Your Discretionary Trust Deed Is A Time Bomb

- *Grant Abbott*

Introduction – A Cautionary Tale:

Consider the recent case of *Owies v JJE Nominees Pty Ltd* (2022). The Owies Family Trust, established in 1970, named a couple's three children as primary beneficiaries. Yet for years the trustee (a corporate entity controlled by the parents) distributed all trust income to the parents and one favoured child, excluding the other two children. When those overlooked children finally challenged the distributions, the Victorian Court of Appeal found the trustee had breached its fiduciary duty by failing to give "real and genuine consideration" to **all** beneficiaries. Despite the deed purporting to give the trustee "absolute and uncontrolled" discretion, the Court removed the trustee for overstepping its bounds. This outcome sent shockwaves through the accounting and legal community – and serves as a stark warning. Had the accountants and advisors involved reviewed the trust deed and beneficiaries more carefully before issuing yearly distribution statements, this costly litigation and family rupture might have been averted.

The lesson:

An outdated or mismanaged discretionary trust deed (DT) is a ticking time bomb. Many Australian family trusts formed decades ago have never been properly reviewed or

upgraded. Accountants often prepare year-end distribution resolutions by rote, without scrutinizing whether the deed's provisions (e.g. who qualifies as a beneficiary, how "income" is defined, when the trust must vest) still align with the client's intentions or current law. As the Owies case shows, blindly relying on an old deed can implode into legal disputes, tax nightmares, or unintended wealth transfers.

Below we explore the **Ten Reasons Why Your Client's Discretionary Trust Deed is a Time Bomb**, each supported by legal authority, followed by solutions to defuse these risks. This briefing is high-level and analytical, designed for accountants and advisors who oversee trust distributions and estate planning. The aim is to arm you with knowledge to identify dangerous trust deed issues and implement protective strategies before it's too late.

Ten Reasons Why Your Client's Discretionary Trust Deed is a Time Bomb

1. Outdated Definition of Trust Income:

The definition of "income" in older trust deeds often does not reflect modern tax law, leading to potential mismatches between trust law income and *taxable* income. In *FCT v Bamford* (2010), the High Court confirmed that a trust deed can define trust income, which determines how tax liabilities are allocated to beneficiaries. Many pre-2010 deeds lack flexible income definitions and still use archaic concepts of income. After *Bamford*, if the deed's income definition is too restrictive or absent, the default tax rules may apply in unintended ways – potentially causing the trustee to be taxed at 47% on undistributed amounts or certain capital gains to be taxed in the wrong hands. For example, a trust deed that defines income as only "receipts of a revenue nature" could exclude capital gains from distributable income, meaning any capital gain would be stuck in the trust (taxed to the trustee at the highest rate) unless the deed is updated. **In short:** an outdated income definition is a time bomb for surprise tax bills. *Legal Authority: FCT v Bamford* (2010) 240 CLR 481; Cooper Grace Ward guidance noting most pre-2010 deeds need updates to income definitions and streaming powers.

2. No Streaming Powers for Capital Gains and Franked Dividends:

Prior to 2011, many discretionary trust deeds did not explicitly allow "streaming" of different classes of income (such as capital gains or franked dividends) to specific beneficiaries. After legislative changes, a trust can only effectively stream capital gains and franked distributions to particular beneficiaries if the deed *permits* it. Without streaming clauses, any attempt to allocate, say, all capital gains to one beneficiary (to utilize their capital gains tax discount) and all dividends to another (to utilize their franking credits) may be invalid. The result is that tax credits or discounts could be lost or allocated contrary to plan. The High Court's decision in *Thomas v FCT* (2018) underscored that streaming franking credits requires adherence to the trust deed and tax law – franking credits must follow the beneficiary who receives the dividend income, unless the deed's terms allow separate treatment. A modern deed typically includes clauses to separately identify and label categories of income and allocate them accordingly. If your client's deed lacks these powers, the trustee's hands are tied, and the trust is exposed to **inefficient tax outcomes** or disputes. *Legal Authority: Thomas v FCT* [2018] HCA 31 (streaming of franked dividends must accord with deed and Div 207 ITAA97); ATO example in TD 2012/21 (adding streaming clauses via amendment).

3. Imminent Vesting Date and Perpetuity Issues:

Many older family trusts are silently nearing their **vesting date** – the date upon which the trust must end and distribute its assets. Historically, trust deeds often specified a vesting date 80 years from establishment (to comply with the rule against perpetuities). A trust settled in the 1970s or 1980s may vest in the next few years if not already extended. An impending vesting date is a ticking time bomb: on vesting, the trust ceases to be discretionary and beneficiaries' interests become fixed, potentially triggering a large CGT event as assets are deemed to be disposed to those beneficiaries at market value. If the trustee and advisers are unaware of the looming vesting, they could unknowingly operate the trust past its term – a serious blunder. (Any attempt to extend *after* the vesting date is usually void.) For example, the ATO has illustrated a case where a trustee discovered the vesting date had passed and tried to extend it retroactively – the extension was invalid, and the continuation of the trust on

new terms caused CGT event E1 (creation of a new trust). Even if vesting is noticed in time, failure to plan an extension or winding up can lead to hurried decisions and suboptimal tax results. Every trust deed should be reviewed for its perpetuity or vesting clause **now** – if it's coming up or if the deed's perpetuity period could be extended (some modern deeds allow perpetuity to be waived under statute), action is needed well before the bomb explodes. *Legal Authority:* ATO Taxation Ruling TR 2018/6 (trust vesting consequences); *FDCT v Turner* (2018) – confirming that when a trust reaches its vesting date, interests vest and the trustee's discretionary powers end.

4. Rigid or Limited Trustee Powers (Including Variation Power):

An outdated deed may handcuff the trustee with antiquated or inflexible powers. Common problems include: **no power to amend** or overly narrow amendment clauses, restrictions on distributing capital, or requirements for consents that are no longer feasible. For instance, some old deeds require the consent of a named person (e.g. an appointor or guardian) to any variation – what if that person is deceased or incapacitated? Without a valid variation mechanism, even minor needed changes (adding a grandchild as beneficiary, extending vesting, etc.) could be impossible without a Supreme Court order. Conversely, if a trustee or advisor attempts a variation that is not permitted by the deed, it will be **invalid** – the original terms prevail, and any actions taken under the "amended" deed (distributions, appointments, etc.) may be void. A sobering example was reported by Macpherson Kelley lawyers: a trust deed's amendment power applied only to clauses "hereinbefore" the power (i.e. earlier in the document). The trustee and accountant had unknowingly been amending provisions that appeared *after* the power clause (including who could be trustee/beneficiary), thinking the changes were valid. In reality, those changes exceeded the power and were ineffective – years of trustee decisions were potentially invalid as a result. Such traps in archaic wording are more common than you'd think. Additionally, older deeds might lack powers to invest in certain assets or make loans, etc., or might bar the trustee from being a beneficiary (a limitation that could impede succession planning). In short, a trust deed with **handcuffs on the trustee** is a danger to effective administration. *Legal Authority: Jenkins v Ellett* [2007] QSC 154 (importance of following variation

power strictly); *Mercanti v Mercanti* [2016] WASCA 206 (court examined scope of deed's amendment and appointor provisions). The Commissioner's view in TD 2012/21 is that as long as a variation is within a valid power (or court-approved), it will *not* constitute a resettlement for tax purposes – underscoring that the *key* is having a robust variation power and using it correctly.

5. Missing or Unintended Beneficiaries in the Deed:

Who can benefit under the trust? The answer is only those persons or entities **within the classes described in the trust deed**. A time bomb ticks when the deed's description of beneficiaries no longer fits the family's circumstances or estate planning objectives. Perhaps the deed only names the settlor's children as beneficiaries, but not grandchildren born later – those grandchildren cannot receive distributions unless the deed is updated. Or the deed might omit in-laws or step-children whom the client now wants to include (or conversely, includes people the client no longer trusts). We have seen cases where an accountant distributed trust income to a spouse or family company, only to later discover the deed **never included** them as permissible beneficiaries – rendering the distribution invalid and exposing the trustee to ATO assessments at the top marginal rate (since a distribution to a non-beneficiary is ineffective, the income is undistributed for tax purposes). The ATO has warned that **reading the deed is critical** in making distributions, and trustees must ensure each beneficiary is within the deed's scope. If your client's deed hasn't been reviewed in decades, it may be operating on a static list of beneficiaries that ignores new family members, evolved family structures, or desired recipients like family trusts or charities. *Legal Authority: Hill v Zuda* [2022] HCA 21 (though an SMSF case, it reaffirms that trust terms *must* be followed exactly); ATO guidance on trust distributions – trustees should confirm eligible beneficiaries per the deed. Regular deed reviews can catch these gaps. Don't let a client's intended beneficiary be left out in the cold (or worse, trigger tax penalties) due to an antiquated schedule of beneficiaries.

6. Exposure to "Foreign Person" Surcharges:

In recent years, several Australian states (including NSW, Victoria, and Queensland) have imposed additional stamp duty and land tax on *foreign*

purchasers or owners of residential land. Discretionary trusts are at special risk: if **any potential beneficiary** of the trust is a foreign person (non-citizen, non-resident), the trust itself can be deemed a "foreign trust" and cop these surcharges – even if no distribution is ever made to a foreign person. Critically, "potential beneficiary" means anyone who could receive trust property under the deed. Many older deeds include very broad classes (e.g. "any descendant of Adam and Eve" or categories that could include non-residents by marriage or remote lineage). That breadth unwittingly turns the trust into a foreign trust in the eyes of revenue offices. For example, in New South Wales a discretionary trust will be deemed foreign *unless* the deed expressly and irrevocably excludes any foreign persons as beneficiaries. Victoria and other states have similar rules. If your client's trust owns (or plans to buy) property, failing to update the deed to include appropriate **foreign beneficiary exclusion clauses** could result in an 8% extra duty on purchase and 2%–4% annual land tax surcharge – charges that can easily total tens or hundreds of thousands of dollars. This is truly a ticking financial time bomb. The deadlines for fixing deeds have passed in some jurisdictions (NSW/Vic had 31 Dec 2020 deadlines for existing trusts), but any trust acquiring property must be fixed *before* signing a contract. Best practice is to amend all family trust deeds *now* to exclude foreign persons (unless the client intentionally wants foreign beneficiaries). *Legal Authority:* NSW Duties Act 1997 (as amended 2020), s.104JA; Vic Duties Act 2000 s.3E.

7. No Succession Plan for Trustee or Appointor Control:

A well-drafted trust deed should anticipate the future: Who takes over control when the current controllers die, become incapacitated, or otherwise exit? Many older trust deeds are silent or ambiguous on succession of the trustee and (if the deed has the concept of an appointor/guardian) succession of the appointor. The appointor (also called *principal* or *guardian* in some deeds) is often the person with power to hire and fire the trustee – effectively the "controller" of the trust. If the appointor dies without a successor named, the power might pass to their legal personal representative by default or as a matter of law… or it might simply lapse, leaving a power vacuum. This uncertainty can lead to ugly disputes, as family members jockey to install themselves as trustee to control assets. Likewise, if an individual trustee dies or a sole director of a

corporate trustee dies, the trust operations can grind to a halt pending appointment of new trustees or directors. Without a clear succession mechanism in the deed, even simple changes become cumbersome – requiring probate, multiple court applications, or risking competing appointments. *Mercanti v Mercanti* (2016) is an example where a father's attempt to pass control via appointor powers led to protracted litigation among family members; the court dissected the deed's wording to determine if the variation of appointor was valid. A modern deed (such as the **Leading Member** or **Family Protection** style trust) builds in cascading appointor succession: e.g., on death of the parent, the role of appointor passes automatically to a specified successor (like the eldest child or a set of children jointly) or as directed in a *Memo of Wishes*. It may also allow an appointor to nominate their successor by deed or will. If the current trust deed lacks these safeguards, the family's wealth is at risk of **ending up in the wrong hands or embroiled in litigation** upon a death or incapacity. *Legal Authority: Jowill Nominees Pty Ltd v Cooper* [2021] VSC 110 (importance of deed terms in appointor succession); Cleardocs guidance on trust appointor role and succession options.

8. Risk of Family Disputes and Litigation:

Beyond the structural issues above, an outdated trust can foment serious family conflict. We saw this with the Owies case – siblings taking trustees (their own parents) to court because the trust was administered in a way they felt was unfair. Other real-world examples abound: a discretionary trust set up by Dad decades ago might upon his passing be controlled by a second spouse or one adult child, who then excludes or minimizes distributions to others. Those "left-out" beneficiaries, even if they have no fixed entitlement, may accuse the trustee of breach of duty (for failing to consider them or acting in bad faith). The courts are increasingly willing to scrutinize how trustees of family trusts exercise their discretionary powers. Even where no breach can be proved, the mere threat of litigation can force costly settlements or impel a trustee's resignation.

Why do these disputes happen?

Often because the trust deed (and related structure) did not put in place a clear **governance framework** to manage expectations and reduce flashpoints. For

instance, older deeds might allow very broad classes of beneficiaries (including in-laws or distant relatives) who can later make nuisance claims. Or they fail to record the settlor's wishes about how the trust should benefit the family, leaving each new controller to impose their own view. Another source of conflict is the lack of an exit plan – if a beneficiary has effectively built up an "equal share" in the trust (say, each of three siblings have come to treat the trust as one-third theirs), but legally the trustee can distribute everything to one sibling, the stage is set for a fight. *Kennon v Spry* (2008) 238 CLR 366, while a Family Court case, showed how trust assets can be fought over: a husband removed his wife as a beneficiary of a family trust, but the Court still treated the trust assets as available to her in the property settlement, ultimately ordering a multi-million dollar payout. In short, a discretionary trust that is not *proactively designed* to handle family transitions can explode into multi-front litigation – sibling vs sibling, step-parent vs step-children, etc. Modern trusts use mechanisms like **bloodline-only beneficiary clauses, independent trustees or co-trustees, mandatory consultation provisions, or even alternate dispute resolution clauses** to mitigate these risks. If your client's deed lacks such protective features, consider it a powder keg in volatile family circumstances. *Legal Authority: Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 (trustee removed for failing to consider all beneficiaries); *Kennon v Spry* (2008) 238 CLR 366 (High Court pierced trust in matrimonial dispute due to control and exclusion of beneficiary).

9. Asset Protection Gaps (Creditor and Spouse Claims):

One big selling point for discretionary trusts is asset protection – assets held in a properly structured trust are generally harder for creditors of an individual to reach. However, an old trust deed may undermine this protection. For example, if a beneficiary becomes bankrupt, the trust deed might automatically vest that beneficiary's share of trust income or capital in them (some deeds have peculiar default clauses). Or the deed might permit *at large* distributions of capital to a particular beneficiary, which a bankruptcy trustee could potentially claim once paid. In family law, if a trust is not clearly delineated as a truly separate entity, the Family Court might treat it as the property of the relationship (especially if the controlling spouse can appoint themselves funds freely).

A **Family Protection Trust (FPT)** model counters this by strictly limiting who can benefit (only bloodline descendants, no in-laws) and often preventing distributions that would end up outside the family bloodline. In an FPT, if a child of the family is going through a divorce, the trust deed might specify that the child's estranged spouse (being no longer a blood-relative) is automatically excluded from any benefit, thus preventing that spouse from being considered a potential object of the trust. By contrast, a generic old deed that includes spouses of children as beneficiaries means *while the couple is married*, the son-in-law or daughter-in-law is an eligible beneficiary of the trust – which could strengthen their claim that trust resources were "matrimonial assets" or at least give them a foot in the door to seek discretionary payments. Moreover, without **protections against family provision claims**, assets left in a standard discretionary trust might still be attacked after the settlor's death under certain notional estate laws (NSW has particularly aggressive laws allowing the court to claw trust assets into an estate in some cases). The FPT approach (discussed more below) seeks to quarantine wealth so that it's not considered part of anyone's estate and only genuine descendants can benefit, reducing the risk of successful claims by ex-spouses or non-family. If the current trust deed doesn't have these safety measures, the family's wealth may be exposed to outside claims if a key individual goes bankrupt or divorces or dies. *Legal Authority: BBI v WAN* [2010] NSWSC 1295 (family trust assets included in notional estate for family provision in NSW); *Cumins v Cumins* (2006) 257 ALR 166 (trust assets accessible by trustee in bankruptcy due to aggressive tax evasion scheme – demonstrates limits of protection where trust used improperly). In sum, **if asset protection is one goal of the trust, an out-of-date deed could fail when tested**.

10. Tax Law Landmines – Section 100A and More:

The tax landscape for trusts is continually evolving. One current "time bomb" area is **Section 100A** of the Income Tax Assessment Act 1936, an anti-avoidance provision targeting certain trust distributions (so-called "reimbursement agreements"). The ATO in 2022 released guidance on 100A, scrutinizing arrangements where trust income is appointed to a low-tax beneficiary but the economic benefit is provided to someone else. While 100A

is about taxpayer behaviour, the trust deed can either mitigate or exacerbate risk. For instance, some modern deeds include clauses to expressly allow or ratify certain beneficiary loan arrangements or to define default entitlements in a way that avoids 100A application. An old deed with rigid or overly broad distribution powers might inadvertently facilitate a 100A risky arrangement without anyone realizing. Additionally, the definition of trust income (as in point 1) and powers to stream (point 2) tie into compliance with tax laws like Division 6, 6E of ITAA 1936. If a deed isn't updated, the trustee might accidentally create a tax problem by following outdated instructions. Another example: **Division 7A** (loans from trusts to company beneficiaries). If a family trust distributes to a corporate beneficiary but then keeps the funds as an unpaid present entitlement, Division 7A can deem it a loan and cause tax issues. Some deeds give trustees the power to sub-trust UPE amounts for beneficiaries or convert them to loans formally. Without these administrative powers, accountants must rely on external agreements which, if handled poorly, could lead to compliance breaches. In short, an out-of-date deed is not synchronized with modern tax avoidance provisions, posing a risk that routine actions could spring a tax trap. *Legal Authority:* ITAA 1936 s.100A (reimbursement agreements); ATO Taxpayer Alert TA 2022/1 (Trust strips and 100A) – highlights need for genuine beneficiary entitlement; TR 2010/3 and PS LA 2010/4 (Division 7A and trust UPE "sub-trust" arrangements). The safe approach is to **upgrade the deed to current best-practice clauses** and ensure the trustee's actions are always square with both the deed and tax law.

In summary, these ten points illustrate why so many long-standing discretionary trusts are latent "time bombs." A trust deed stuck in the 1970s or 1980s (or even 1990s) may lack the provisions to handle 2025 realities: tax streaming, extended lifespans of trusts, cross-border tax rules, complex family dynamics, and evolving legal precedents. For each issue above, there is a corresponding solution or protective measure – but it requires proactive effort to review and upgrade the trust deed (and sometimes the overall trust structure).

Defusing the Bomb: How to Modernize and Protect Trust Structures

The good news is that with the right legal tools, even an old ticking trust can be *defused* and brought up to the standard of a modern fortress-like structure. Here we outline key solutions:

- **Upgrade to a Modern Trust Deed (LYD/LY Legal):** The foundational step is a comprehensive deed update or replacement. Using an expertly drafted modern discretionary trust deed (such as the latest template from LightYear Docs (LYD) combined with legal review by LightYear Legal) can immediately address many of the issues identified. A modern deed will have: a flexible income definition aligned with tax law; streaming powers for all income types; an extended (or eliminated) perpetuity period to push vesting off for up to 150 years (where law permits) or indefinitely in South Australia; wide trustee powers including robust variation powers; clearly defined beneficiary classes including future descendants and excluding unwanted persons (like foreign individuals if needed, or ex-spouses); and built-in succession of control provisions. Importantly, the upgrade should be done by **qualified legal professionals** to ensure the changes themselves are valid and don't trigger a resettlement. With the LightYear Docs system, accountants can collaborate with LY Legal to generate a tailored deed upgrade (often called a *Deed of Variation* or full *Deed Restatement*) using the **Trustify™** platform. This ensures all necessary clauses (foreign beneficiary exclusion, 100A-safe wording, etc.) are inserted. The result is effectively a new trust deed for the existing trust, without changing the trust's legal identity or triggering CGT (so long as the variation power in the original deed is properly utilized, see the CGT discussion below). Upgrading to a modern deed is like replacing a Nokia 2000 with an iPhone 16 – it brings the trust from outdated and limited to cutting-edge, with tools to handle today's challenges. Every advisor should inventory their clients' discretionary trusts and recommend upgrades for those more than ~5–10 years old. The cost of upgrade is minor compared to the potentially catastrophic cost of doing nothing.
- **Family Protection Trust (No Named Beneficiaries, Bloodline Only):** For families deeply concerned about asset protection and lineage control, the **Family Protection Trust (FPT)** is an optimal solution. An FPT is essentially a

discretionary trust with special provisions to ensure the trust's benefits stay within the bloodline and under the guidance of successive family leaders. One hallmark of an FPT (as implemented by LY Legal's Leading Member Trust Deed) is **no individually named beneficiaries** in the deed – instead, classes like "lineal descendants of [Founders]" are used. This avoids the need to ever update the deed for new births or marriages; all blood descendants are automatically included, and importantly non-blood individuals (spouses of descendants, step-children, etc.) are **excluded** from benefitting (unless expressly allowed in a particular circumstance). By having no named beneficiaries, the deed also neatly side-steps any risk of a beneficiary predeceasing or a name being wrong – it's all class-based. The FPT typically appoints a **Leading Member (or Principal)** – usually the patriarch or matriarch – who has the power to direct the trust or appoint/remove trustees. Crucially, the deed will say that upon the Leading Member's death or incapacity, the role passes to the next in line (a successive appointor). For example, Dad as Leading Member is succeeded by Mum if Dad dies, then upon Mum's passing it goes to the eldest child, and so on (with flexibility to nominate a different child or split roles, according to the family's wishes). This *succession of appointor/trustee control* is predetermined, avoiding fights. The FPT structure also **prohibits distributions outside the bloodline** – meaning a child's spouse cannot receive assets (which both protects against divorce claims and ensures that in-law families don't siphon off wealth). The advantages of an FPT are highlighted by LYD: it provides *"blood relatives beneficiaries only"* and protection against family provision claims and Family Law claims. Essentially, because the trust assets will never vest in an outsider nor form part of an estate, they are much harder for a non-family claimant to attack. Converting an existing discretionary trust to an FPT may involve a deed variation that swaps out the beneficiary schedule and control provisions (again, something to be handled by trust law specialists). In some cases, clients choose to establish a **new FPT** and gradually transfer assets to it (or make it a beneficiary of the older trust to distribute to). The FPT is often described as "the Rolls-Royce of trusts" – it aligns with the client's *deepest* wish: to keep wealth for the benefit of their descendants and no one else. For ultra high-net-worth families or those with complex dynamics, this solution drastically lowers the risk of future conflict or dissipation of wealth.

- **Sub-Trusts to Ring-Fence Wealth for Estate Planning:** A powerful companion to the FPT concept is the use of **sub-trusts** or **sub-funds** within a trust structure to ring-fence portions of the family wealth for different branches or purposes. In practice, this can be done in a few ways. One approach is often called *trust splitting* (though that term also has a specific tax connotation, discussed later). Trust splitting in the *practical* sense means dividing the trust's assets and operations such that, for example, Child A effectively manages and benefits from certain assets, and Child B from others, with minimal overlap. Rather than waiting until a dispute arises, a deed can be drafted or amended to allow the trustee to allocate assets to separate sub-trust accounts for each beneficiary's line. Each sub-trust can have its own trustee or controller (perhaps the parent during their life, then the respective child for their sub-trust after the parent's death), while the overall trust remains one legal trust for tax purposes until perhaps a formal split is done. By ring-fencing in this manner, the family achieves a **virtual separation** of wealth without the formality of creating multiple trusts at inception. It can greatly simplify estate planning: upon the principal's death, the trust deed might dictate that the main trust immediately splits into, say, three equal sub-trusts – one for each child's family – and each sub-trust then operates independently (each child perhaps becoming appointor of their sub-trust). This way, siblings don't remain entangled in a joint trust (a common source of conflict), and assets intended for each branch are protected from claims of the other branches. We can analogize: a traditional discretionary trust is a single pot everyone dips from; a modern approach is to give each family branch their own labeled pot from the start. Sub-trusts are also useful for **generation-skipping** planning – e.g. grandparents set up a sub-trust that a grandchild can only access at a certain age or for certain purposes, without exposing it to the grandchild's parents' control. It's important to design any sub-trust arrangement carefully with legal advice, because if implemented ad hoc it could risk a resettlement (as the ATO's view in TD 2019/14 warns – a *pure* trust split creating a new trust for certain assets can trigger CGT). However, there are ways within a single deed to allow separation of control without immediately creating a new trust tax-wise. Indeed, Example 2 of ATO TD 2019/14 describes a scenario of *separating control* of some assets for succession purposes that did **not** result in a new trust, by amending the deed to allow additional trustees

and separate appointors for parts of the fund. With expert drafting (as available through LY Legal's *Trust Splitting* or *Family branch sub-trust* strategies), one can ring-fence without immediate tax triggers. The end result is a much more granular and secure estate plan: each beneficiary's share of the trust can be managed for their needs, protected from others' creditors or spouses, and if desired, eventually spun off into a completely separate trust entity when tax-efficient to do so. This approach stands in stark contrast to the all-in-one-bucket approach of old family trusts.

Case Study: Traditional DT vs. Family Protection Trust – *The Smith Family Scenario:* To illustrate the above solutions, consider the Smiths. In Scenario 1, John and Jane Smith have a traditional discretionary trust set up in 1990 with themselves as trustees and primary beneficiaries, and their two adult children listed as general beneficiaries (along with any future grandchildren, spouses, etc.). The deed hasn't been updated in 30 years. When John passes away, Jane becomes sole trustee. One child, Alice, is very involved in the family business (owned by the trust) and expects to one day control it; the other child, Bob, is estranged. Jane, influenced by Bob or perhaps a new partner, might exercise her absolute discretion to favor one over the other. Indeed, suppose Jane issues distributions mostly to Bob's children (her grandkids) and little to Alice. Alice, being a beneficiary in class, has no automatic right to anything and grows frustrated. Eventually, suspecting that Jane is not acting fairly, Alice considers legal action. The trust deed's lack of clear succession means that if Jane becomes infirm, a question arises: who steps in? Bob may try to appoint himself. Alice moves to injunct distributions. The family business is now paralysed and headed for court, with arguments over the trust's past conduct (did Jane consider both kids? was there a fiduciary breach?) similar to *Owies*. Additionally, the trust deed included Bob's now ex-wife as a beneficiary (by virtue of being a "spouse of a child"), and that ex-wife has surfaced to claim that certain distributions or dealings were done to defeat her claims in their divorce – pulling the trust into that litigation as well. This traditional scenario is rife with **litigation risk and family fallout**, exactly the outcome one hopes a trust would prevent, but unfortunately one that outdated trusts often *incur*.

Now contrast Scenario 2: John and Jane instead had upgraded to a **Family Protection Trust** structure. The deed was modernized such that only bloodline descendants of John and Jane can benefit; John is the Leading Member and Jane the next in line. The deed also, at John's passing, automatically appoints Alice and Bob

as joint trustees (or perhaps a professional trustee plus them as an advisory committee) *and* immediately creates two sub-trust accounts – one designated for Alice's family line, one for Bob's. The rules might say each sub-trust's income and capital should ideally be applied for that line's benefit, and neither sibling (nor their branch) has any claim on the other's sub-trust. Now, when John dies, there is far less uncertainty: Jane takes over temporarily but she knows the plan is for both kids to be involved per the deed's terms. She cannot simply allocate everything to one side because the deed's framework guides separate treatment. In fact, if the deed so provided, Jane might even cease to have a role after John's death (some Leading Member trusts require that control passes to the next generation on the first death to avoid a surviving spouse being influenced by say a new partner). Alice and Bob each effectively inherit *controlled use* of half the trust without the assets leaving the trust (preserving asset protection). If Bob tried to claim more than his share, the deed's terms and the existence of sub-trusts would make it difficult – he has no power to remove Alice's line as beneficiaries or take Alice's sub-trust assets. Suppose Bob had a rocky marriage; since it's an FPT, his wife was never a beneficiary, and upon divorce the court sees that Bob alone doesn't have unfettered access to trust assets (he's co-trustee with Alice or a trustee company, and the trust is explicitly for the benefit of *all* John's descendants). The trust assets are thus more insulated from the divorce claim. Meanwhile, because the trust's succession was settled, there's no fight between Alice and Bob over who controls the trust – each has defined powers for their sphere. This Scenario 2 demonstrates how a modernized approach provides **clarity, protection, and peace**. The differences are stark: in Scenario 1 (old DT) the Smith trust became a battleground; in Scenario 2 (FPT with sub-trusts) the Smith trust operates like a well-oiled machine through generations, with far less room for ambiguity or conflict.

CGT Implications of Trust Deed Changes – Avoiding the Tax Traps

Whenever the topic of changing trust deeds comes up, advisors must consider capital gains tax (CGT) and stamp duty. A major fear is that a significant variation of a trust deed could be treated by the tax authorities as a **resettlement** – that is, the trust is considered to have effectively ended and a new trust begun, causing a CGT disposal of all assets (and possibly duty on property). Fortunately, both case law and ATO

rulings have evolved to allow sensible amendments in most cases **without** triggering such consequences, but careful compliance is key.

Tax Determination TD 2012/21 addresses when CGT event E1 or E2 happens on amending a trust. The ATO's view (following the principles from *Commercial Nominees* and *Clark v FCT* cases) is that if changes are made in accordance with a valid power in the deed, and the changes do not fundamentally alter the trust's essential nature (in particular, they do not cause assets to start being held for a completely new set of beneficiaries or on new fixed entitlements), then **no CGT event occurs**. In other words, a properly executed deed upgrade or variation is not a taxable resettlement so long as the continuity of the trust estate remains. For example, TD 2012/21 gives an example of adding a definition of income, inserting streaming powers, and extending a vesting date on a decades-old trust – and concludes that doing so under the deed's amendment power does *not* give rise to a CGT event. Likewise, adding or removing beneficiaries within the scope of the original class (e.g. expanding "issue of X" to include future issue) typically would not trigger CGT. The critical exception is if you **terminate the existing trust and create a new one in substance**. For instance, if a discretionary trust was amended to such an extent that it effectively becomes a fixed trust for one beneficiary (breaking the nexus with the original beneficiary class and purposes), that would likely be a resettlement (CGT event E1). But standard upgrades aimed at modernizing (even substantial replacements of deed text) are usually fine when done under the deed's own powers. It is always recommended to seek legal advice on the specific wording of the power and the changes – a trust law specialist can ensure the amendment deed is crafted to maintain continuity (often reciting that it's made under the variation power, and that the essential beneficiaries remain the same).

Tax Determination TD 2019/14 is a newer guidance that specifically looks at "trust splitting" arrangements. Trust splitting typically refers to splitting one discretionary trust into two or more, usually by appointing a new trustee over some assets and restricting benefit of different assets to different beneficiaries. The ATO in TD 2019/14 concluded that a trust split **can** trigger CGT event E1 because it may result in a new trust being created over the assets that are under the new trustee's control. In the TD's Example 1, a family trust was split so that certain shares were transferred to a new trustee company for the benefit of certain members of the family exclusively, while the original trustee kept the other assets for the other members. The ATO viewed this as creating

a new charter of rights and obligations – essentially a new trust over the carved-out assets – and thus a resettlement (CGT event E1 on those assets at market value). However, the TD also provides an Example 2 (as referenced earlier) where a deed was amended to appoint separate trustees for separate parts of the fund for succession reasons, but with provisions to keep the trust as a single fund for other purposes (e.g. sharing expenses, losses, and some joint decision-making). In that scenario, the ATO accepted it did *not* amount to a new trust – thus no CGT event. The nuance is important: simply upgrading a deed to a modern form, or even implementing an *internal* sub-trust scheme, will not usually cause a CGT issue if done properly (consistent with TD 2012/21). But formally splitting a trust into two independent trusts, or any change that financially segregates assets irrevocably for different beneficiaries, could be seen as creating a new trust (per TD 2019/14). Additionally, changing the *trustee* of a trust (e.g. from individual to corporate trustee) does **not** by itself trigger CGT – that's just a change in trustee, not a change in the trust relationship, provided the trust assets remain for the same trust. The main message to advisors is: involve legal and tax experts when contemplating substantial changes. With guidance, one can structure changes to avoid CGT events. For instance, if the goal is to split family assets, it may be wiser initially to keep it under one deed with sub-funds (no CGT) and only demerge via a resettlement at a later time when maybe a CGT rollover or concession is available. Also note, state **stamp duty** laws vary – many states do not impose duty on mere variation of a trust deed, but if a variation changes beneficial ownership or adds a new trust, duty could apply. Again, keeping within the confines of the original trust scope is key to avoiding duty, much like CGT.

In summary on tax: A trust deed upgrade done by experienced professionals will be structured so that it **does not inadvertently trigger CGT or duty**. Both TD 2012/21 and TD 2019/14 guide what *not* to do. The former gives comfort that most ordinary updates (income clauses, extending vesting, adding beneficiaries, etc.) are safe. The latter warns that if you effectively sever a trust into truly separate pieces, you can have a taxable event. Thus, defusing the time bomb should not set off a tax explosion – if handled correctly, it will be a smooth controlled operation with no tax surprises.

Professional Risk: Why Accountants Should Partner with Legal Experts (Trustify™ Solution)

It should be evident by now that discretionary trust deeds are complex legal instruments. Any changes to them, or even interpreting their provisions (such as "who

is a beneficiary?" or "can we stream this capital gain?"), constitute legal work that carries risk. Accountants play a pivotal role in administering clients' trusts – especially at year-end for tax distributions – but there is a **professional risk** if an accountant oversteps into legal territory or fails to flag issues. The scenario of accountants issuing distribution statements without checking the deed (as in our introduction) can lead not only to client disputes or tax problems, but potentially to **liability for professional negligence** if the accountant's oversight contributed to a loss. For example, if an accountant advises a distribution to a company to cap tax at 30% but doesn't realize the company isn't a valid beneficiary under the deed, the ATO could hit the trustee with 47% tax and penalties – the client may then look to the accountant for compensation.

Likewise, undertaking a trust deed "upgrade" using an off-the-shelf template without legal guidance is dangerous. As one law firm observed, "Many believe that amending a trust deed is a simple process and too often, it is done by accountants and even lawyers who don't give proper attention…especially where the trust deed is older". If the amendment is done incorrectly – e.g. not following the deed's required procedure or missing a required consent – the variation could be invalid or even cause a resettlement. The accountant who facilitated such a change could face not only an unhappy client but also potentially a claim, and since preparing legal documents is outside the scope of typical accounting professional indemnity insurance, they might find themselves personally exposed. The excerpt above also highlights that old deeds with archaic language can be misinterpreted by the unwary. It is **crucial** to involve those who read these documents for a living.

The safer, smarter approach is for accountants and financial advisors to **partner with trust law specialists** when dealing with trust deed upgrades or complex variations. Using a solution like **LY Legal's "Trustify™" service** means that the heavy lifting is done by qualified lawyers who stand behind their work. Trustify™ is an end-to-end platform whereby the accountant or adviser can input the family's details and objectives on the LightYear Docs system, generate the draft tailored deed or variation, and then have LY Legal review, settle, and execute the final document with the client. The process is efficient (leveraging technology for speed and consistency) but maintains full legal compliance – importantly, the law firm's professional indemnity insurance and expertise cover the advice and drafting. In essence, the accountant remains a valued facilitator and strategic advisor, but **shifts the legal risk** to the lawyers whose job it is to ensure the deed is sound. This is not only a risk mitigation

tactic, it's a value-add for the client: they get a legally binding, court-tested quality outcome rather than a DIY patch that could unravel. Moreover, LY Legal and similar firms often provide **letters of advice and trustee resolutions** as part of an upgrade package, giving the client (and the accountant) a defensible paper trail that the variation was done properly and in the trust's best interests.

Remember, under the accountants' Code of Ethics (APES 110) and common law, you must act within your competence and not dabble in legal advisory beyond general guidance. Recommending a trust deed review is good practice; attempting to rewrite the deed yourself is not. By engaging LY Legal's Trustify™, you also gain the ability to obtain training on using the LYD platform effectively for future documents – meaning your firm can confidently service clients' structuring needs with legal backup at all times.

Finally, consider the **indemnity and peace of mind** aspect: if something ever did go awry with a deed that was upgraded via a law firm, the client has recourse against the law firm (and the firm's insurance). If an accountant did it alone and it went wrong, guess who bears the loss? In today's contentious environment, that protection alone is worth the professional collaboration.

Conclusion and Call to Action

Australia is witnessing increased scrutiny on trust arrangements – from courts willing to intervene in dysfunctional family trusts to tax authorities clamping down on outdated trust practices. As a trusted accountant or advisor, you are in a unique position to safeguard your clients' wealth by ensuring their discretionary trust deeds are not forgotten "set-and-forget" documents, but rather living instruments kept up-to-date and fit for purpose. The mantra to convey is: **review regularly and upgrade proactively**. A discretionary trust deed should ideally be reviewed **annually** or at least every few years, especially whenever there are significant tax law changes (e.g. new trust tax rulings) or family changes (marriage, divorce, new children, death of a member, etc.).

If you suspect that any of your client's trust deeds might be a ticking time bomb, now is the time to act. We recommend contacting the specialists at LY Legal Services for a Trust Deed Review and Upgrade service. You can reach out via email to nush@legalbackoffice.com.au for a personalized discussion, or simply **book a Discovery Session** with the LY Legal team to explore the best solutions for your

client’s situation (visit the LightYear Docs website and click “Book a Discovery Session”). During this free initial consultation, the team will help analyse the current deed, identify any dangerous clauses or omissions, and map out a plan – whether it’s converting to a Family Protection Trust, implementing sub-trust strategies, or other estate planning measures.

Additionally, consider leveraging training resources for using the LYD platform – with some guidance, your advisory firm can efficiently handle trust establishments and variations in-house in collaboration with LY Legal. This empowers you to deliver holistic service (tax + legal structuring) to your clients.

Professional Reminder: Always keep documentation of advice to review or vary a trust deed, and ensure the client signs off on engaging legal experts for the task. This not only covers you, it reinforces to the client the seriousness of proper trust management. The cost of prevention (updating a deed) is negligible compared to the cost of cure (untangling a trust dispute or tax mess). In the words of an old maxim, *“An ounce of prevention is worth a pound of cure.”*

Your client’s discretionary trust deed should be a cornerstone of their wealth plan – not a landmine waiting to blow up their legacy. By recognizing the warning signs and acting now to modernize and fortify these structures, you will protect your client’s interests, uphold your professional duty, and possibly save everyone a fortune in future legal fees and taxes. That “time bomb” trust can become a stable, enduring family treasure for generations to come – with your guidance and the right legal support.

Contact LY Legal (Legal Back Office): nush@legalbackoffice.com.au – to arrange a trust deed review, upgrade, or training session today. Let’s defuse those ticking trust time bombs before they go off.