TRUST COMPONENTS

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Settlor</td>
<td>Person who makes the original property settlement to create the trust.</td>
</tr>
<tr>
<td>Settled sum</td>
<td>Nominal sum bestowed by the person to create the trust.</td>
</tr>
<tr>
<td>Trust property</td>
<td>Assets held by the trustee.</td>
</tr>
<tr>
<td>Trustee</td>
<td>A trustee is not a separate legal identity. The trustee is the person (including a company) who operates the trust estate as legal owner of the trust property.</td>
</tr>
<tr>
<td>Beneficiary/object</td>
<td>Person who will benefit from the distribution of trust income/property.</td>
</tr>
<tr>
<td>Trust deed</td>
<td>Memorandum that governs the operation of the trust.</td>
</tr>
<tr>
<td>Vesting period</td>
<td>Trust deeds generally allow the trustee to appoint and move the vesting date at their absolute discretion.</td>
</tr>
<tr>
<td></td>
<td>Legislation determines the final vesting date, e.g. 80 years in Victoria.</td>
</tr>
<tr>
<td>Guardian</td>
<td>Person from whom consent must be gained before a change can be made to the trust deed.</td>
</tr>
<tr>
<td>Appointor</td>
<td>Person with the power to appoint and remove the trustee.</td>
</tr>
</tbody>
</table>
Types of Trust

- the “bare” trust – the trustee holds property simply as nominee
- the “fixed” trust - interests may be fixed as to income or capital or both
- the unit trust – a variant on the fixed trust is a unit trust
- the discretionary trust - the trustee is given a “discretion” to choose the share or amount of income or capital
- the hybrid trust – has the elements of both a fixed and discretionary trust
- the deceased estate – tax rules in Division 6 ITAA 36 apply

Role of the Settlor

- Best to have an unrelated party in the role of settlor to minimise the potential application of s 102 ITAA 36.

- Section 102 will not be triggered where the settler is a mere contingent beneficiary.

- For s 102 to apply the settlor must have power to revoke or alter the trust so as to acquire a beneficial interest in the trust income or trust property or their children who are under 18 must acquire an interest in the trust income.
Trustees

• Corporate or Individual Trustees
  – The use of an individual as trustee is generally a less costly
  – The trustee is personally liable for the debts incurred in their capacity as
    trustee and are indemnified from trust assets

• Use of a Corporate Trustee
  – Provides more protection – but do not overuse a corporate trustee
  – See DFC of T (Superannuation) v Fitzgeralds & Anor 2007 ATC 5105
  – The assets of the trustee acting in its own right will be subject to claims
    against the trustee for liabilities incurred in relation to the trust (but the
    reverse will not apply provided that necessary documentation and
    procedures are in place)

Change Beneficiaries / Trustee - Resettlements

• The identity of beneficiaries is an essential element of the
  trust

• A change of beneficiaries may result in a re-settlement of a
  trust

• A change in the membership of a continuing class of
  members will not constitute a change in the beneficial
  ownership

• The change of trustee does not trigger immediate tax
  consequences -CGT event A1 does not occur.
Change Beneficiaries / Trustee - Resettlements

- Whether changes to a trust create a new trust (a resettlement) will depend on the particular circumstances.
- In FCT v Clark (2011) 79 ATR 550, Court considered that the indicia of continuity identified in Commercial Nominees apply equally for the purposes of the income tax laws governing trusts.
- Court held that changes which ATO argued had brought about a break in the continuity of the trust estate were insufficient to have had that effect.

Change Beneficiaries / Trustee - Resettlements

- Following Clarke decision, ATO withdrew the document - Creation of a new trust – Statement of Principles August 2001 – which set out its views on this issue.
- In TD 2012/21, ATO acknowledged that, as a result of decision in FCT v Clark, approach set out in the Statement of Principles was not sustainable.
- ATO now accepts that "continuity of trust is a function of whether the trust continues in existence under trust law in contradistinction to having terminated".
Vesting of Trust

• Most trust deeds have a standard vesting date of 80 years from the commencement date of the trust.

• More unusual vesting periods include “21 years after death of last living descendant of King George V alive at the time the trust was established”

Vesting of Trust

• Trust deeds generally have default distribution mechanism to distribute trust fund on vesting date where trustee has not exercised discretion to distribute.

• Where the vesting date has been overlooked, the trust fund will usually be held on trust by the trustee for a defined class of beneficiaries (referred to for present purposes as ‘primary beneficiaries’).
Vesting of Trust

• From a tax perspective, the vesting of the trust results in the primary beneficiaries becoming absolutely entitled to the trust fund, and CGT events E5 or E7 would likely occur (depending on the nature of the trust property).

• The effect of CGT event E5 or E7 is that the trustee will make a taxable capital gain on post-CGT assets if the market value of the assets exceeds their cost base. The beneficiaries would acquire the trust property at the vesting date, with a cost base equal to its market value.

Vesting of Trust

• From a revenue perspective, stamp duty is usually chargeable on transfers and certain other transactions relating to land, including transactions resulting in a change in beneficial ownership of land.

• Depending on default distribution provisions in trust deed, vesting of a trust that results in a change in interests in land could be a dutiable transaction.
Vesting of Trust

Can vesting be avoided?
- Generally trust property vests within 80 years
- South Australia has abolished the perpetuity period
- If a trust deed has a shorter vesting date, such as 40 years, the vesting date can potentially be extended to avoid unwanted consequences.

Vesting of Trust

Extending the vesting date – power under the trust deed
- Some trust deeds give the trustee power to extend the vesting date.
- If the trustee exercises this power properly, and does not exceed the perpetuity period, the extension will be valid, and the trust can continue.
Vesting of Trust

Extending vesting date – no power under the trust deed

• Some trust deeds do not contain a power to extend the vesting date.

• Supreme Court in most States has the power to vary trusts under their respective trust legislation where it is for the benefit of the beneficiaries of the trust

• Recent case of *Re Plator Nominees [2012] VSC 284* – court agreed to extend vesting date – court considered:
  – benefits and disadvantages of proposed variation,
  – purpose of trust and settlor’s intention in establishing trust

Vesting of Trust

• Resettlement of the trust should also be considered when extending the vesting date.

• With withdrawal of Statement of Principles August and issuing TD 2012/21 where trustee exercises a valid power to extend vesting date, there should not be a resettlement.

• If no power, consideration should be given to trust structure and settlor’s intention at time trust established

• If there is a clear reason why shorter vesting period was nominated, caution should be exercised before any attempt is made to extend the vesting period.
Trustees that are beneficiaries

- A trustee can be a beneficiary in a trust but it cannot be the only beneficiary.

- The fact that the trustee is a beneficiary in a trust may impact on the ability of third parties to make a claim against the assets of the trust – see the case of Richstar Enterprises case.
  
  - The extensive control that the person had over the appointment of the trustees and distributions made by the trust created (at least) a contingent interest in the trust properties sufficient to bring them within the s 9 definition.

- Note – Moignard v FCT

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Taxation of trusts - Division 6

[Diagram showing decision flow for taxation, including conditions and outcomes for s 95, s 97, and s 99 Trustee Assessments.]
Present Entitlement – Unit and Discretionary Trusts

- Entitlement will be set out in the trust deed
  - A beneficiary with a fixed interest will be entitled to an amount commensurate with that interest
  - In a discretionary trust present entitlement will not be determined until the trustee makes a determination

- *Pearson v FC of T 2006 ATC 4352 – Caution* - A unit holder in a unit trust may not always be presently entitled to a proportionate share of the income without the trustee making any determination

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Present Entitlement – Reimbursement Agreement

**REIMBURSEMENT AGREEMENT – SECTION 100A**

- The term “reimbursement agreement” is defined as any agreement, arrangement or understanding providing for:
  - the payment of money (including a payment by way of loan) to
  - the transfer of property to, or
  - the provision of services or any other benefits for,

- any person other than the beneficiary, being an agreement entered into for a purpose (not necessarily the sole or principal purpose) of reducing the tax liability of a person.

- Raftland case and others – presence of reimbursement agreement triggers application of section 100A

- Effect is that “distribution” and transactions relevant to reimbursement agreement are disregarded
Present Entitlement – Reimbursement Agreements

• Anti-avoidance provisions operate to strike down present entitlement in the presence of a reimbursement agreement.

• Raftland Pty Ltd Case – distribution created an indebtedness but it was not a “real debt” that was intended to be paid
  – *It was held that the entitlement under the Raftland Trust deed was not intended to have substantive legal effect. Accordingly s 100A(1) applied*
  – *Trustee was taxed on the income to which no beneficiary was presently entitled*

Update – **ATO Guide on reimbursement agreements**

• **Section 100A ITAA 1936** can apply where a beneficiary is made presently entitled to trust income that is intended to be directed to another person. The effect of the application of section 100A is that the trustee is made taxable on the distribution at the top marginal rate, currently 49% with the Medicare levy.

• It appears from the ATO Guide that the ATO is interpreting section 100A more broadly than it has in the past.
Default Vesting Clauses

- In the absence of an appointment of income the trust deed will determine that the default beneficiaries are presently entitled.
- Commissioner generally allows an additional period of two months after the end of the year of income to make a distribution – this approach generally has no legal effect.
- Case R105 84 ATC 692 – purported trust distributions after the end of the year were ineffective - the specified default beneficiaries were presently entitled to the income of the two years.
- BRK (Bris) Pty Ltd Case – the default provisions did not work in the circumstances – poorly drafted trust deed.

Default Beneficiaries and Disclaiming Entitlement

- Ramsden’s Case – was the default clause effective and could the beneficiaries disclaim entitlement?
- The default beneficiaries were presently entitled and could disclaim the income but had to do it within a reasonable period – when they became aware of the distribution.
- To be effective, a disclaimer had to extend to the whole of that subject matter hence a disclaimer confined to one only of those accounting periods was necessarily ineffective. In the absence of an appointment of income the trust deed will determine that the default beneficiaries are presently entitled.
Effective Disclaimers

• Where there is a distribution to a person it vests in the person even before knowledge of the transfer, subject to his right when informed of it to say, if he pleases, 'I will not accept it'.

• **Effect of making a Disclaimer** - TD 2001/26
  - A renunciation by a beneficiary of an actual interest in a discretionary trust (the interest being a CGT asset) would give rise to CGT event C2
  - A disclaimer by a mere beneficiary of a discretionary trust has no tax effect
  - A disclaimer by a default beneficiary may require further consideration

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**Tax Update – Dec 2016 / Jan 2017**

**Trust resolutions held to be valid (GREEN) - TVKS v FCT [2016] AATA 1010**
• The individual taxpayer was a beneficiary of the Woodchester No. 4 Trust and the Bristol Trading Trust.
• In May 2013, the Commissioner issued amended assessments to the taxpayer for 2005-06 and 2006-07.
• The Commissioner increased her taxable income from $9,000 to $10.1 million for 2005-06, and from $9,500 to $3.2 million for 2006-07.
• The Commissioner made the amendments as a result of increases to the trusts’ net incomes, which were distributed to the taxpayer.
• Archer Property Pty Ltd (Archer Property) was the trustee for the Woodchester No. 4 Trust.
Tax Update – Dec 2016 / Jan 2017

Trust resolutions held to be valid (GREEN) - TVKS v FCT [2016] AATA 1010

- On 30 June 2006, Archer Property resolved to distribute 100% of the “income of the trust, as defined in the deed” for the income year ended 30 June 2006 to the taxpayer (Archer Property Resolution).
- In December 2015, the taxpayer executed a “Disclaimer of Entitlement to Income” in respect of each trust.
- The documents stated that she disclaims and rejects absolutely any entitlement to any income, capital or gift from the trusts, from 1 July 2005.

- The AAT considered a number of issues.
- These include:
  - whether the taxpayer’s deeds of disclaimer are effective to prevent her being presently entitled to the net income of the two trusts
  - whether the Archer Property Resolution was ineffective as the trust deed only permitted Archer Property to distribution “Net Income”.

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Tax Update – Dec 2016 / Jan 2017

Trust resolutions held to be valid (GREEN) - TVKS v FCT [2016] AATA 1010

- The AAT handed down a decision that these particular distributions from d on the basis trusts comprise assessable income of the beneficiary taxpayer
- This was held on the basis that the taxpayer’s purported disclaimers of interest were invalid, and that the trust resolutions were effective in distributing the income to her.

UPE written off as bad debt is not deductible - TD 2016/19

- TD 2016/19 sets out the Commissioner’s view that a beneficiary of a trust is not entitled to a bad debt deduction under s25-35 for an unpaid present entitlement (UPE) that the beneficiary purports to write off as a bad debt.
- According to the TD, a UPE is a beneficiary’s right to receive an amount of trust income and/or capital that:
  - arises as a result of the beneficiary having been made presently entitled to that amount, and
  - has not been satisfied (including by being paid to or as directed by the beneficiary, or by being effectively converted into a loan from the beneficiary) or effectively disclaimed.
Proportionate v Quantum Approach

- The proportionate approach has received greater support from decided cases where the excess of net income results from an income amount.

- The proportionate approach does not deliver the fairest result where the income beneficiaries are not entitled to a share of the capital of the trust – See Richardson’s Case.

- The Zeta Force Case supports the proportionate approach where the difference is of an income nature.

The Importance of Trust Income

- Section 97(1) relies on the presence of trust law income (income in accordance with the trust deed or generally accepted accounting principles) - in the absence of trust law income the proportionate or quantum approach cannot be applied satisfactorily.

- Cajkusic’s Case demonstrates the difficulties in applying either view where there is no trust law income and so the net income is assessed to the trustee under s 99A.

- In Bamford V FCT, High Court sanctioned proportionate approach as appropriate methodology.
Update – Practice Statement **PS LA 2015/2**

- The ATO states in the Practice Statement that it will not issue an original trustee assessment more than 4 years after the relevant trust tax return was lodged, or for the 30 June 2014 and later income years, more than 2 years after lodgment if the trust was a small business entity (and none of the qualifications in item 3 of the table in s 170(1) of the ITAA 1936 apply).
- According to the Practice Statement, the time limits listed above do not apply in the following circumstances:
  - if the trustee has not lodged a trust return for the year in question;
  - if the Commissioner is of the opinion that there has been fraud or evasion;
  - where an extended or unlimited amendment period would apply; or
  - where the time limit is extended – in cases where the ATO has started to examine the affairs of a trust (or related entity) and the examination will not be completed within the time limits, the ATO may seek the trustee's agreement to extend the period.

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**Taxation of Trusts - Recent Government Initiatives**

- On 24 October 2012, the Government released a policy options paper for reforms to the taxation of trusts
- The options paper articulates the design of 2 alternative models:
  - *Economic Benefits Model (EBM)*; and
  - *Proportionate Assessment Model (PAM)*
- Adoption of either EBM or PAM means that trusts will not be taxed as companies!! – legal and tax status remain in current framework
Overview of nature and scope of Government options proposed

• **EBM**
  - is a quantum approach model
  - seeks to allocate taxable income to beneficiaries based on the amount actually distributed to each beneficiary
  - trustee (effectively) obtains a tax deduction for distributions made to beneficiaries and bears the tax on any undistributed balance.

• **PAM**
  - is a proportionate approach model (proportionate within a class or classes)
  - seeks to allocate taxable income to beneficiaries based on their proportionate share of "trust profit" (to be legislatively defined)

General observations

• Both approaches endorse an unencumbered ability to stream income classes to different beneficiaries - expense allocation rules ensure that various classes of income are appropriately calculated.

• Also, proposal to extend distribution date from 30 June to 31 August (i.e. the provision of a 2-month extension) - will overcome the type of compliance problems faced at 30 June 2012.

• However, many trust deeds would need to be updated to accommodate this proposal
Overview of nature and scope of Government options proposed

Path Ahead

- Submissions have closed.
- Govt undertook to issue Exposure Draft Bill in 2016 (further consultation will be sought)
- Uncertainty as to timeline now but in principle accepted

Trust Losses

<table>
<thead>
<tr>
<th>Type of trust</th>
<th>50% stake test</th>
<th>Same business test</th>
<th>Pattern of distributions test</th>
<th>Control test</th>
<th>Income injection test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed trust other than a widely held unit trust</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Unlisted widely held trust</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Listed widely held trust</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unlisted very widely held trust</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wholesale widely held trust</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Non-fixed trust</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Family trust</td>
<td></td>
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<tr>
<td>Excepted trust (other than a family trust)</td>
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</tbody>
</table>
Advantages of a family trust

The advantages of a family trust:

• Easy access to trust losses – only income injection test to be satisfied

The income injection test applies where:

• Trust has a deduction (including a prior year loss) in the income year
• There is a scheme under which:
  – the trust derives assessable income;
  – a person not connected with the trust provides a benefit (directly or indirectly) to the trustee or a beneficiary (or their associates); and
  – a return benefit is provided to the outsider, and
  – it is reasonable to conclude that the assessable income has been derived, or the benefits have been provided, wholly or partly (but not merely incidentally) because the deduction (loss) is allowable.

Advantages of a family trust

The advantages of a family trust:

• Entitlement to franking / imputation credits for beneficiaries of a discretionary trust
  – “Qualified person” test can be satisfied – 45-day holding period rule
  – Trustee treated a “qualified person”
  – Qualified person requirement need not to be met when de minimis concession applies (franking credits less than $5,000)
Advantages of a family trust

The advantages of a family trust:

• Normally no access to prior year losses in companies by satisfying COT where shares held by discretionary trust
• However if trust is family trust, COT can be met and access to company tax losses available
  – Trustee of family trust treated as one shareholder
  – No need to trace through beneficiaries

Disadvantages of a family trust

The disadvantages of a family trust:

• Limiting distributions to family members otherwise Family Trust Distributions Tax at 49%
• Only revocable if not utilised
Family trust election (FTE)

CONDITIONS

• The trustee of the trust makes the election
• The election must be in writing and in the approved form
• The trustee nominates an income year, called the “specified income year”, that is the first year in which the trust is “family trust”.
• The election must name an individual as the person whose family group is taken into account in relation to the election and it must contain such other information as the Commissioner requires
• FTE must be in writing in the approved form.
• The Commissioner releases the approved form each year.
• For example, Commissioner released “Family trust election, revocation or variation 2016” form for use to make FTE specifying 2004/05 or a later income year, revoking a FTE in the 2011/12 income year, or varying the test individual.

Interposed entity election

• A company, trust or partnership is required to make an interposed entity election (IEE) before it can be included as part of a family group
• IEE will be relevant where members of the primary individual’s family do not have fixed entitlements to all of the income and capital of the interposed entity.
• IEE can be made for an income year later than the year in which the family trust election is made.
• IEE must specify a date in the income year from which it takes effect
• IEE can be made at any time in relation to an earlier income year, rather than having to be included in the tax return.
• This option is only available to entities that have acted as if they were a family entity, but an IEE cannot be made if the entity does not pass the family control test at the end of the relevant income year.
• IEE is revoked when FTE is revoked
CLOSE

QUESTIONS?????