



Recent developments affecting your trust



New developments mean now is the time to ensure your trust is well structured.

Most readers who operate their business through a trust structure, or have a family trust for investment purposes, are more than likely aware of the recent extensive media coverage in relation to trusts. There have been two major developments that affect how your trust distributes income.

The first development was the decision from the High Court case 'Bamford'. This decision was followed by two publications from the Australian Taxation Office (ATO) outlining their interpretation of the case and how ATO officers will treat trusts going forward.

One of the biggest issues of concern from these publications is the ATO's statement that the amount included in a beneficiary's assessable income for the year must consist of an undissected or unallocated proportionate share of the entirety of the trust tax income. This means the ATO believes a trustee cannot stream different classes of income to different beneficiaries for tax purposes, but rather, each beneficiary must include a portion of all classes of income in their tax return.

For example, a trustee may distribute all capital gains to an individual beneficiary to access the 50% capital gains tax discount, and all other

income to a corporate beneficiary to access the 30% company rate of tax. Under the ATO's view, both the individual and the company need to include a share of the capital gains and all other income, therefore, the portion of the capital gain distributed to the company would not receive the 50% discount.

The second development relating to trusts was the release by the ATO of a tax ruling and publication dealing with unpaid present entitlements (UPEs) to a company beneficiary. A UPE arises where the trustee resolves to distribute income from the trust to a company, but doesn't physically pay the cash over to the company bank account.

The ATO now believes that UPEs convert to a loan because of an implied agreement between the company and trust, and because the company hasn't called for that amount to be physically paid. This represents a significant departure from the ATO's previous view and has the potential to create a deemed dividend back to the trust with serious tax implications.

So what does this mean for your trust?

Don't panic. Trusts are still a very useful

structure, but care needs to be exercised by the trustees and their advisors to avoid unintended outcomes.

In regards to trust distributions, the ATO has advised that because of the considerable uncertainty that existed before Bamford's case, ATO officers should not select trusts for active compliance for the year 2009/2010 and prior returns, provided there isn't a deliberate attempt to exploit the law. However, there will be a much stricter approach to reviews going forward and ATO officers have been instructed not to rely on the distribution statement contained in the trust tax return, but instead, review in detail the trust deed and all other relevant documents including trustee resolutions or minutes and financial accounts.

It is critical that trustees take a great deal of care when deciding which beneficiary to distribute to and ensure minutes are prepared having considered the provisions of the trust deed, and draft minutes on or before 30 June, to avoid any unintended tax consequences. A template from your accountant in most cases will not be sufficient.

Also, your advisor should be reviewing your trust deed to determine if it should be amended, and can be amended, to account for these recent developments.

In regards to unpaid distributions to companies, the ATO has accepted that this is a change in their view and UPEs prior to 16 December 2009 will not be treated as loans unless the financial accounts of the trust and company both record the amount as a loan. Post 16 December 2009, UPEs will be treated as a loan unless certain conditions are met. Therefore, it is critical that going forward any distribution to a company is either paid or is on terms that meet the conditions accepted by the ATO.

We do not necessarily agree with the ATO's view on these matters, nor do we believe their position is supported by law. However, given the active compliance in this area and the ATO's recent publications, a taxpayer is putting themselves at significant risk if they do not comply with the ATO's new approach. If you operate your business through a trust structure or have a trust for investment purposes, you should be discussing these recent developments with your advisor.

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