

COUNTDOWN TO 31 AUGUST 2011

TRUST STREAMING AND DISTRIBUTION ISSUES

4 AUGUST 2011

Peter Slegers

Tax & Revenue Group



Cowell Clarke

Commercial Lawyers

BEYOND BAMFORD

“Put not your trust in money, but put your money in trust”

- Oliver Wendell Holmes, Sr 1809-1894

- Income/capital streaming
- Advent of *Tax Laws Amendment (2011 Measures No. 5) Act 2011*
- Enacted 29 June 2011 – applies for year ending 30 June 2011
- Temporary measures only..... more to come

OVERVIEW

- Framework
- Specific entitlement concept
- Impact on trust deeds
- Practical pointers for trust distribution minutes

FIRST.... SOME TERMINOLOGY

- Tax net income = s95 net income
- Trust income = income of trust estate/distributable income, consider trust deed
- Income equalisation clause: equates trust income with tax net income
- Income recharacterisation clause: power to treat capital as income (vice versa – *Forrest case?*)

FRAMEWORK

- Facilitate streaming of capital gains (CG) and franked distributions/dividends (FD)
- Beneficiary no longer assessed under division 6 on CG or FD
- Assessment under CGT/imputation provisions
- Beneficiary assessment depends on “your share” of CG/FD
- Must determine beneficiary’s share

FRAMEWORK

- Beneficiary's share:
 - CG/FD to which beneficiary specifically entitled; or
 - If no beneficiary specifically entitled, assessed on adjusted division 6 percentage of CG/FD
- Adjusted division 6 percentage – proportion of trust income excluding CG/FD to which beneficiaries specifically entitled
- Proportionate approach – tax net income as a proportion of trust income

FRAMEWORK

- CGT and imputation provisions at beneficiary level modified – avoid double counting
- Supposed to not affect “other income” – remains to be seen
- Trust laws still paramount – need for streaming power under trust deed, creation of specific entitlement
- Specific entitlement concept central to new measures

SPECIFIC ENTITLEMENT

Specific entitlement to capital gains

- Depends on:
 - Extent to which beneficiary receives or can reasonably be expected to receive
 - In accordance with the terms of the trust
 - Net financial benefit
 - Referable to capital gain
- Capital gain recorded in its character in the records or accounts of the trust

CAPITAL GAINS

- Reasonably expected to receive – present entitlement acceptable according to EM
- Terms of trust: includes exercise of power under trust deed
- Net financial benefit referable to capital gain
- Proceeds equal to capital gain after offsetting trust's capital losses
- **Capital gain** is gross of 50% discount – significant observation

CAPITAL GAINS

- Need to have specific entitlement to tax sheltered and taxable component
- Example:
Trust makes \$100 CG
 - \$50 tax sheltered by 50% discount
 - \$50 taxable – included in tax net income
- Beneficiary must receive/be reasonably expected to receive \$100
- Often capital distribution of tax sheltered \$50 required – sea change in distribution minutes

CAPITAL DISTRIBUTION REQUIRED

Dealing with \$100 gross capital gain eligible for 50% discount

Trust Deed Income Concept	Capital Distribution
Income equalisation clause	Only covers \$50 taxable amount Capital distribution of other \$50 required
Ordinary concepts/accounting income	Doesn't cover either – capital distribution of \$100 required
Income re-characterisation clause	Potentially * no capital distribution required
Income includes all capital profit	

FRANKED DISTRIBUTIONS

Specific entitlement to FD

- Extent to which beneficiary receives/reasonably expected to receive
- Net financial benefit referable to FD
- Recorded in its character as a FD in the records or accounts of the trust
- Net financial benefit: FD net of directly relevant expenses

DIRECTLY RELEVANT EXPENSES

- Driven by concerns from “super franking”
- Trust with franked dividend income and other income
- Individual beneficiary may only receive \$1 of net dividend income (because of allocation of expenses) but entitled to tax refund because of franking credits attaching to gross dividend
- Other income distributed elsewhere
- Expense allocation practices also about ensuring positive dividend balance

DIRECTLY RELEVANT EXPENSES

What are they?

- Management fees and interest on borrowings for share portfolio – only example in EM
- General expenses not acceptable even if apportionment reasonable
- Expenses: Tax advice, accounting fees, superannuation contributions?
- Can you apportion between expenses relating to different sources of income?

TIMING ISSUES

Second element – recorded in its character in records or accounts of trust.

Trust minutes and sub-accounts required?

Timing: When recorded?

- By year end for FD
- Two months after year end for CG

Commissioner's announcement: IT 328 and 329 relied upon for 2012: But what next?

TIMING ISSUES

Risk management for accounting practices:

- Ideally – resolution by 30 June required by trust deed
 - certainly by 31 August 2011
- Resolution required at least – maybe documented later
- Ongoing debate

TRUST DEEDS

Should I amend?

- For flexibility yes
- For sake of it no – won't fix problem
- How does trust deed apply? What are you trying to achieve?
- Facts and circumstances paramount

DISTRIBUTION RESOLUTIONS

Some practical pointers

- Streaming clause paramount
- Separate resolution for: CG, FD and other income – separate each source
- Capital distributions now paramount if discount capital gain
- Invoke discretions: streamings, income recharacterisation, expense allocation etc
- Still depends on income or capital distribution

TRUST STREAMING AND DISTRIBUTION ISSUES

FINAL OBSERVATIONS

COUNTDOWN TO 31 AUGUST 2011

TRUST STREAMING AND DISTRIBUTION ISSUES

4 AUGUST 2011

Andrew Sinclair

Tax & Revenue Group

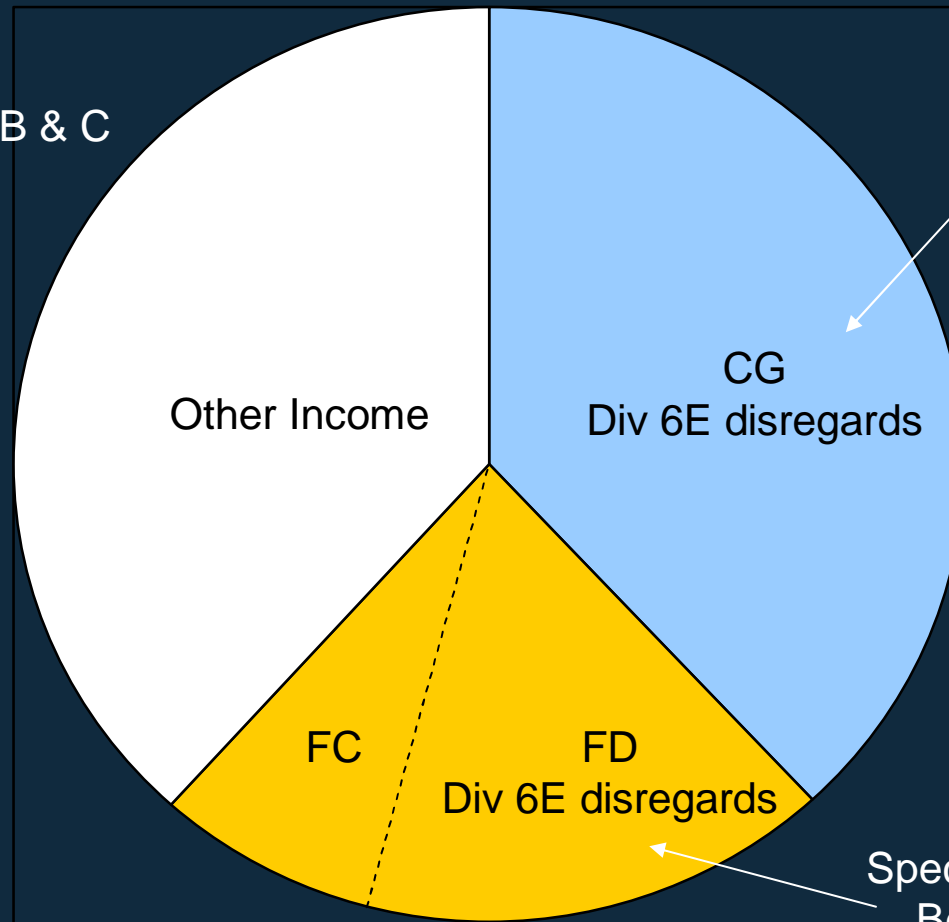


Cowell Clarke

Commercial Lawyers

If net income > zero

Beneficiaries – A, B & C



Specifically Entitled Beneficiaries? If not, then proportionate

Specifically Entitled Beneficiaries?

Trust

Dividend income (fully franked)	70,000
Imputation credit	30,000
Capital gain (50% discount eligible)	1,000,000
Interest income	50,000
Tax Net Income	<hr/> 650,000 <hr/>

Calculate beneficiaries' share of:

- capital gain
- franked distribution (not gross up)

Trust Deed – Income Equalisation Power

Beneficiaries (If A & B specifically entitled, net financial benefit)

A	- Income	500,000
	- Capital distribution (tax free discount)	500,000
B	- Dividend	70,000
	- Plus imputation credit	30,000
C Pty Ltd	- Interest	50,000

Consider CGT significant individual impact

“Deemed Gain” (115-228(3))

- No-one can be specifically entitled?
EM 2.58 and 2.59
- In specie trust asset distribution
- Net financial benefit
 - referable to capital gain

Potter Trust

- Holds post-CGT land – private use, held over 12 months

Cost	100,000
Market Value	600,000

- No other income in Trust
- Sale of land
- In specie distribution to Harry (beneficiary)

Sale

Capital gain (gross) 500,000

Consider “Income” definition:

- income may be
 - 500,000; or
 - 250,000 (after discount)

Need for capital distribution

Income/capital recharacterisation power

In specie Distribution to Harry of Land

Trust capital gain (gross) 500,000

EM 2.59:

suggest absolutely entitled to trust asset may expect
net financial benefit referable to deemed gain

ie. Harry (\$500,000)

- Trustee minute/resolution important

Trust

Sale SB CGT asset, gross gain \$1M

Discount	(500,000)
----------	-----------

50% AAR	(250,000)
---------	-----------

Replacement Asset Choice	(250,000)
--------------------------	-----------

Tax Net Income	Nil
----------------	-----

2 years later – J5?

Summary

- CG / FD – Beware
- Trust Deed
 - Definitions vital
 - Distribution Resolutions
- 31 August 2011
 - Specifically entitled
 - Character of receipt
- Ideal – 100% specific entitlement
- Impact on CGT concession stakeholder
- Deed Amendments
- Watch the developments