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Trusts Distributions

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June 2011

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Overview

This presentation covers the following:

- Tax Laws Amendment (2011 Measures No.5) Bill 2011: Schedule 3 Interim changes to the taxation of trust income.
 - The provisions
 - Example calculations.

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Trust income changes

Full re write of the Division 6 provisions relating to the income of trusts deferred:

- TLA (2011 Measures No.5) Bill provides an interim measure for the 2011 year (and potentially beyond) and until the full changes are developed
- Bill currently before Parliament and uncertain if it will be passed before 30 June 2011
- Law and its interpretation still WIP – education bodies are only just rolling out presentations and what it means
- ATO issued guidance on 10 June to trusts to advise that although the changes are not yet law, the provisions are to apply to the 2010/2011 year and 'may' be relevant to resolutions made by 30 June
- Accordingly they recommend consideration of these provisions
- Note EM states low compliance costs expected!

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Trust income changes

Summary:

- Under the revised approach
 - Quantum approach for specifically entitled franked distributions and capital gains and allows for streaming of them
 - But note that for old deeds that do not include capital gains in the income of the trust or have a re-characterisation clause, the capital gain streaming provisions can be applied
 - Franked distributions need to be recognised under the deed to be streamed
 - Balance of income proportionate
 - Anti avoidance provisions for use of exempt entities
 - Compare to old law (ATO view) that all income assessed proportionately to all beneficiaries that are entitled to the income of a trust

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Trust income changes

- Amends Divisions 6 (ITAA36), Divisions 115-C and Subdivision 207-B (ITAA97)
- Inserts a new Division 6E into the ITAA36
- Three steps for franked distributions and capital gains to be streamed
 - Step 1 - Apply Division 6 as per previous practice
 - So still need positive trust law and tax law income
 - Streaming still needs to be permitted by the trust deed
 - Step 2 - Beneficiaries assessed on specifically entitled capital gains and franked distributions
 - Step 3 - Division 6E removes Step 2 amounts from the Division 6 amounts that are assessable to beneficiaries

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Trust income changes

- More detailed overview of the provisions
 - Capital gains and franked distributions (and the attached franking credits) that beneficiaries are **specifically entitled** to are streamed on a quantum basis, along with their tax attributes
 - Amounts to which no beneficiary is specifically entitled to will flow proportionately
 - Dividends will be reduced by **directly relevant expenses**
 - Capital gains and franked distributions on an item by item basis
 - Offset capital losses when determining capital gains – remembering the ability to choose which specific gains a loss will be offset against
 - Not able to treat franking credits separately or CGT discount
 - After adjusting for capital gains and franked distributions (net of directly relevant expenses), general expenses are offset against the other income and it is taxed proportionately

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Trust income changes

Problem areas

- Specific entitlement
- Directly relevant expenses
- Where taxable income is less than combined sum of capital gains and franked distributions

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Trust income changes

- Specific entitlement
 - Must receive the financial benefit (in amount)
 - Needs to be recorded in the accounts
 - Can group but essentially a distribution by distribution and capital gain by capital gain allocation
 - Refer examples on pages 25 and 26 of the EM
 - Cannot be specifically entitled to a deemed gain
 - Refer examples on pages 31 and 32 of the EM re clauses
 - Entitlement to an unspecified amount such as the balance of trust income, this is not sufficient (not the same as the balance of a defined capital gain or class of franked distribution)
 - Can create through a chain of trusts – need to apply provisions at each step in the chain

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Trust income changes

- Directly relevant expenses
 - Applies to franked distributions only
 - E.g. borrowing costs, portfolio management fees
 - If directly relevant expenses exceed income, cannot distribute (i.e. For negatively geared shares)
 - Note examples 2.4 and 2.5 on pages 29 & 30 of the EM

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Trust income changes

- Where taxable income is less than combined sum of capital gains and franked distributions
 - Will arise if say negative geared property or general expenses that are not directly relevant to capital gains or dividends
 - Approach is a rateable reduction of the franked distributions and capital gains so that the taxable amount is limited to the taxable income under the ordinary application of Division 6
 - Formula – multiply by
 - Taxable income of the trust (excluding franking credits)/(net capital gain of the trust + net franked distributions)

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Trust income changes

- Example (based on Example 2.26 facts from the EM)
 - Deed defines income as ordinary income plus net capital gains (specific example 2.29)
 - Net rent \$100,000 – no specific entitlement
 - Fully franked dividend of \$70,000, \$50,000 of direct expenses – Claire specifically entitled to the net dividend of \$20,000
 - Another fully franked dividend of \$70,000 – no directly relevant expenses and no specific entitlement
 - Discount capital gain of \$100,000 (after discount) –Ash specifically entitled to 50% of the discount gain
 - Non discount capital gain of \$100,000, offset by capital loss of \$50,000 – Bradshaw specifically entitled
 - Ash also entitled to another \$50,000
 - Dawson gets the balance (\$120,000)
 - Taxable income is \$400,000
 - Distributable income is \$340,000 (\$400,000 less \$60,000 franking credits)

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Trust income changes

- Example outcomes
 - Specifically entitled amounts – taxable income
 - Ash taxed on \$50,000 of discount gain
 - Bradshaw is taxed on a non-discount net capital gain of \$50,000
 - Claire is taxed on a net dividend amount of \$20,000 plus \$30,000 of imputation credits = \$50,000
 - Total taxable amounts so far = \$150,000
 - Leaves \$250,000 to be allocated (Other \$50,000 of discount gain, \$100,000 net rent and \$100,000 fully franked dividend) (Represent \$220,000 in trust income –difference is the franking credit)
 - Unallocated capital gains and dividends
 - Ash entitled to \$100,000 – so he has a 45.5% interest in the remaining items
 - Dawson is therefore entitled to \$120,000 = 54.5%

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Trust income changes

- Extra amount to allocate \$250,000 for tax
- Remaining discount gain of \$50,000
 - 45.5% to Ash = \$22,750
 - 54.5% to Dawson = \$27,250
- Remaining dividend \$100,000 (\$70,000 + \$30,000)
 - 45.5% to Ash = \$45,500 (\$31,850 + \$13,650)
 - 54.5% to Dawson = \$54,500 (\$38,150 + \$16,350)
- Now apply Division 6E
 - Initial Division 6 tax amount \$400,000
 - Less distributed dividends and capital gains \$300,000
 - Amount remaining \$100,000
- Ash gets 45.4% = \$45,400 (\$150,000 - \$72,750 - \$31,850 = \$45,400)
- Dawson gets 54.6% = \$54,600 (\$120,000 - \$27,250 - \$38,150 = \$54,600)

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Trust income changes

- Summary


	Ash	Bradshaw	Claire	Dawson
Dividend \$50,000			\$50,000	
Dividend \$100,000	\$45,500			\$54,500
Discount gain \$100,000	\$72,750			\$27,250
Net non discount gain \$50,000		\$50,000		
Net rent \$100,000	\$45,400			\$54,600
Total	\$163,650	\$50,000	\$50,000	\$136,350

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Questions



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