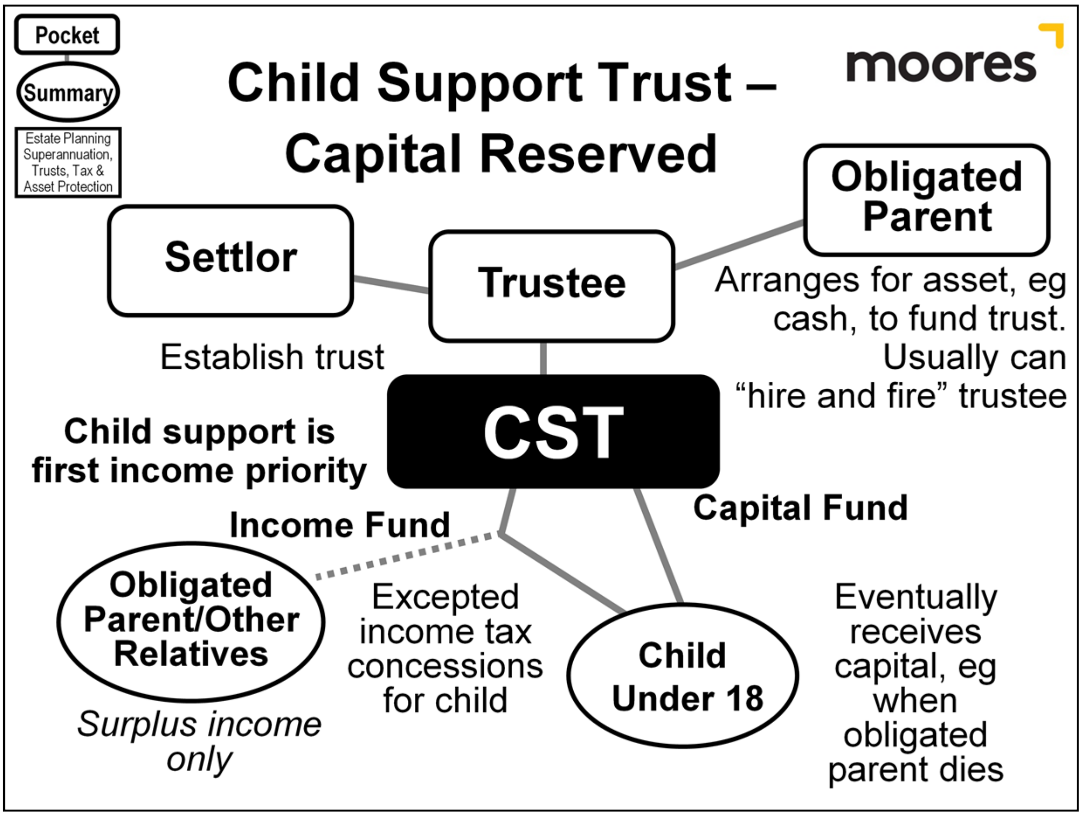

Major Reasons for a Capital Reserved Child Support Trust

To ensure funded child support arrangements are in place following a domestic relationship breakdown. # To have child support payments (concessionally) taxed as excepted income in the hands of the child, rather than included in the obligated parent's income and taxed at the parent's higher marginal tax rate, eg 46.5%. # To set aside a capital sum for ultimate payment to the child – payment usually occurs when the obligated parent dies, but can be advanced to the child at an earlier or later date.

Trustee/Control

Usually the obligated parent or a company controlled by the obligated parent. Control is held by the appointor (usually the obligated parent) until the trust ends and the capital beneficiary takes over absolute ownership. The capital beneficiary cannot be changed and no additions can be made to the class of income beneficiaries.

Trust Income and Capital

While trust income needs to be defined as accounting income, income beneficiaries are taxed by reference to the proportion and type of taxable income (including net capital gains) spent on or allocated or paid to them, with credit for any tax already paid, eg dividend franking credits. The trustee is usually expressly empowered to reimburse beneficiaries for any CGT liabilities. Capital profits (usually subject to a 50% discount) are taxed both when trust assets are disposed to 3rd parties and on winding up of the trust. Loans to the trust usually need to be on arm's length terms.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and non-excluded beneficiaries of the trust.

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CST – Barriers

Need binding child support obligations

- Transfer by obligated parent/associate of asset, eg
  - cash (no transfer costs)
  - listed shares (CGT may be payable)
  - unlisted shares, land & buildings (CGT, State duty & GST may be payable)

Capital must endure and ultimately be received by the child, eg when obligated parent dies (often this is not perceived as a disadvantage)

Binding child support obligations

• Must be in consequence of a breakdown of marriage or de facto relationship.

• No requirement for parents to have cohabited.

Assets to be Transferred

• Cash (if available) minimises transfer costs and income can be generated by loans to related parties if the trustee wishes – depreciating assets are not usually suitable as the capital must have enduring value and eventually be paid to and benefit the child.

• Transfer of assets to the trust is a CGT event (not a problem for cash).

• GST is usually payable on assets that are not marketable securities.

• State duty is an establishment cost issue for land.

• Fully or partly paid preference or ordinary shares or units may be an appropriate trust investment (the use of partly paid and/or preference shares/units may minimise the amount of funding needed to get the trust going). Depending on the estate planning objectives of the obligated parent (see below), it may be preferable that any shares or units do not have the potential to appreciate, eg redeemable at par.

Assets to be Acquired

• Not essential to fully fund the trust from the outset – transfers can be in stages.

• Usually the objective during the years when child support funds are needed is to generate as much income as possible – note arm's length rate constraints on the amount of income that can be generated – see TR 2002/02.

• Whether any long term (or post child support years) capital growth is wanted depends on the estate planning objectives of the obligated parent.

CST – Stages

While child support obligations are still in place – Child support obligations always have first priority, only surplus income can be discretionary

When child support obligations have finished – Trust operates as a discretionary income trust (or in the case of a fixed trust, interest is no longer charged)

When obligated parent dies/decides to end trust – Child receives trust capital

2 or More Children – Need for Separate Trusts

Where there is more than one child to be provided for, separate trusts are recommended for each child. The separate trusts are usually administered together and are often established by a single Deed. The definitions of income and capital in the Deed are the accounting definitions (because the requirement for "accounting" capital to eventually be paid to the child).

Death Benefits

This type of trust is not recommended to receive death benefits, in view of CGT Event E4. Instead, financial support for the child can be achieved by the creation of:

• account based or other pensions or annuities can be established, providing that the trustee of the superannuation fund is willing and able to assist with creating the pension or annuity;

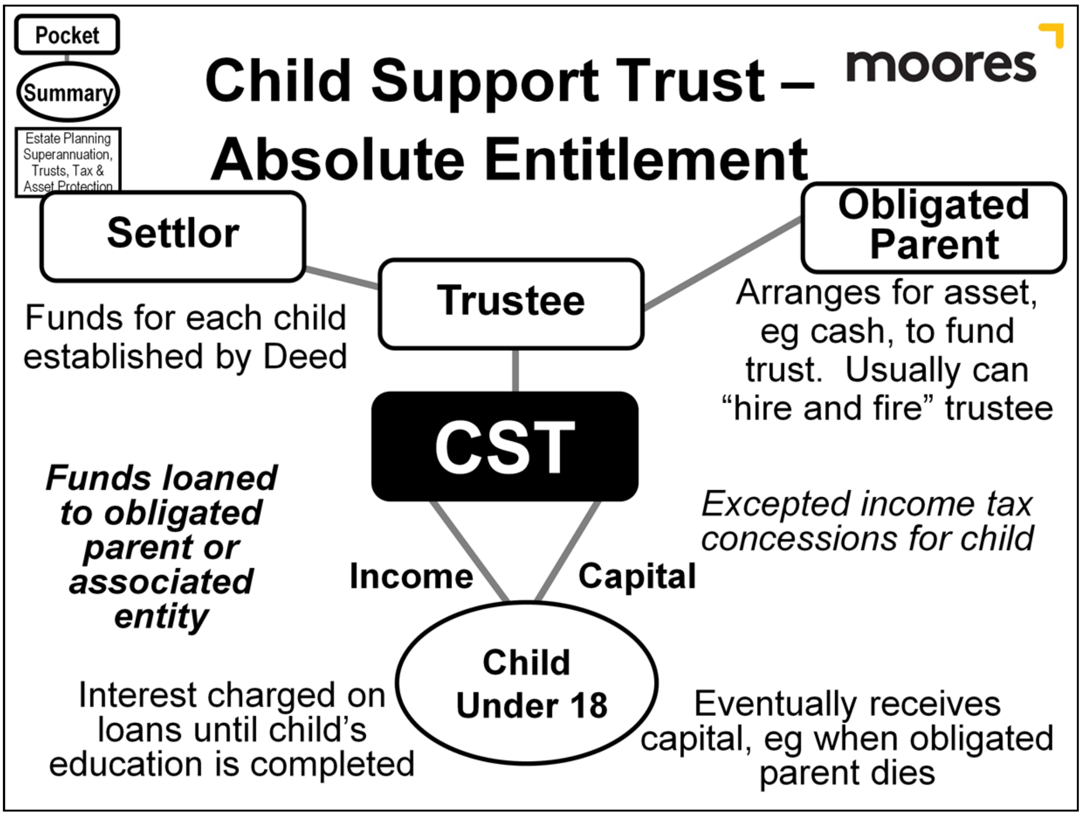
• a fixed trust, eg along the lines of the fixed child support trust alternative; or

• any of range of different types of testamentary trusts within the Will of the person wishing to provide the support.

Potential for Use of Child Support Trusts

Child support trusts are not frequently established because they must satisfy the particular requirements of s102AG(2)(c)(viii).

For many salary and wage earners, these trusts are not worth considering because of the difficulty in finding a suitable asset to transfer to and fund the trust. Some salary and wage earners (or their parents) and many self employed obligated parents are, however, able to provide the necessary funding and a child support trust provides an opportunity to tax effectively fund their child support obligations.



Major Reasons for an Absolute Entitlement Child Support Trust

To achieve most of the advantages of a non-fixed child support trust (other than flexible income distributions). # To be certain that assets will pass to the child with a CGT event occurring when the trust ends.

Trustee

Usually the obligated parent or a company controlled by the obligated parent.

Ultimate Control

Control is held by the appointor (usually the obligated parent) until the trust ends and the capital beneficiary takes over absolute ownership. The beneficiary cannot be changed and, unless the assets of the trust are ones that prevent a handover, eg a documented lifetime loan, (unlike the non-fixed version) the child can demand payment of the capital on attaining 18 years.

Trust Income and Capital and Pension Means Testing

The beneficiary is taxed on the taxable income (including net capital gains) of the trust, with credit for any tax already paid, eg dividend franking credits. The trustee is usually expressly empowered to reimburse the beneficiary for any CGT liability. Capital profits (usually subject to a 50% discount) are taxed when trust assets are disposed to 3rd parties, but (unlike a capital reserved trust) not on winding up of the trust. Loans to the trust usually need to be on arm’s length terms.

Trust income and assets can be counted for Centrelink means testing purposes for both trustees and the beneficiary of the trust.