reduce the risk of your estate inadvertently passing to a creditor of your child.
- There may also be benefits in situations where a beneficiary has a vexatious ex-partner or is currently going through a separation or divorce.
- Testamentary trusts can also be used to effectively skip generations, for example your children may already be financially secure and you want to ensure your grandchildren are independently provided for in the longer term.

## Service trust

A service trust is a term used by the medical profession to broadly describe a trust that provides services to a medical practitioner in the operation of their medical practice. The service trust charges a service fee to a medical practitioner (or his/her practice entity) in return for the performance of various services such as the provision of premises, equipment, medical supplies, admin and nursing staff, booking, billing and collection facilities and IT systems etc. Usually the service fee includes a mark-up on the cost of those services to the service trust so that the service trust will make a profit. This structure results in the medical practitioner's professional fees being split such that the medical practitioner's net professional income is lower but the service trust derives a corresponding amount of business income. This allows a doctor to distribute the income the service trust derives to the beneficiaries of the service trust (who may include the medical practitioner's family members) in a tax-effective manner. This may be a preferable outcome to the medical practitioner who could not otherwise split personal exertion income and share it with a family member.

Please note that there are specific taxation rulings on the operation of service entities that limit the margin or mark-up of costs of the service entity. You should seek legal and tax advice to ensure that you comply with the Australian Taxation Office (ATO) requirements.

Here is an example of a typical service entity arrangement for a medical practice:

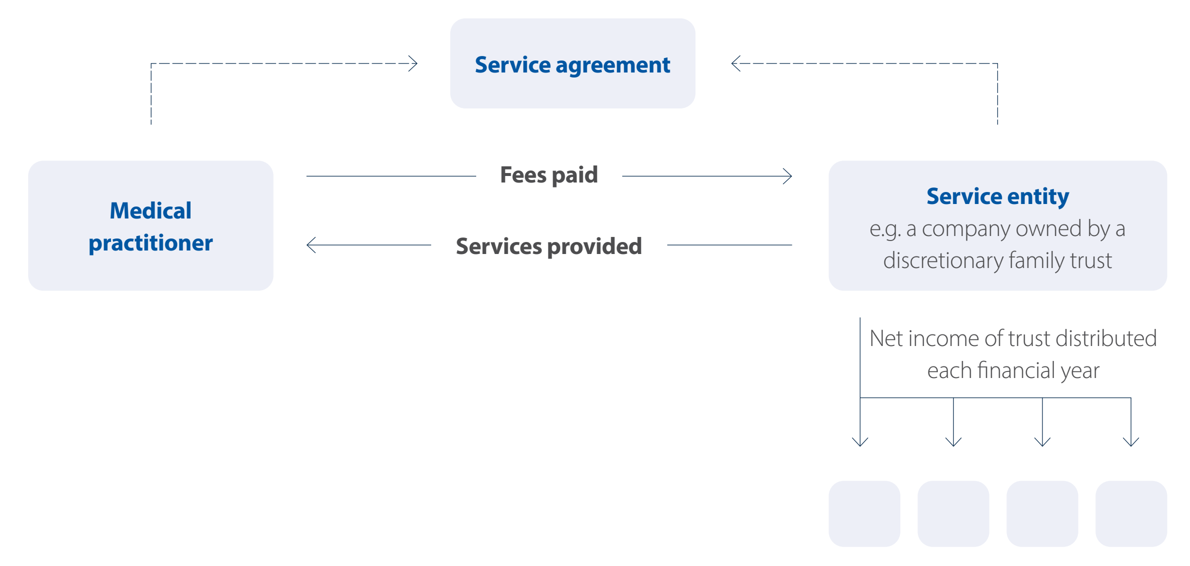
**How a service entity might look in a practice (see table on the following page):**

Dr Exrae runs a radiology practice with a receptionist, practice manager and two radiographers. He has a partner and an adult child in the family trust. In the practice, Dr Exrae has the following:

- plant and equipment with a written down value of $1 million
- plant and equipment financing costs of $300K p.a.
- annual salaries of staff plus on-costs of $350K p.a.
- practice premises lease $150K p.a.
- other business overheads of $250K p.a.
- gross billings of $1,800,000 p.a.

Under a direct holding structure, Dr Exrae generates income after tax of $424,373, however by restructuring Dr Exrae is able to increase after-tax income to $598,556, a tax saving of $174,183.

This example is a simplification and is illustrative only. You should seek appropriate legal, tax and accounting advice. For example, the profit margin that a service trust can charge may depend on the medical practitioner's specialty.



## Direct holding structure

| | |
|---|---|
| **Income** | |
| **Total billings** | **$1,800,000** |
| **Expenses** | |
| Plant and equipment | $300,000 |
| Staff salary and on-costs | $350,000 |
| Practice premises lease | $150,000 |
| Other business overheads | $250,000 |
| **Total expenses** | **$1,050,000** |
| **Income before tax for Dr Exrae** | **$750,000** |
| Income tax payable | $(325,627) |
| **Net income after tax** | **$424,373** |

## Margin allocation to service entity

| | |
|---|---|
| 5% of total billings | $90,000 |
| 7.5% of written-down value | $75,000 |
| 3.5% of staff costs | $12,250 |
| Nil as market rate | $0 |
| 5% of other expenses | $12,500 |
| **Total gross margin to service entity** | **$189,750** |

## Service entity structure

| | |
|---|---|
| **Income** | |
| **Total billings** | **$1,800,000** |
| **Less margin attributable to service entity** | **$189,750** |
| **Less expenses** | |
| Plant and equipment | $300,000 |
| Staff salary and oncosts | $350,000 |
| Practice premises lease | $150,000 |
| Other business overheads | $250,000 |
| **Net billing income to Dr Exrae** | **$560,250** |
| Income tax payable | $236,444 |
| **Net income after tax** | **$323,806** |
| **Income distributed through family trust** | $189,750 |
| Income distributed to Dr Exrae's partner | $94,875 |
| Income distributed to Dr Exrae's adult child | $94,875 |
| Less income tax liability | $49,056 |
| **Combined net income after tax** | **$274,750** |
| **Net after tax income** | **$598,556** |

**Total tax savings of $174,183** through adopting a service entity structure

## Get advice that suits your situation

This factsheet is a guide only and does not represent financial, tax or legal advice. The team at Doctors Wealth Management can review your situation and recommend a solution for your individual circumstances.

You can find additional resources and information about Doctors Wealth Management at **avant.org.au/doctorswealthmanagement** or call **1800 128 268**.



To learn more about the difference that financial advice tailored for doctors can make to your financial wellbeing, book an appointment today. Visit **avant.org.au/doctorswealthmanagement** or call **1800 128 268**.

**Always in a doctor's best interest**