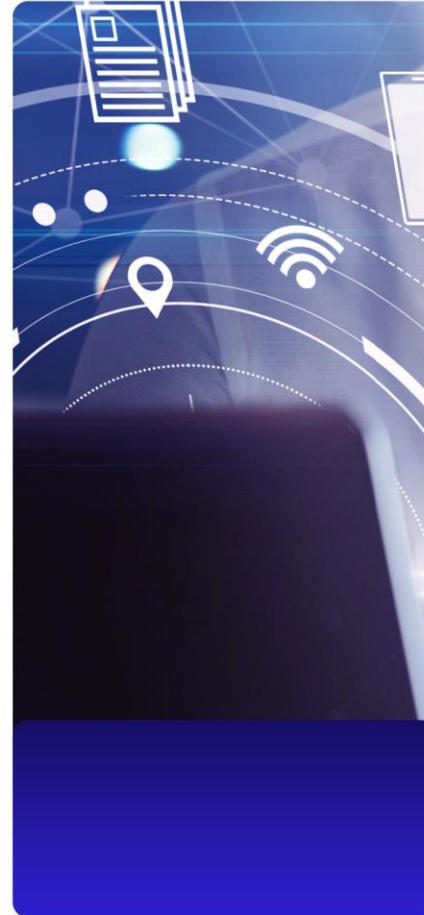


6-Webinar series

 Hot topics by members for members

1.5 CPD hours per webinar



Part 3: Trust Distributions - Harder than you think

Presenters:

Adrian Cartland, Cartland Law
Sally Storey, CTA, Brentnalls

Welcome and opening address

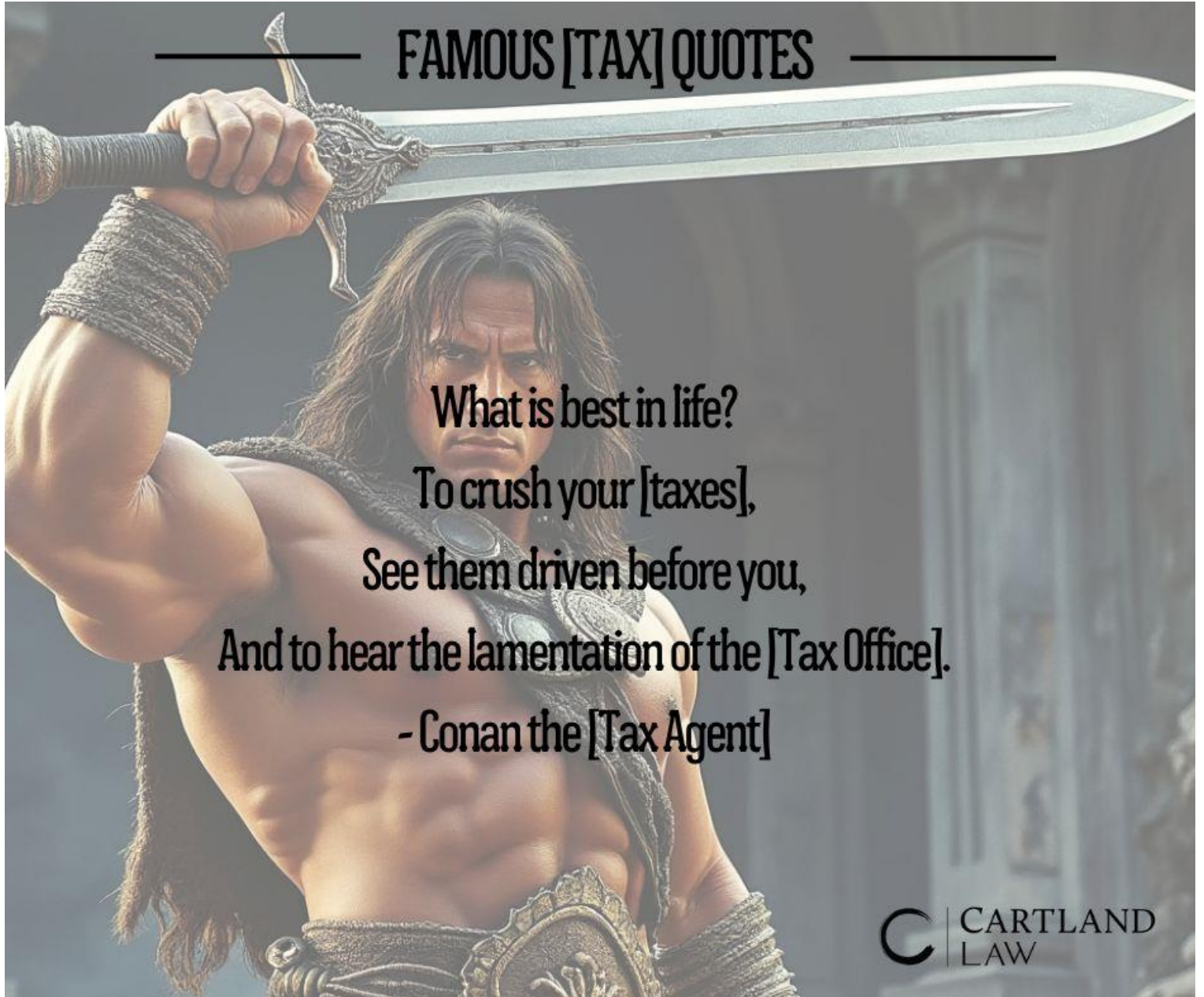
Presenter:

Lucy Simeoni, CTA, WRP Legal & Advisory

What's in this session

- Ten critical issues with trust distributions
- There will be some law
- Some accounting
- Some “tax related” Arnie quotes

Taxinator says:



FAMOUS [TAX] QUOTES

**What is best in life?
To crush your [taxes],
See them driven before you,
And to hear the lamentation of the [Tax Office].
- Conan the [Tax Agent]**

**CARTLAND
LAW**

The Basic Case

- Adam holds Greenacre absolutely for Ben
- Cash accounting
- Up to date accounts
- No liabilities
- Pile of money on the kitchen table representing profits
- Late afternoon 30th June
- Ben is presently entitled to the trust income

Ten Things I Hate

1. The accounting basis: accruals instead of cash
2. The passing of the knowledge from trustee to beneficiary about the amount to which the beneficiary is entitled
3. Whether the trustee has present or potential liabilities
4. Whether the trustee (as a company) may have Corporations Act remedies against the distribution could unwind it
5. Whether the trust has carried forward losses or negative net assets

Ten Things I Hate (cont)

6. Whether the trust deed requires that income should be proved to exist
7. How the income of the trust is measured
8. If the trust deed requires that the income be set aside on a separate trust
9. If there is some property being distributed that cannot be identified
10. If the amount is required to be paid

Division 6 Overview

- S96 trustee is not taxed
- S97 makes assessable the beneficiary of the trust estate on that net income, provided other circumstances are met
- Incorporates the equitable principles of present entitlement and vested in interest and possession
- Definition of 'net income' in s95
 - s99A if not taxed
 - If presently entitled at 30th June then taxed – cannot change afterwards - *Carter*

Deemed Present Entitlement – s95A(2)

- *(2) For the purposes of this Act, where a beneficiary has a vested and indefeasible interest in any of the income of a trust estate but is not presently entitled to that income, the beneficiary shall be deemed to be presently entitled to that income of the trust estate.*
- Possibly to enable present entitlements for minors with accumulated income – *Harmer*
- Security interest over vested interest won't have PE – s95A(2) can remedy – *Dwight*
- If need to resort to Court in order to claim are vested and indefeasible but not PE – *Estate Mortgage*
- Generally will not be vested and indefeasible

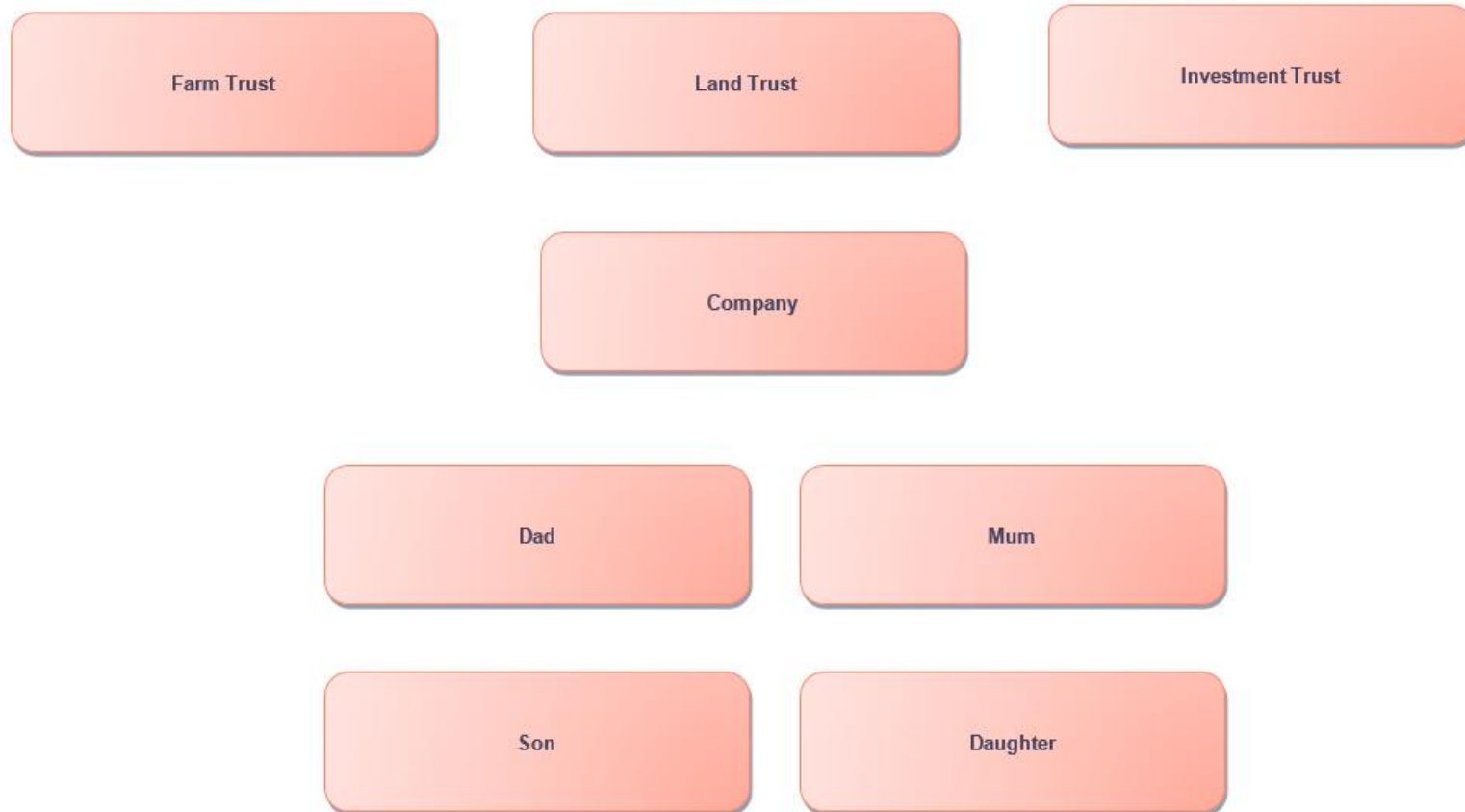
Deemed Present Entitlement – s101

- Discretionary trusts where trustee has exercised their discretion
- Deemed to be presently entitled to the amount *paid* or *applied*

Income

- Proportionate approach to income distributions – *Bamford*
- Income is not property (neither is cryptocurrency)
- Income is measurement – *Spanish Prospecting*
- Accounting revaluations can be income – *Clark v Inglis*

Structure



Accounting Profit / Taxable Income / Trust Income

- 3 different concepts
- Tax return labels
- TR 2012/D1 – a 4th concept

TD 2012/D1

Paragraph 13

Notwithstanding how a particular trust deed may define income, the 'income of the trust estate' for Division 6 purposes must therefore be represented by a net accretion to the trust estate for the relevant period. In effect, the statutory context places a cap on what the income of the trust estate may be for Division 6 purposes. Specifically, for these purposes, the income of a trust estate for an income year cannot be more than the sum of:

- the accretions to the trust estate (whether accretions of property, including cash, or value) for that year;
- less any accretions to the trust estate for that year which have not been allocated, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), to income [and therefore cannot be distributed as income]; and
- less any depletions to the trust estate (whether depletions of property, including cash, or value) for that year which, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), have been allocated as being chargeable against income.

Farm Trust

Income		\$
	Grain Income	2,000,000
	Livestock Income	500,000
Expenses		
	Cropping Expenses	- 900,000
	Livestock Expenses	- 100,000
	Depreciation	- 100,000
	Overheads	- 500,000
Accounting Profit		900,000
Add:		
	Accounting Depreciation	500,000
Less:		
	Tax Depreciation	- 60,000
	SB Skills & Training Boost	- 1,000
Taxable Income		1,339,000
Add:		
	SB Skills & Training Boost	1,000
Trust Income		1,340,000

Land Trust	
Income	\$
Rent	100,000
Expenses	
Interest	-75,000
Accounting Profit	25,000
Taxable Income	25,000
Trust Income	25,000

Investment Trust		
Income		\$
	Dividends	100,000
Expenses		
	Interest	-100,000
	Overheads	- 5,000
Accounting Profit		- 5,000
Add:		
	Franking Credits	40,000
Less:		
	LIC Capital Gain Deduction	- 1,000
Taxable Income		34,000
	LIC Capital Gain Deduction	1,000
Less:		
	Franking Credits	- 40,000
Trust Income		- 5,000

Investment Trust		
Income		\$
	Dividends	100,000
	Farm Trust Distribution	50,000
Expenses		
	Interest	-100,000
	Overheads	- 5,000
Accounting Profit		45,000
Add:		
	Franking Credits	40,000
	Taxable Trust Distribution	74,389
Less:		
	LIC Capital Gain Deduction	- 1,000
	Accounting Trust Distribution	- 50,000
Taxable Income		108,389
Add:		
	LIC Capital Gain Deduction	1,000
	Trust Income	74,444
Less:		
	Franking Credits	- 40,000
	Taxable Trust Distribution	- 74,389
Trust Income		69,444

Presently Entitled - Whiting

- *The words "presently entitled to a share of the income" refer to a right to income "presently" existing— i.e., a right of such a kind that a beneficiary may demand payment of the income from the trustee*
- *A beneficiary who has a vested right to income (as in this case) but who may never receive any payment by reason of such right, is entitled to income, but cannot be said to be "presently entitled" as distinct from merely "entitled."*
- *Until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities, and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries.*

Presently Entitled - Harmer

- *The parties are agreed that the cases [...] establish that a beneficiary is "presently entitled" to a share of the income of a trust estate if, but only if:*
 - *(a) the beneficiary has an interest in the income which is both vested in interest and vested in possession; and*
 - *(b) the beneficiary has 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.*

Some Accounting Issues

- *Harmer* says don't need to know income by EOFY. But what is the entitlement?
- "Incurred" can be difficult – eg Long service leave incurred when taken or employee resigns – *Nilsen Developments*
- Need to have suitable profits available if want to distribute – eg capital -*Lachberg*
- Company law is different to trust law – separate accounts
- A distribution where there is nil income fails – *Cajkusic*
- Negative net assets trust will struggle – e.g. overdraft but makes trading income

The Unwanted Beneficiary

- Can you have a “tax purposes only” beneficiary?
 - s100A
 - Sham
- Beneficiary become bankrupt
- Children want “their share” but that is inconvenient

Resisting the Beneficiary - *Chianti*

- Money was not set aside – sub trusts fail
- Equitable claim for vested interest in property set aside?
- If no more for a trustee to do then there is an action for money had and received – a debt
- Need to communicate the debt – e.g. in accounts
- When does the present entitlement arise? Likely post-30th June

Land Trust

Balance Sheet

Assets		\$
	Cash	10
	Land	1,000,000
Liabilities		
		-
Equity		
	Settled Sum	10
	Gift Reserve	1,000,000

Land Trust

Balance Sheet

Assets		\$
	Cash	10
	Land	5,000,000
Liabilities		
		-
Equity		
	Settled Sum	10
	Gift Reserve	1,000,000
	Asset Revaluation Reserve	4,000,000

Land Trust

Balance Sheet

Assets		\$
Cash		10
Land		5,000,000
Liabilities		
Bank Loan		2,000,000
Equity		
Settled Sum		10
Gift Reserve		1,000,000
Asset Revaluation Reserve		4,000,000
Less Capital Distribution		- 2,000,000

***Fischer v Nemeske* – Corpus Distribution**

- Distribution of revaluation of Aladdin shares
- “*an amount equal to*” the reserve was distributed was what parties meant
- 2/5 held distribution vested an interest in the property and created a debt
- 5/5 agree that IF property was set aside then there would be an effective distribution
- 5/5 held that IF there was an effective distribution then there would be a debt

Corpus Distribution

- Discretionary Trust – **CGT Event E5**
 - Benefit of Class Trust over Unit Trust held by multiple Discretionary Trusts
 - Stamp Duty exemption
- Distribute a cheque or Bill of Exchange
- Trustee should indorse the Bill – it is *choate* and hence property vs promissory note
- Eg A draws on B payable to Trustee who indorses and distributes to A.
 - Then do B draws on A to T then to B to have closing off transactions.
- Specific entitlement follows to beneficiary when later CGT is triggered.

***Bendel* – A Prediction**

- No Sub-Trust of income
- Gageler J view from *Fischer v Nemeske*
- Money had and received is next step => debt
- Or.... Was there no present entitlement?

Streaming

- Specific Entitlement
- Subdivision 115-C of the Income Tax Assessment Act 1997
- Entitlement condition
- Recording condition

Deceased Estates

- Concessional rates of tax under s99 rather than s99A for 3 years
- No Medicare levy
- Commissioner's discretion
- Based on stage of administration

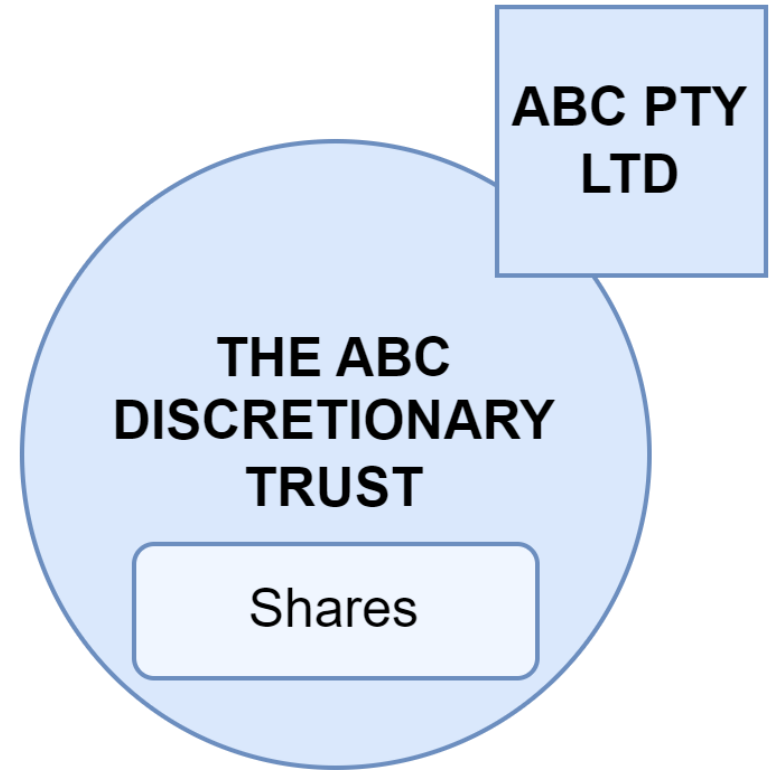
Deceased Estates

Stage of administration	Present Entitlement
Initial Stage	No beneficiary presently entitled
Intermediate Stage	Present entitlement only to extent of amounts actually paid to or on behalf of beneficiaries
Final Stage	Present entitlement to all

Based on IT 2622

The Vested Trust

- Trust from 1960's vested in 2020
- Sole asset is \$10M of shares in a holding company
- Negligible cost base
- \$5,000 liability to beneficiary who paid accounting fees of trust
- Accounts not up to date
- **CGT Event E5** occurred?



Beneficiary A

Trustee's Right of Indemnity - *Buckle*

- *“48. Until the right to reimbursement or exoneration has been satisfied, "it is impossible to say what the trust fund is". The entitlement of the beneficiaries in respect of the assets held by the trustee which constitutes the "property" to which the beneficiaries are entitled in equity is to be distinguished from the assets themselves. The entitlement of the beneficiaries is confined to so much of those assets as is available after the liabilities in question have been discharged or provision has been made for them. To the extent that the assets held by the trustee are subject to their application to reimburse or exonerate the trustee, they are not "trust assets" or "trust property" in the sense that they are held solely upon trusts imposing fiduciary duties which bind the trustee in favour of the beneficiaries.”*

Present Entitlement and Indemnity

- *Whiting - “Indeed, it is difficult to see how he can be entitled at all to income which must be applied in satisfaction of some prior claim: [...] until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities, and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries.”*
- Oswal – no absolute entitlement
- TR 2004/D25 - problematic
- Corporation Act is further impediment – *Carter Holt Harvey*

How to Distribute

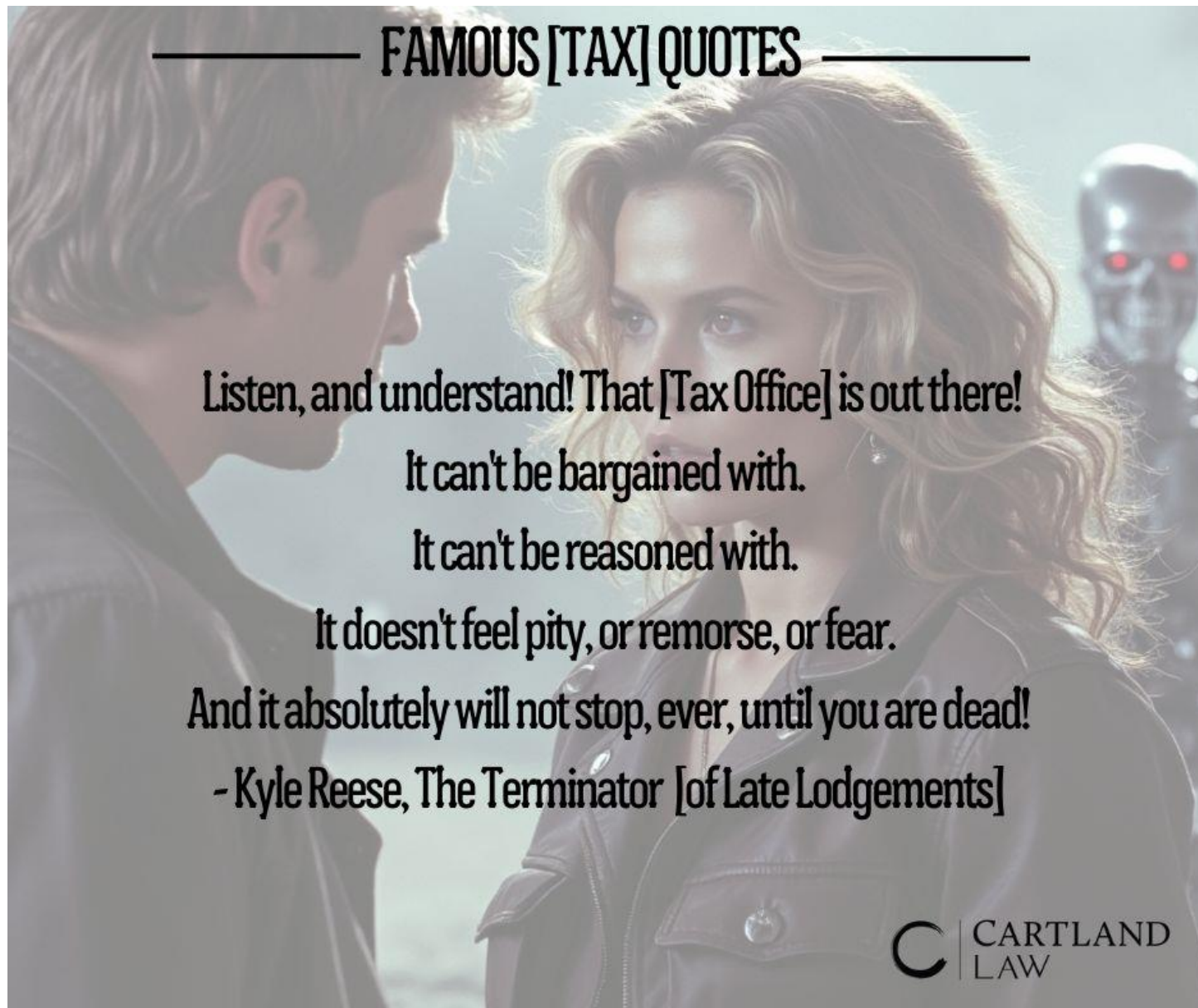
- *White v Shortall* if fungibles – could be a **CGT Event** over all shares
- Bank account is not cash – it is a *chose in action*
- “Pay” an amount to satisfy. E.g. promissory note
- Distribute “by way of” payment. Therefore, no debt/entitlement created
- Set aside an amount, or assets. Eg Speckled sheep - Jacob (Genesis 30:32)

The Distribution of a Brick

- Brick satisfies the UPE
- Or could make distribution “by way of” brick
 - acceptance confers tax liability
 - No further claims on trust
- E.g. Distribution of Units to satisfy UPEs to a loss Unit Trust



Taxinator says:



Thank you

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