

# ALERT

15 MAY 2012

## Trust deeds and the *Tax Law Amendment (2011 Measures No 5) Act 2011*

Trust deeds must be reviewed to ensure their terms allow for compliance with the provisions introduced by the *Tax Law Amendment (2011 Measures No 5) Act 2011* (TLAA5). Failure to ensure that trust deeds contain the necessary terms may result in income being streamed inappropriately, or assessed to the trustee.

### Legislative background

Changes brought by the TLAA5 were designed to address a number of uncertainties and longstanding problems with the taxation of trusts, some of which were highlighted by the *High Court decision in Commissioner of Taxation v Bamford [2010] HCA 10*.

Those changes were introduced pending a broader review of the taxation of trusts – including a rewrite of Division 6 of Part III of the *Income Tax Assessment Act 1936* (1936 Act).

The amendments:

- enable the streaming of capital gains and franked distributions to beneficiaries for tax purposes

- introduce anti-avoidance rules targeted at inappropriate trust distributions to exempt entities.

### Key points and deadlines

- The new rules allowing streaming of capital gains and franked dividends.
- To stream you will need to make resolutions **by 30 June 2012 and 31 August 2012**.
- To stream franked dividends, you must record in the accounts or records of the trust ('records' includes distribution minutes) that a beneficiary is 'specifically entitled' to an amount of a franked dividend **on or before 30 June**.
- To stream capital gains, you must record in the accounts or records of the trust that a beneficiary is specifically entitled to an amount of a capital gain **by 31 August**.

Trust deeds should be reviewed to ensure they enable trustees to classify amounts of income by their source and make distributions



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of that classified income – this will be critical if a beneficiary is to be 'specifically entitled' to a capital gain or franked dividend.

## Why the rush?

The Commissioner of Taxation has made clear that this year there will be no time concessions. Trustees who have not made effective distributions by 30 June will be assessed under section 99A at the highest marginal rate.

For the year ending 30 June 2012, the Commissioner has:

- withdrawn IT 328 and IT 329, which together allowed a 'grace period' for the passing of resolutions to 31 August in each year
- introduced the Trustee Resolution Compliance Project for the 2012 tax year, under which he will be writing to a selected number of trustees in May 2012 and monitoring the

resolutions and tax returns to ensure compliance under the new requirements for 30 June.

## The mechanics of the streaming amendments

Broadly, the streaming amendments work as follows:

- Through a legislative process set out in the new Division 6E of the 1936 Act, effectively streamed capital gains and franked dividends will be backed out of Division 6 and taxed to the beneficiary on a quantum basis (that is, on the actual amount streamed) under Subdiv 115-C (capital gains) and Subdiv 207-B (franked dividends) of the *Income Tax Assessment Act 1997*.
- Any capital gains or franked dividends that are not effectively streamed will continue to be taxed to the beneficiaries under Division 6 on a proportionate basis.
- To effectively stream a capital gain and/or franked dividend, the trustee must make a beneficiary 'specifically entitled' to the amount of the capital gain or franked distribution and the requirements to do so are now prescribed in the legislation.
- The trustee must be able to make a beneficiary 'specifically entitled' to a capital gain and/or franked dividend pursuant to the prevailing terms of the trust and the specific entitlement must be reflected in the trust's accounts or records. These enabling terms must be in the trust deed or available to the trustee by the operation of legislation, common law or equitable rules. The streaming amendments do not give the trustee the power to stream capital gains or franked dividends where they do not already have this power.

Ensuring that the trustee has created a 'specific entitlement' in favour of a beneficiary, in a way recognised by the legislation, is the critical issue and the key to achieving an effective taxation outcome in respect of a 'streamed' capital gain and/or franked dividend under the streaming amendments. This should be ensured before 30 June.

## 'Specifically entitled'

The definition of 'specifically entitled' has been refined. It is broadly the same (with some necessary modifications) for both capital gains and franked dividends. The ability to stream is based on the beneficiary being entitled to a 'financial benefit' in respect of the capital gain or franked dividend.

Under the streaming amendments, the specific entitlement is calculated by applying this statutory formula:

$$\frac{\text{Capital gain x Share of net financial benefit}}{\text{Net financial benefit}}$$

Some complexity lies within the elements of this formula. The issue will be how the provisions and definitions work in operation.

## Comment

It is now essential to review your trust deeds to ensure they comply with the provisions introduced by the TLAA5. Failure to adjust trust deeds to enable compliance will mean that income will not only be streamed appropriately, but will be assessed to the trustee.



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Certain resolutions must be made before 30 June 2012 and 31 August 2012 to take advantage of the changes. While momentum for change initially related to ensuring trust deeds met various technical conditions arising from legislation, these resolutions may be overlooked due to the timing.

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**Should you require assistance in reviewing and amending your trust deeds, or advice on any taxation related matter, please contact:**

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