TAX TALKS

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324 | Default Beneficiary

A default beneficiary might save your trustee from paying top marginal tax rates on trust income and capital gains – without a 50% CGT discount.

Default Beneficiary

In the last episode – episode 323 – we spoke about missing trust distributions and how a default beneficiary can save the trustee from paying top marginal tax rates when you have no resolution to distribute the trust income.

In this episode let's look at the concept of default beneficiaries again. What makes a default beneficiary? What do they get and when? And does anybody pay any tax on the trust income if the default beneficiary's amendment periods for those years have already past? Or will that income never be taxed?

These are just some of the questions Paul Goldin of Vectigal Legal in Melbourne will discuss with you in this episode.

Here is what we learned. But please listen in as Paul explains all this much better.

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Default Beneficiary

To work out to what extent a beneficiary or trustee might pay tax on trust income, you run through these six steps:

1 – Does the trust deed list a default beneficiary?
2 – What do they get?
3 – Did the beneficiary accept the distribution or revoke it?
4 – Has the relevant tax return been lodged?
5 – What amendment period applies?
6 – Has the amendment period passed?

Let's go through these now step-by-step.

1 – Does the trust deed list a default beneficiary?

A trust prepares a tax return but doesn't pay any tax. Somebody else is to pay the tax. And this somebody is either a beneficiary who received the income or capital through a proper distribution. Or a default beneficiary. Or – if there is no default beneficiary – the trustee.

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As long as you have a valid distribution resolution, it doesn't matter whether the deed lists a default beneficiary or not. But when you don't, then it does.

Because without a distribution and without a default beneficiary the trustee gets assessed at 45% (plus 2% Medicare if the trustee is an individual) and – if a capital distribution – without a 50% CGT discount.

2 – What does the default beneficiary get?

The deed might list a default beneficiary for the capital upon vesting, for any capital distributions before vesting as well as any income distributions. It might not say 'default beneficiary' as such but use words like 'failure to act' or similar.

3 – Who gets assessed?

A default beneficiary can refuse the distribution, especially if they weren't the ones who got the actual payment. If you didn't get the cash, you surely don't want to pay tax on it.

But be careful that the default beneficiary didn't accept the distribution through their action. If you accepted the money or goods, then you can't revoke it and end up with assessable income. And this applies even if you thought they were a gift and didn't realise they were a trust distribution you have to pay tax on.

If the default beneficiary successfully revokes the distribution, then the trustee gets assessed on the capital and/or income. But if a 'normal' beneficiary rejects the distribution, then the other 'normal' beneficiaries get assessed in equal parts, unless of course there are no other beneficiaries. If the latter, the trustee gets assessed.

A 'normal' or default beneficiary might qualify for the 50% CGT discount. A trustee doesn't.

4 – Has the relevant tax return been lodged?

So now that you have established that a beneficiary or the trustee – depending who ends up with the assessable income – is to include the trust capital or income in their tax return, the next question is: Have those tax returns been lodged?

If they haven't, then no amendment period has started or ended and you don't need to worry about amendment periods.

However, if the corporate trustee hasn't lodged a return in its capacity as a trustee and just lodged a No-Return-Necessary notice ('NRN') – because that is what corporate trustees usually do – then no amendment period started as such. An NRN notice doesn't count as a trust return with assessable income. And hence doesn't trigger the start of the amendment period by law.

But there is PSLA 2015/2 (Law Administration Practice Statement), which deals with assessments. If the trustee lodges a NRN, the ATO has advised in PSLA 2015/2 that they will treat this as a return with assessable income.

However, the ATO has a history of revoking PSLAs, often retrospectively.

5 – What amendment period applies?

If you have lodged the tax returns, then the amendment period might save you.

The amendment period is two years for individuals and small business. And four years for large business and – this is important – potential trust beneficiaries. So for this scenario the amendment period is usually four years.

6 – Has the amendment period passed?

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If the amendment period hasn't passed, you need to amend. And pay tax on the assessable trust income.

But if the amendment period has passed, you can no longer amend. And hence might get out of paying tax on the trust income.

That is a very short summary of what we learned in this episode. But please listen in since Paul Goldin explains all this much better than we ever could.

MORE

Missing Trust Distributions

Losses Need an FTE

Testamentary Trust Law Change

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