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Trust Income Distributions and the Role of the Deed: Getting It Right –
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With:

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Information provided is general in nature; precise application depends on specific circumstances



Overview

- Trustee company constitution and distributions
- Trust distributions, income definitions and streaming
- Eligible beneficiaries including foreign persons and family trust elections
- Distributing non-assessable capital gains, tips for different income definitions
- Documentation and evidence
- Consequences of invalid distributions



Company constitution review

- 'Read the deed' mantra
- Considered good governance to avoid potential traps
- Ensuring minutes of meetings or resolutions are compliant
- Resolutions are effective upon the last of the director to sign (consider the digital age)
- Bespoke company constitution provisions with tailored decision-making rules
- Are single director companies allowed or does the governing document require two directors



Distributing trust income

“(1)...where a beneficiary of a trust estate who is not under a legal disability is presently entitled to a share of the **income of the trust estate**:

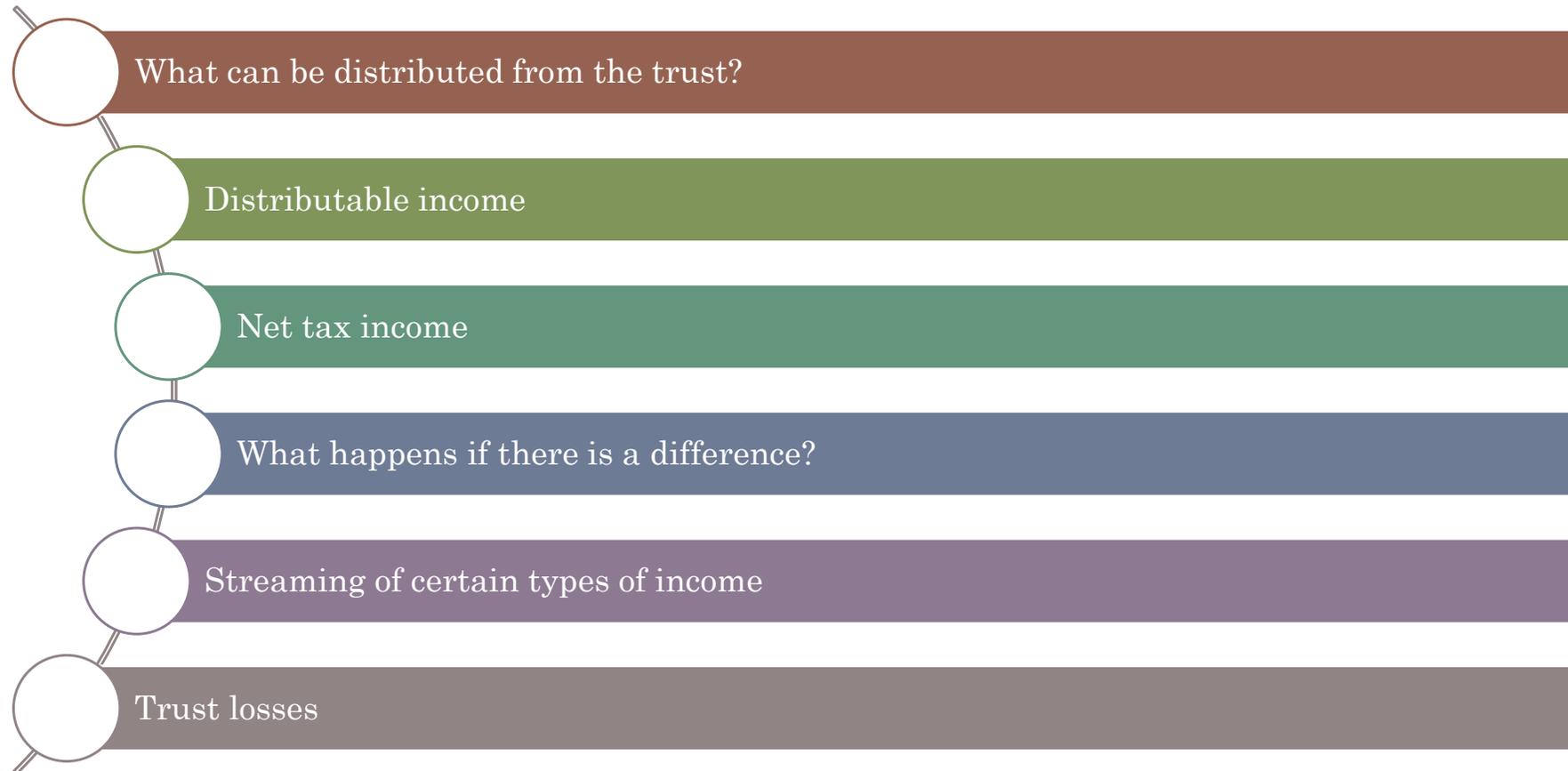
(a) the assessable income of the beneficiary shall include:

(i) so much of that share of the **net income of the trust estate** as is attributable to a period when the beneficiary was a resident”

- *Section 97 Income Tax Assessment Act 1936*



Distributing trust income



What happens if there is a difference?



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Bamford

Correct approach to adopt is the **proportionate approach**

Other queries?

- A capital gain was made in a later year
- Sought to distribute capital gain as income beneficiaries
- Commissioner argued that capital gain could not be distributed as capital gains were not ordinarily considered as 'income' (and thus were taxed at the top marginal rate per section 99A ITAA 1936)
- Taxpayer argued that the capital gain could be distributed as income as there was a power in the trust deed to allow the trustee to include a capital gain as income for distribution (i.e. Distributable Income)
- Held that Distributable Income was determined in accordance with the terms of the trust deed, general trust law and appropriate accounting principles



Faces of Distributable Income

- 'according to ordinary concepts'
- 'means the net income of the Trust Fund calculated in accordance with section 95(1) ITAA 1936'
- 'Trustee may determine the income of the Trust Fund for each accounting period...'
- Each meaning impacts whether certain 'income/gains' are included
- TR 2012/D1: notional income(e.g. Division 7A deemed dividend) not income of the trust estate; considers an 'accretion to the trust fund' as income of the trust estate
- Limits to recharacterization – *Forrest*: unique facts regarding hybrid trust



Streaming

Bamford

- Streaming was not possible – as tax flowed in proportion to distribution
- Classifying separate classes would have such distributions flowed in proportion between beneficiaries

Interim streaming provisions introduced:

- Capital gains
- Franked distributions
- Allowed trustee to separate 'stream' (distribute) such capital gain or franked distributions to other beneficiaries (or in different proportions):
- Useful if certain persons held capital losses
- Useful if distributing to other corporate entities



Streaming

Specifically entitled

- Beneficiaries to be made 'specifically entitled' to such capital gains or franked distributions being streamed
- I.e. beneficiaries must receive or reasonably be expected to receive an amount equal to the 'net financial benefit' linked to the capital gain or franked distribution
- Separately record character of such amount in records of the trust
- Complementing resolutions, accounts, ledgers and financial statements

Allocating expenses

- Trust deed contains appropriate expense powers; otherwise expenses allocated directly against relevant class of income
- Expenses directly relevant to franked distributions (e.g. interest expenses) applied against franked distributions



Sample resolution

Income re-characterisation and streaming

• Pursuant to the terms of the Trust deed including:

- (a) the power of the trustee to determine Distributable Income at clause ##; and
- (b) the power of the trustee to classify such Distributable Income as a separate category of income as the Trustee decides at clause ##,

it is resolved that the Distributable Income of the Trust includes such amounts equal to the net income of the Trust as defined in section 95 Income Tax Assessment Act 1997 (excluding Notional Amounts) in addition to the following whether derived directly or indirectly (including by entitlement through other trusts):

- (c) all franked dividends received by the Trust during the Relevant Period, and that the franked dividends be identified as a separate category of income;
- (d) all realised capital gains (including any discount capital gain under subdivision 115-A Income Tax Assessment Act 1997 (Cth), and such other capital gains not otherwise taxable) received by the Trust during the Relevant Period and that the capital gains be identified as a separate category of income.



Traps for capital gains streaming

Assume

- \$100,000 rental income
- \$1,000,000 capital gain

Proposed distribution

- Rental income to Husband and Wife
- Capital to Dad (who has made massive capital losses during his lifetime)

Depending on the definition of Distributable Income

- Equals ordinary income – a capital distribution would be needed to be made to ensure Dad is specifically entitled to the capital gain
- Equals section 95 income – an income distribution relating to 50% of the capital gain needs to be made in conjunction with 50% of the capital gain via an interim capital distribution
- Equals such amount as the trustee determines – trustee has flexibility

Read the deed – not all trust deeds are made equal



Sample resolution wording

Capital distribution

- Pursuant to clause ### it is resolved to distribute the Capital of the Trust Fund as follows:
- An amount equal to the difference between the capital gains and net capital gains within the meaning of section 995-1 ITAA 1997 made by the Trust in the income year (**non-assessable capital gains**) to the beneficiaries in the amounts or proportions to which the discounted capital gains have been distributed.
- ###% of the disregarded capital gain referable to the sale of [details of CGT asset sold] to [Beneficiary]
- ###% of the disregarded capital gains under section 152-110 ITAA 1997 referable to the sale of [details of CGT asset sold] to [Beneficiary]
- \$### of the disregarded capital gains under section 152-325 ITAA 1997 referable to the sale of [details of CGT asset sold] paid to [Superannuation Fund] being applied and paid 100% in respect of and treated as a contribution made for [Beneficiary]

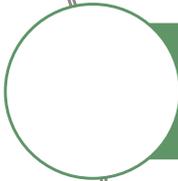
(choose appropriate options depending on the characteristic of the disregarded capital gain)



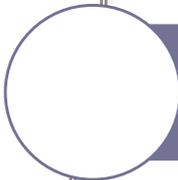
Trust losses



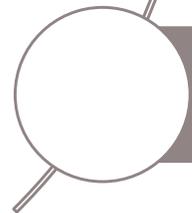
Upton v Brown – absence to the contrary in the deed – losses must be made up out of profits of subsequent years and not out of capital



Ability to opt out of applying losses against profits?



“Trustee may in its discretion determine...whether a loss which has occurred in an earlier Accounting Period is not to be recouped or made up out of income in the current Accounting Period”



E.g. It is resolved pursuant to clause ## of the Trust Deed not to recoup \$### carry forward revenue losses when determining distributable income and to carry that loss forward into subsequent accounting periods.



Traps for franked dividends

Assume

- Carry forward losses of \$80,000
- Franked dividends equal to \$75,000 and \$25,000 franking credits
- Capital gain of \$50,000

Trust deed

- Distributable Income defined in the deed as 'income according to ordinary accounting principles'
- No provision in trust deed not to offset prior year trust losses
- No provision in trust deed to redefine income

Franking credit trap

- Carry forward losses exceeds Distributable Income
- No beneficiary able to be made presently entitled to franked dividends
- Capital gain can be streamed by separate capital distribution

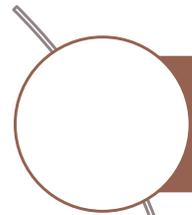


Questions for the deed?

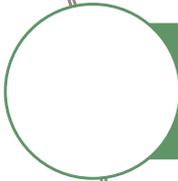
- What is Distributable Income defined as?
- Is there sufficient power to determine what distributable income is or categorise trust receipts/expenses on revenue or capital account?
- Is there discretion to categorise and account income received as separate classes of income, specifically capital gains or franked distributions?
- Is there discretion to categorise and account expenses against separate classes of income and group classes of income?
- Is there discretion to enable separate classes of income to be and distributed to different beneficiaries in such proportion as the trustee decides?



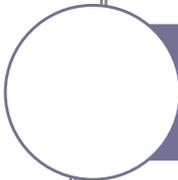
Questions for the deed?



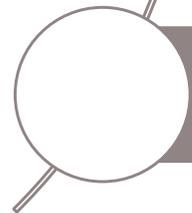
Is there a power to carry forward losses (e.g. the trustee is not required to utilise losses if not suitable)?



Is there a power to offset income with previous year losses?



Can the trustee make capital distributions prior to vesting?



What happens to any income not distributed or accumulated under a trustee's discretion?



Who is a beneficiary?

- Do they fall part of the beneficiary class *and do classes of beneficiaries differ*
- Are they specifically excluded (as a named person)
- Common excluded classes of persons – settlor
- Common excluded classes of persons – trustee, former trustee
- Common excluded classes of persons – foreign persons (particularly where the trust is acquiring property)



Excluded beneficiaries

Fourth Part: Excluded Class

(a) The Settlor

(b) Any person who settles any other property on the Trustee as an addition to the Trust Fund.

(c) Every person claiming under or in right of the persons referred to in sub-clauses (a) and (b) above

- Example exclusion wording: Settlers and 'Notional Settlers'



Excluded beneficiaries

13 Exclusion from benefits

It is hereby declared that the Settlor and his estate, the Trustee and any former Trustee and any corporation or Trust in which the Settlor or his estate or the Trustee or any former Trustee has any actual or contingent beneficial interest are specifically excluded from all or any benefits whatsoever under this Trust except the Trustee in respect of its fees, charges and remunerations under sub-clause 8.3 hereof.

- Example exclusion wording: Trustee and former Trustees



Excluded beneficiaries

25 Limitation on distributions to foreign persons
Despite anything to the contrary in this deed, if any of the Secondary or Tertiary Beneficiaries are foreign persons within the meaning of the *Foreign Acquisitions and Takeovers Act 1975* (Cth) the percentage of the Net Income in any year or capital at any time that the Trustee may Distribute to any one of those Beneficiaries or any two or more of them must not exceed the maximum percentage that the Trustee can Distribute without breaching that Act

- Example exclusion wording: Foreign Persons



Excluded beneficiaries

22 Distribution Restrictions

The Trustee shall not make a distribution or do any other act which would:

- (1) cause the Trust to become a 'foreign trust' for the purpose of the Duties Act 2000 (Vic) or the Duties Act 2001 (Qld); or
- (2) cause the Trustee to be a 'foreign person' for the purposes of the Duties Act 1997 (NSW) or the Land Tax Management Act 1956 (NSW); or
- (3) cause the Trustee to be a 'foreign person' for the purposes of the Foreign Acquisition and Takeovers Act 1975 (Cth)

- Example exclusion wording: Foreign Persons

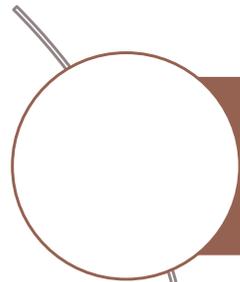


Foreign person exclusions

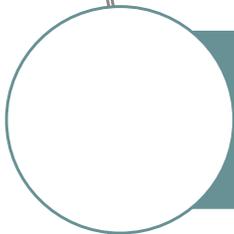
- Meaning differs depending on legislation
- 'FATA' broadest meaning as Australian citizen can be a foreign person
- NSW legislation that refers to FATA definition reduces the broad application not to apply to Australian citizens, certain permanent visa holders
- Other States have different definitions
- Ultimately must take the broadest defined legislation when interpreting clause
- Can still apply to trusts that do not hold property (as clause has become common-place)



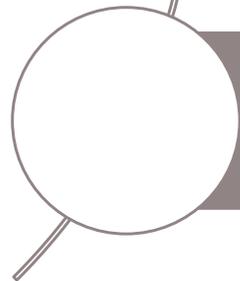
Other potential excluded persons



Recipient trusts that vests after the perpetuity date of the distributing trust



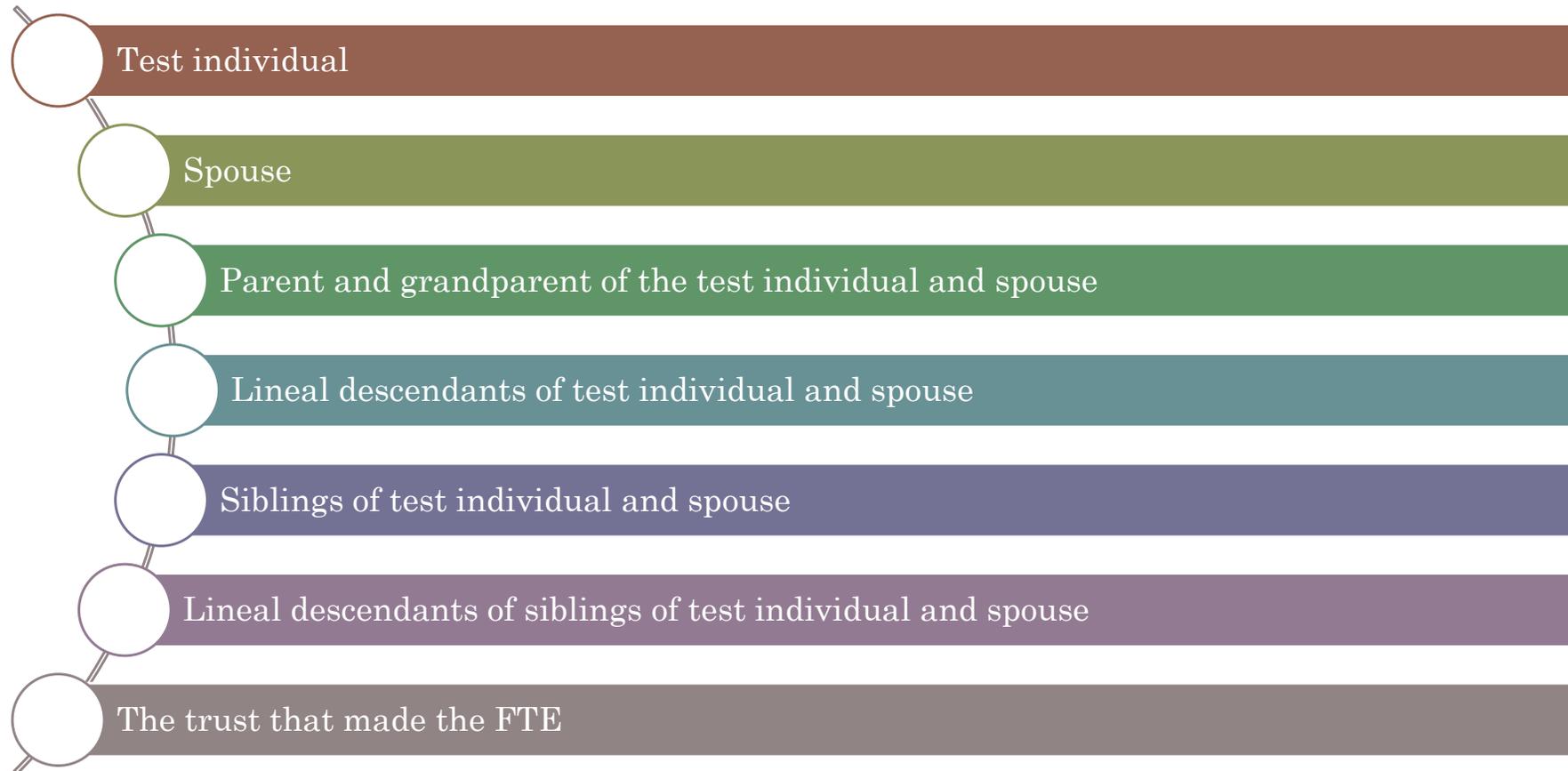
Persons (and their associates) on social security benefits



Persons who are not part of a test individual's family group following a family trust election being made

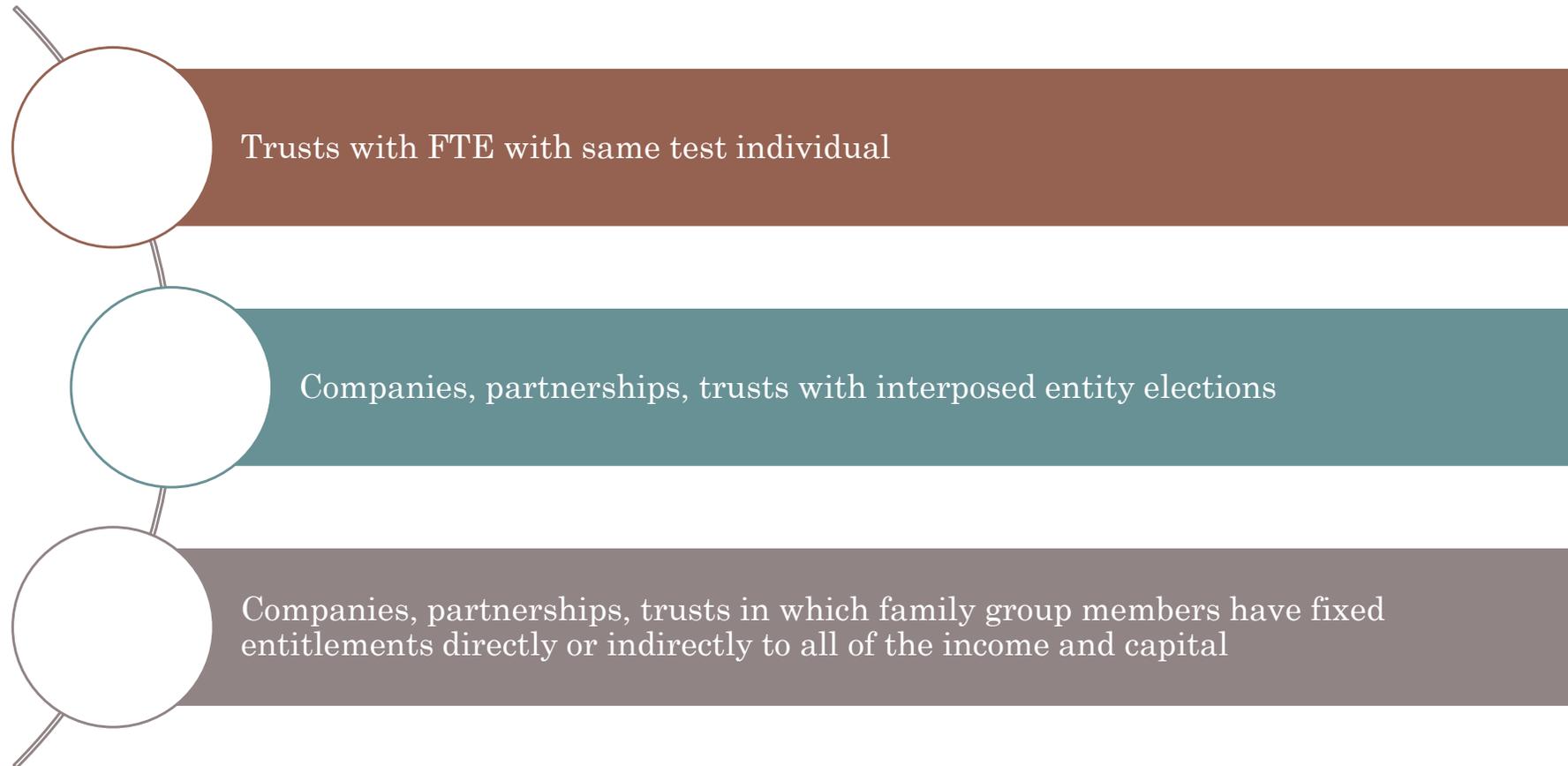


Family group





Family group





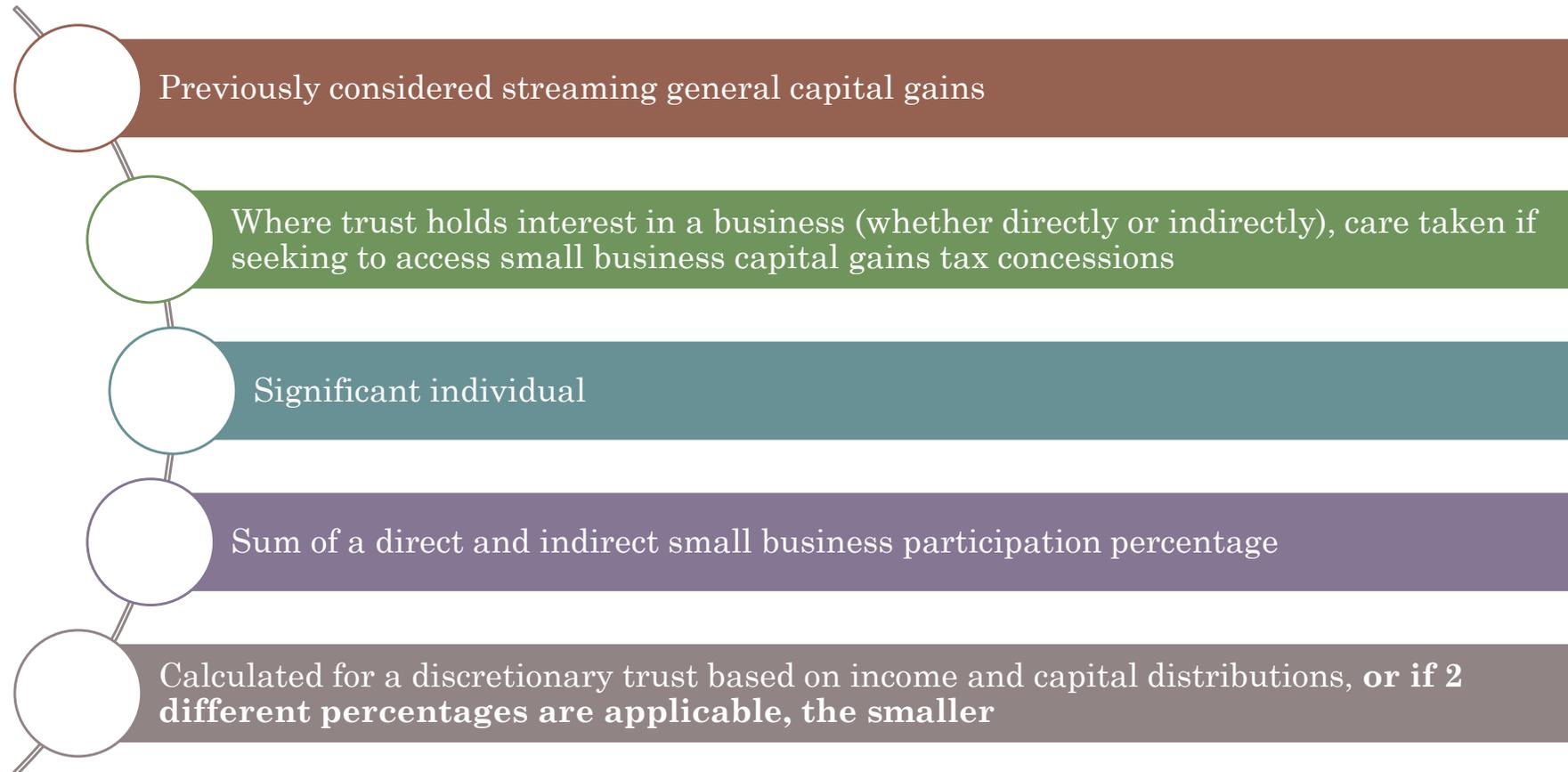
Family trust election traps

- Applies when a family trust election made
- Top marginal rate
- Trigger if trust confers a present entitlement or distributes income or capital to someone outside the family group
- Definition for 'distributes' broad (can include in-specie transfers and forgiveness)
- Individual trustee liable
- Company trustee liable along with each person who was a director of the company at the time of distribution (all jointly and severally)

Capital distributions and SBCGT Concessions



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Capital distributions and SBCGT Concessions



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“references to distributions of “income” in the context of determining an entity’s direct small business participation percentage in a trust mean the income of the trust, determined according to the general law of trusts, to which a beneficiary could be entitled. Depending on the deed and/or actions of the trustee, this may be an amount that differs from the ordinary income of the trust’

- ATO ID 2012/99

Capital distributions and SBCGT Concessions



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Assume

- Trust holds 50% interest in a company
- \$90,000 capital gain arising from sale of company
- \$10,000 ordinary income

Proposed distribution

- Beneficiary A receives capital gain (\$90,000)
- Beneficiary B receives income (\$10,000)

Depending on the definition of Distributable Income

- Option 1: Distributable Income contains recharacterisation power
- Option 2: Distributable Income equals ordinary income or net tax income

Capital distributions and SBCGT Concessions



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Distributable Income contains recharacterization power

- Beneficiary A held a 90% direct small business participation percentage (\$90,000/\$100,000) and a 45% indirect small business participation percentage in the company (90% * 50%)
- Beneficiary B holds a 5% indirect small business participation percentage
- As Beneficiary A holds at least a 20% small business participation percentage, requirements met

Distributable Income equals ordinary income or net tax income

- *'result would be different if the trustee had not resolved to treat capital gain as income of the trust and had instead distributed the capital gain to beneficiary A as a capital distribution. The additional basic condition...would not be met because beneficiary A and B would each have a direct small business percentage in the trust worked out under item 3 of the table...of 0% (being the smaller percentage of the distributions of capital and income to which each beneficiary is beneficially entitled'*



Evidentiary requirements

- Other issues in addition to 'what is Distributable Income' and 'who are valid beneficiaries'
- Review trust deed for any procedures or consents required
- Ensure appropriate evidence is retained to ensure such processes are complied with
- E.g. *The trustee may exercise any for the following powers where it has given the Appointor at least three day's written notice ...The power to Distribute Income*
- Does the resolution need to be prepared in a particular way based on the terms of the deed



Evidentiary requirements

- Does the resolution need to be prepared before 30 June (i.e. by 29 June of a particular financial year)
- Has documents been provided within the appropriate timeframes and do you hold evidence of execution within the required time (or is there evidence to the contrary)
- The Trustee for Goldenville Family Trust A/C Xiangming Huang and Commissioner of Taxation (Taxation) [2025] ARTA 1355*
- Where minutes purported to have been signed prior to 30 June were prepared in May the following year

The Trustee for Goldenville Family Trust



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Factors in determining trust minutes not signed on or before 30 June of the relevant financial year

- No documented or contemporaneous evidence produced
- Appointed director of trustee company having no day-to-day understanding of the activities of the company – control exercised by husband of director and director not fluent in English
- Multiple versions of a 30 June resolution with different signatures with no explanation
- 30 June resolution containing an 'estimated' distribution amount that was identical with the final tax return figure
- Metadata showing that the resolution was not created until May the following year

Evidence obtained from trustee company director, her husband, their business partner (associated with the family trust activities) and the accountant



Evidence – general

- Ensuring tax planning strategies undertaken with sufficient time to prepare appropriate minutes
- Appropriate file notes and correspondence retained on file to evidence discussions and determinations prior to 30 June
- Trust minutes sent to clients for execution with sufficient time for execution in compliance with corporations law/company constitution as well – consider appropriateness of electronic signing
- Arranging for any fully executed minutes to be uploaded and retained on file as soon as possible (as opposed to 11 months after the purported execution)

Invalid distributions and section 99A



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- *The Trustee for Goldenville Family Trust A/C Xiangming Huang and Commissioner of Taxation (Taxation) [2025] ARTA 1355*
- Held income was for default beneficiaries of the trust
- Review wording of trust resolution: percentages v specified amounts
- Care taken as may be argued section 99A applies (Trustee taxed at top marginal rate)
- Beware 'reverse engineered' provisions - the ATO's concerns outlined at issue 1 of TD 2012/22EC

Contact details

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