Trust distributions – 6 W’s

Overview

- Who – Who are we distributing to?
- What – What are we distributing from the trust?
- When – When do we have to distribute from the trust?
- Why – Why are we distributing from the trust?
- How – How are we distributing from the trust?
- Where – Where are we distributing to?

Underlying themes

- Don’t ASS-U-ME
- Read the deed
- Accountants and lawyers should be leveraging off from each other
  - Accountants will generally be closer to the strategy of the distribution
  - Lawyer’s can ensure complex resolutions are effective

Who

- Who are the beneficiaries? – *Harris v Harris*
- Is there uncertainty in who can be a beneficiary through the lack of defined terms (spouses, relatives, issue)?
- Have there been events that may have impacted on who could be a beneficiary?
- Have documents and powers been validly exercised?
- Are there excluded beneficiaries?
  - Common classes of people include trustees, settlor and ‘notional settlors’
- Family trust elections, or interposed entity elections?
- Does the trustee have the power to appoint or remove a beneficiary?

Who

- Discretionary beneficiary's interest is just a 'mere expectancy' and can compel proper administration on trustee– *Gartside v IRC* [1968] AC 553
- Beneficiary's interest based on terms of the trust deed – *DKLR Holding Co (No. 2) Pty Ltd v Commissioner of Stamp Duties; CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)*
- Beneficiary's interest subject to trustee's right of indemnity out of trust assets (unless excluded) – *Octavo Investments Pty Ltd v Knight*
- Right in indemnity is a right in the nature of a lien or charge – *Chief Commissioner of Stamp Duties (NSW) v Buckle*
- Right of indemnity can be even enforced if there has been a change of trustee – *Lemery Holdings Pty Ltd v Reliance Financial Services Pty Ltd*

Who

- Distributions to trusts and ‘wait and see’ – *Nemesis Australia Pty Ltd*
- Family trust distributions tax – FTE and Family Group
- Notional settlor, thought to avoid section 102 ITAA 1936 – but *Truesdale v FCT*
- TFN’s may be needed in relation to withholding and reporting rules

Who – Example 1

(iii) Any and all of the children, grand-children or grand-children of the mother and the father whether livin at the date of this Deed or born hereafter;

(b) *Child*, *Children* and *Issue* includes ex nuptial children and legally adopted children;

Who – Example 2

F. "<u>Nominated Beneficiary</u>" means any person or limited or unlimited liability company or any trust who is nominated as hereafter provided to become an eligible beneficiary. The following shall not be capable of being nominated as aforesaid;-

(i) a person referred to in paragraphs (i) to (x) inclusive of the definition of "the Eligible Beneficiarie contained in this clause; or

(ii) the Settlor; or

(iii) any person or company who or which is or has bee a trustee of this Trust;

(iv) the legal personal representatives of the mothe or the father in such capacities and who or which is at the relevant time the subject of a subsisting nomination made under clause 2(c) hereof.

Who – Example 3

"Exclusion from Benefits

Notwithstanding any definition or other provision in this Deed of Settlement, it is hereby declared that:—

(a) the Settlor, his estate and any corporation or trust in which the Settlor or his estate has any actual or contingent beneficial interest are specifically excluded from all or any benefits whatsoever under this Trust; .... and

(b) *any person who donates, assigns or transfers for less than full market value any item of property to the Trustee with the intention that such item of property be added to the Trust Fund will be specifically excluded from all or any benefits whatsoever under this Trust.*"

Who

- Varying the trust deed
- Trust cloning
- Distributing to an interposed entity
- Rectification

Who and the impact of foreign surcharges

- Stamp duty surcharge:
  - NSW – 4% (residential related property excluding primary production)
  - Victoria – 7% (land capable of being used or which a person intends to develop for residential purposes with some limited exceptions)
  - Queensland – 3% (houses/apartments and development sites for houses/apartments)
- Land tax surcharge:
  - NSW – .75% (residential land)
  - Victoria – 1.5% (all land)
- FIRB approval:
  - Non-resident foreign persons prohibited from purchasing established dwellings
  - Note exemptions and thresholds (not covered)

Who and the impact of foreign surcharges

- Foreign Acquisitions and Takeovers Act 1975 (Cth):
  - Foreign person includes “a trustee of a trust in which an individual not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest”
  - Ordinarily resident includes individuals who have bene in Australia for 200 or more days in the 12 months preceding the relevant point in time
  - Substantial interest means “the person, together with any one or more associates, holds a beneficial interest in at least 20% of the income or property of the trust”
  - A substantial interest for a trust where ‘a trustee has a power or discretion to distribute the income or property of the trust to one or more beneficiaries, each beneficiary is taken to hold a beneficial interest in the maximum percentage of income or property of the trust that the trustee may distribute to that beneficiary’
- Any discretionary trust that has a foreign beneficiary, is a foreign person

Who and the impact of foreign surcharges

- Duty surcharge:
  - NSW follows FIRB definition from previous slide
  - VIC has own definition for foreign person but follows similar rule in that a foreign trust is where any foreign person holds a substantial interest, and the substantial interest at section 3B *Duties Act 2000* (Vic) includes maximum interest for a discretionary trust
  - QLD has a different test which defines a foreign trust (section 237 *Duties Act 2001* (QLD)) a trust where 50% of the trust interests is held by a foreigner. Noting a trust interest is defined to be the interest of a 'taker in default of an appointment by the trustee'
- Land tax surcharge:
  - NSW is the same as for duty
  - VIC for a trust where an absentee beneficiary is a specified beneficiary (being someone specifically named)
  - Note QLD has no land tax surcharge but has different rules for absentees (failure to obtain primary production exemption for land tax)

What

- Income or capital?
- What is income?
- Income for tax purposes
- Income under the trust deed
- Difference between income definitions
- TR2012/D1
- Absence of definition of income

What

- Income according to accounting principles
- Income according to section 95 ITAA 1936
- Income determined by trustee

	No Income definition	Equalisation Definition	Re-characterisation Definition
Distributable Income	accounting income	accounting income	accounting income
		assessable capital gain	assessable capital gain
			non-assessable capital gain
			disregarded capital gain
	franked dividend	franked dividend	franked dividend
		Div 7A dividend – payment	Div 7A dividend – payment
Distributable Capital	assessable capital gain		assessable capital gain
	non-assessable capital gain	non-assessable capital gain	non-assessable capital gain
	disregarded capital gain	disregarded capital gain	disregarded capital gain
	Div 7A dividend – payment		Div 7A dividend – payment
ATO Excluded Distributable Income	market value substitution capital gain	market value substitution capital gain	market value substitution capital gain
	franking credit	franking credit	franking credit
	Div 7A dividend -loan	Div 7A dividend -loan	Div 7A dividend -loan
	CFC & Transferor Trust attributable income	CFC & Transferor Trust attributable income	CFC & Transferor Trust attributable income
	Part IVA deemed income and assessable capital gain	Part IVA deemed income and assessable capital gain	Part IVA deemed income and assessable capital gain
	trust distribution receipt of excluded distributable income	trust distribution receipt of excluded distributable income	trust distribution receipt of excluded distributable income

ALTERNATIVES

What

- Truly tailoring what ‘distributable income’ is
  - Reclassifying income and capital gains – *Forrest v FCT* (can’t change context)
  - Reclassifying and allocation of outgoings – *Cajkusic v FCT* (avoid no distributable income)
  - Allocation of capital losses
  - Non recoupment of revenue losses – *Upton v Brown*
- Streaming – *Bamford and TLAM No.5*
  - Classifying separate classes of income
  - Ensuring specific entitlement

What

- Streaming traps
- Capital gains
  - No trust income
  - Capital gain on individual assets
  - Asset revaluation accounts
  - Splitting between income and capital to effect specific entitlement
- Franked dividends
  - Ability to be classed as one class of income to avoid franking credits trapped
  - Expenses against relevant franked dividends
  - Franking credits cannot be separately streamed

What – Example 1

(j) "Income" of the Trust includes all profits or gains taken into account in calculating the net income of the Trust, and exempt income, as defined in Section 95(1) of the Act, notwithstanding that the whole or any part thereof may otherwise include Corpus of the Trust.

- Received trust distribution of capital gain (including gross amount)
- We amended to allow for a capital distribution as well per the clause below

(b) The Trustee may at any time prior to the vesting date distribute Corpus or any part thereof to any Corpus Beneficiary in such amount as it thinks fit. The Trustee shall make a record of such distribution and upon the vesting date or earlier termination of this Trust take such payments into account as it thinks fit.

When

- Historical ATO position – IT 328 and IT 329, now withdrawn
- Tax position – A beneficiary’s present entitlement must arise at the latest by the end of the income year – *FCT v Ramsden*
- Trust position – Read the deed
- Best practice, take the earlier period
- Note concessions for specific entitlement for capital gains

Why

- Small business capital gains tax concessions
  - Connected with
  - Small business concession stakeholder
- Trust losses
  - Pattern of distribution test
- Division 7A
- Section 100A

How

- Read the deed
- Some deeds have obscure limitations based on various aspects of tax law – i.e. a limitation on distributions to 39% of the total distributions
- Other deeds just have specific consents required, or notice periods
- Are procedures required, including if resolutions can be made orally, and then later recorded in writing

How – Example 1

1.1.10. "Maximum Percentage " means the percentage specified in Part 12 of the Schedule.

3.14. Notwithstanding this Clause 3 the Trustee may not pay, apply or set aside an amount in excess of the Maximum Percentage of the income from the Trust Fund in any year to or for the benefit of:

3.14.1. a Secondary Beneficiary unless that Beneficiary is an Approved Secondary Beneficiary; or

3.14.2. a Tertiary Beneficiary unless that Beneficiary is an Approved Tertiary Beneficiary.

PART 12 (MAXIMUM PERCENTAGE) THIRTY NINE PERCENT (39%)

How – Example 1 (cont)

discretion.

8. Add the following clause 35:

Limitation of Entitlements

36. Notwithstanding any other provision of this Deed, when exercising the Trustee's discretion under clauses 3.1, 4.2 and 4.3:

(i) the Trustee must not distribute more than 39% of the income of the Trust Fund distributed in that year to any Beneficiary who is not an Unlimited Beneficiary, and that beneficiary's Small Business CGT Affiliates; and

(ii) the Trustee must not distribute more than 39% of the capital of the Trust Fund distributed in that year to any Beneficiary who is not an Unlimited Beneficiary, and that beneficiary's Small Business CGT Affiliates.

How – Example 2

Trustee must not exercise certain powers until Appointor has been given notice

5.12 The Trustee may exercise any of the following powers where it has given the Appointor at least three day's written notice of the exercise of the power, including specific details of how the power is to be exercised:

5.12.1 The power to Distribute capital.

5.12.2 The power to resolve in writing how capital is to be Distributed on the Vesting Day.

5.12.3 The power to Distribute Income or accumulate it.

5.12.4 The power to resolve in writing how Income is to be Distributed.

5.12.5 The power to choose a person to whom capital or Income is to be Distributed.

5.12.6 The power to create a sub-trust.

Where

- Talking about foreign beneficiaries
- Section 98 ITAA 1936
- 45% rate of tax for a non-resident individual
- Withholding tax
- Capital gains and loss of 50% discount
- Ultimate beneficiary reporting rules
- Foreign tax offset credit
- Conflicting tax laws of a foreign jurisdiction