issue 9 | april 13

scoop

entertaining the law

Dequetteville Chambers
1 Dequetteville Terrace
Kent Town South Australia 5067
phone +61 8 8132 5000
facsimile +61 8 8363 1633
admin@baggiolegal.com.au

Trust Distribution Minutes: Shifting the goals

In our experience, many advisers have taken the view in the past that trust distribution minutes are a simple document to be generated without much thought or process.Very often, a template trust distribution minute is used without any consideration of the circumstances and without regard to the terms of the trust deed.

This view is no longer sustainable (if it ever was); indeed, we regard this area as a risk for most accounting practices. This is due in particular from increased compliance measures from the ATO, changes in the ATO's position, changes in the law and recent Court decisions. Some of the more recent changes include:

- ATO Compliance Action
  The ATO has always struggled with trusts from a policy perspective – in particular, their perceived used as tax minimisation structure. In our experience, when the ATO commences compliance actions in respect of trust distributions their first action is to request a copy of the trust deed, the relevant trust minutes and the financial accounts; the ATO then considers whether there is any discrepancy between the requirements and definitions of the trust deed, the relevant trust minutes and the relevant financial accounts.

  Tip: Consider the definition of income in the trust deed. If you require a different definition (and the trust deed permits you to do so) then the procedure in the trust deed to use a different definition must be followed (typically, a resolution in the same minute). The financials should then reflect the manner in which the distribution occurred e.g. if income includes a net capital gain, then the financials should also indicate a distribution of that net capital gain as income.

- Changes in the ATO's position
  The ATO's issue of *TR 2010/3* and *PS LA 2010/4* has, by the ATO's own admission, resulted in a change in the ATO's practice. The effect of these rulings means that the utility of corporate beneficiaries within trust groups has been greatly diminished because of the application of the Division 7A rules and the limited scope to avoid application of the rules under the PS LA.

  Tip: Carefully consider all UPEs which exist after 16 December 2009 and in particular the application of the above rules. Ensure that UPEs are labelled as UPEs and not beneficiary loans etc. Be particularly vigilant and obtain further information as required where there are multiple accountants involved (e.g. 2 family groups in a common business with separate accountants – the decisions of 1 family group can often affect the other family group).

scoops

In light of the complexity, uncertainty and unwelcome ATO/ legislative attention around family trusts, many of you may be suggesting to clients a corporate structure where once you would have suggested a family trust. What is most appropriate for your client will depend upon the circumstances, but a clear understanding of the differences between the 2 entities must be appreciated and explained. Also, where you are restructuring, don't forget: stamp duty, GST, income tax and CGT must be managed in the usual way - even for such intra group transactions!

Andrew Baggio
LLB MTax BA GCLP FTIA

William Chau
LLB BCom(Corp. Fin.) GDLP

- Bamford Decision

  The 2 key take aways from the Bamford decision (and to a lesser extent the Cajkusik decision) are that: (1) the terms of the trust deed are vital and may have a significant effect on the ultimate taxation position and (2) tax is assessable to beneficiaries on a proportionate (rather than a quantum) basis.

  Tip: Always consider the terms of the trust deed. Exercise caution where 'income' under the terms of the trust deed differs from net income for taxation purposes. Where an original trust deed has been lost, take rectification action as soon as possible; we have reconstructed trust deeds from photocopies or from other trust deeds "of the same vintage" in the past.

- Amendments to Trust Net Capital Gain Rules

  Under the amendments to Subdivision 115-C ITAA97, the net capital gains of the trust are assessable to: (1) the person(s) specifically entitled to the amount of the gain or (2) if there is no specific entitlement, the persons entitled to a share of the income of the trust estate under Division 6 ITAA36. While this may seem straight forward, the operation of the section itself may lead to problems.

  Tip: Always consider whether a beneficiary will be assessable – we have previously run into difficulties with loss-making businesses or negatively geared property.

  Consider the following Balance Sheet for a fairly simple vanilla negative-geared property trust.

XYZ Trust

Balance Sheet as at 30/6/2012

Trust Funds (Deficit)			
Settled Sum	$ 10.00		
Accumulated Profits (Losses)	($ 100,000.00)		
			($ 99,990.00)
Represented By:			
Assets			
Property	$ 100,000.00		
		$ 100,000.00	
less Liabilities			
Bank Mortgage	($ 100,000.00)		
Loan from Beneficiary	($ 99,990.00)		
		($ 199,990.00)	
Net Assets			($ 99,990.00)

On 1 July 2012, the Property is sold for $400,000.00. $199,990.00 is used to repay the bank and the loan from the beneficiary. Leaving $200,000.00 that the trust may distribute (ignoring the $10 settled sum).

For the trust, the taxation position would be as follows:

Losses applied		**Losses not applied**	
Capital Proceeds	$ 400,000.00	Capital Proceeds	$ 400,000.00
Cost Base	($ 100,000.00)	Cost Base	($ 100,000.00)
Capital Gain	$ 300,000.00	Capital Gain	$ 300,000.00
50% Discount	($ 150,000.00)	50% Discount	($ 150,000.00)
Net Capital Gain	$ 150,000.00	Net Capital Gain	$ 150,000.00
Apply Income Losses	($ 100,000.00)		
	$ 50,000.00		

Note that:

- *Depending on the definition of income, there may not be income for the trust to distribute – with the result that the trustee cops the entire capital gain at top marginal rates!*
- *If $50,000 is distributed to the beneficiary, his share of the capital gain is actually only 1/3 ($50,000/$150,000). The beneficiary is taxed on $16,666.67 and the trustee is taxed on the remaining $33,333.33 - at top marginal rates!*
- *If the whole amount of the net capital gain is distributed to a beneficiary (i.e. not applying income losses), the benefit of the income losses is foregone.*

Call us if you need you trust minutes/ trust deeds reviewed or wish us to conduct an in-house training session on this important topic for you and your team