



Chat Legal Pty Ltd  
ABN 64 621 391 553  
letschat@chatlegal.com.au  
GPO Box 989, Brisbane, QLD 4001  
Level 16, 97 Creek Street, Brisbane, QLD 4000  
<https://chatlegal.com.au>

# Let's chat

Trust Distributions for June 2022 – May 2022

With:

Darius Hii – Tax and estate planning lawyer; Chartered Tax Advisor; and Director at Chat Legal

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



# Picking distributable income

- Distributable income means what can be distributed under the terms of the trust as income
- Tax flows with distributable income
- *FCT v Bamford* [2010] HCA 10 – adopting the proportionate approach
- What is distributable income?



# What is distributable income?

- Terms of the trust deed
  - 'income according to ordinary concepts'
  - 'net income of the Trust Fund'
  - 'such amount as the Trustee may in its discretion determine'
- How does the definition affect
  - Capital gains
  - Dividends
  - Franking credits
- Recharacterisation cannot wrongly classify a receipt as a capital gain where such receipt is income – *Forrest v FCT* [2010] FCAFC 6



# Does it matter

- Income only – i.e. trading income/rent/interest
- Capital gains included
- Dividends received
- Combination
- Notional amounts – TD 2012/D1
  - ATO position that notional income amounts only income to extent of set-offing notional expenses
  - That is income may only be cash or a current year accretion of the trust funds
- Notional capital gains (i.e. market value substitution gain)
- Franked distributions



# Flexibility of income definition

- Variations required where:
  - Need ability to reclassify income



# Creating present entitlements

- Need for a beneficiary to be:
  - Presently entitled
  - Occasionally specific entitlement required where dealing with capital gains and franked distributions
- *Harmer v FCT* (1991) 22 ATR 726:
  - ‘interest in the income which is both **vested in interest and vested in possession**’; and
  - ‘**a present legal right to demand and receive payment of the income**, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment’



# Words matter – set aside

- Distribution not required to be presently entitled
- Note trustee indemnity over trust assets and argument present entitlement not present if relevant assets are subject to trustee indemnity
- The need to be able to ‘pay, apply or set aside’
  - Place such amounts on trust for the beneficiary themselves – set aside
- Power in trust deed to determine how to distribute:
  - Place on loan account
  - In-specie distribution
  - Sub-trust



# Specific entitlements

- Required to stream capital gains or franked distributions to specific beneficiaries
- Creating a present entitlement creates specific entitlement as well (i.e. paying, applying or setting aside such amounts)
- Specific entitlement requires 'net financial benefit' which means that the *beneficiary has received or is reasonably expected to receive*
- Means that in order to validly stream, steps must be taken to ensure entire amount distributed to 'streamed' beneficiary:
  - Consider terms of a trust deed defining income as ordinary income or tax income
  - Consider notional capital gains (and that beneficiaries cannot receive anything tangible)





# When entitlements made

- Read the deed should they reference 29 June
- At most by 30 June
- Prior administrative practice of 31 August has ceased
- Follow the process of the deed in making a valid resolution:
  - Any consents
  - Whether written or not
  - Whether specific information required
- Written evidence of decision made by appropriate date key, even if formally typed after 30 June
- Company makes decision by resolution requires it to be in writing



# Beware the default position

- Where income not distributed or accumulated, consider default position:
  - Individuals as takers in default
  - Income accumulated
  - Trust as a default beneficiary
- Beneficiaries to receive the balance



# Balance wording

- *Lewski v FCT* [2017] FCAFC 145
  - 'Balance' to the applicant
  - No income to the applicant initially
  - Income reassessed following an audit denying carry forward losses
  - Beneficiary subsequently disclaimed any interest to the default distribution
  - Disclaimer invalid due to time and document informalities



# Default beneficiaries

- *FCT v Carter* [2022] HCA 10
  - 5 default beneficiaries received income not distributed or accumulated
  - Disclaiming attempts failed due to lack of evidence and defective documentation
  - For the purposes of section 97(1) they assess the present entitlement *immediately before the end of the income year for the stated purpose of identifying the beneficiaries who are to be assessed with the income of the trust*
  - Legislation looks to the right to receive an amount rather than the receipt of such amount
  - Section 97(1) focusses on identifying legal right of beneficiaries immediately prior to the end of the income year:
    - 'taxation liability of the beneficiaries is determined by ascertaining the proportion of the distributable income of the trust estate to which each beneficiary is presently entitled just prior to midnight at the end of the year of income and then applying that proportion to the 'net income of the trust estate'



# Default beneficiaries cont.

- *FCT v Carter* [2022] HCA 10 cont.
  - If disclaimers allowed and the question of present entitlement may be resolved after the end of the income – uncertainties would arise for all parties (ATO, trustees, beneficiaries and potentially settlors, which would not be fair, convenient or efficient)
  - Law surrounding disclaimers still the same
  - Issue related to the interpretation of trust taxation
- Similar line of argument applied to disclaimers of discretionary trusts and grouping for payroll tax purposes a few years ago
- Interesting to note *Carter* had various issue with the minutes:
  - Different versions with different times were obtained
  - Lack of proper corporate governance regarding the resolutions (i.e. not clear quorums and authority to sign)
  - Trust deed term not followed as guardian consent not obtained, despite guardian being the signor of the resolution (wearing two hats)



# A note on streaming

- Ensure amounts to be streamed made clear by classifying and segregating into appropriate classes
- Ensure steps are taken to have net financial benefit flow with the intended streaming (whether capital distributions are required for capital gains depending on the definition of income)



# Exercising powers

- Written rather than done 'in the mind' recommended
- Recommend specifying power being relied on
- Reduces mistakes such as assuming powers are included in the terms of the trust



# Tax adjusted distributions

- *'so much of the distributable income that results in [NAME] having a taxable income of \$[NUMBER]'*
- Not recommended as uncertainty present on entitlements on a specific date





# Distribution options

- Specifying amounts distributed
  - If balance beneficiary – to balance beneficiary
  - If no balance beneficiary – ambiguity as could be to:
    - Default beneficiary; or
    - Be in proportion
- Specifying proportions of distributable income
  - Additional income taxable to beneficiaries in same proportion



# Some tax tips

- Focus on the unusual transactions (streaming, notional amounts, trust losses)
- Review deed:
  - Income definition
  - Streaming powers
  - Trust loss provisions (noting that unless a power exists trust losses must be applied to income and cannot be deferred)
- Resolutions before required under deed or 30 June
- Minutes made in accordance with corporate rules (timing)
- Contemplate effect of contingencies, else default provisions may apply



# Drafting tips

- Resolution should tell a story:
  - What's the point of resolution – distributing income and/or capital
  - What is the income being distributed – defining income and whether references to capital gains/franked distributions required
  - Who are intended to benefit from the income – confirming beneficiaries are valid beneficiaries
  - Is any income being segregated – recording and classifying separate income classes
  - Are any trust losses being utilised
  - Is any amount being accumulated
  - How to deal with each income class
  - How to deal with any capital distribution
- Reference to clause numbers will support the story



# No no's

- Section 100A
- Circular trust distributions:
  - Original Trust distribute to Trust 2
  - Trust 2 distributes back to Original Trust
- “Washing machine” arrangements – noting the recent case of *Guardian*

# Contact details

## Darius Hii

Tax and estate planning lawyer; Chartered Tax Advisor; and Director at  
Chat Legal Pty Ltd

[darius@chatlegal.com.au](mailto:darius@chatlegal.com.au)

0403923374