TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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96 | Taxation of Trusts Div 6 ITAA36

The taxation of trusts mainly lives in the ‘old’ ITAA36. The plan was to re-write and reform Australia’s tax laws but this is yet to happen.

Taxation of Trusts Div 6 ITAA36

In the episode attached Paul Mackenroth of Cleary Hoare in Brisbane will walk you through the framework of Division 6. Here is a summary.

To listen while you drive, walk or work, just access the episode through a podcast app on your mobile phone.

s96 Trustee (Usually) Doesn’t Pay Income Tax

The basic idea of Div 6 is that the trustee doesn’t pay income tax on the trust’s taxable income. The beneficiaries do. But there are exceptions when the trustee does need to pay.

> *s96: Excepted as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon the income of the trust estate.*

s97 Presently Entitled Beneficiaries (Usually) Pay Income Tax

Whenever a beneficiary is presently entitled to a share of the income and not under a legal disability (minor, bankrupt etc), then the beneficiary is assessed on that income.

If the beneficiary is a resident, then the full amount is included in their assessable income. But a non-resident beneficiary only needs to include the portion that is attributable to Australian sources.

Presently Entitled

ITAA36 doesn’t define the term “presently entitled”. Instead all attempts to define the term refer back to *FCT v Harmer.*

Per *Harmer*, a presently entitled beneficiary has an interest in the income which is both vested in interest and vested in possession, and the beneficiary has a present legal right to demand and receive payment of the income.

s 101 Beneficiary deemed presently entitled upon trustee resolution

In a discretionary trust, a beneficiary is deemed to be presently entitled the moment the trustee exercises their discretion and allocates an amount to that beneficiary.

> *s101: …Where a trustee has a discretion to pay or apply income of a trust estate to or for the benefit of specified beneficiaries, a beneficiary in whose favour the trustee exercises the trustee's discretion shall be deemed to be presently entitled to the amount paid to the beneficiary or applied for the beneficiary's benefit by the trustee in the exercise of that discretion.*

s 95A (1) Payment Makes No Change to Present Entitlement

Where a beneficiary is presently entitled to any income of the trust estate, the beneficiary continues to be presently entitled regardless of whether the amount is paid or applied for the beneficiary.

s 95A (2) Deemed presently entitled when Vested and Indefeasible Interest

Where a beneficiary has no present entitlement, but a vested and indefeasible interest in any of the income of a trust estate, the beneficiary is deemed to be presently entitled to that income of the trust estate.

Timing of Present Entitlement

Timing plays a big role when it comes to making beneficiaries presently entitled. It used to be a lot more laissez-faire. There used to be a 2 months grace period. And you could ask for the Commissioner's discretion. But all that went through the window with *Harmer v FCT* (1991), *BRK (Brisbane)* (2001), Ramsden v FCT (2004) and *Colonial First State Investments v FCT.*

Since *Colonial First State Investments v FCT*, a beneficiary can only be presently entitled to income which the trustee has appointed in the beneficiary's favour prior to the year end

Income of the trust estate

The law doesn't actually define 'income of the trust estate'.

In *Bamford's* case it was given its ordinary meaning by the general law of trusts and the trust deed.

According to *FCT v Totledge Pty Ltd* income of the trust estate is the net amount after subtracting all expenses on revenue account from income on revenue account.

Distributable Income

A beneficiary can only be presently entitled to income which is legally, ie according to trust law, available for distribution to the beneficiary. This is the case even when at the relevant time it may not actually be in the trustee's hands for distribution.

If expenses on revenue account exceed income on revenue account then there will be no distributable income.

Most modern trust deeds now include an income equalisation clause.. Also called 's95 clause', this clause 'equalises' trust and net income.

s 97 "So much of that share"

s97 talks of 'so much of that share'. But for a long time it was not clear whether this meant a quantum or proportionate approach. But the proportionate approach prevailed. We have to thank *Bamford v FCT* and *Zeta Force Pty Ltd v FCT* for that.

Now a beneficiary includes “so much of that share” of taxable income in their assessable income as they receive distributable income.

s95 Definition of “net income of the trust estate”

s95 defines net income. Net income means

> *s95: …the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions,*
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> *except deductions under Division 393 of the Income Tax Assessment Act 1997 (Farm management deposits) and except also, in respect of any beneficiary who has no beneficial interest in the corpus of the trust estate, or in respect of any life tenant, the deductions allowable under Division 36 of the Income Tax Assessment Act 1997 in respect of such of the tax losses of previous years as are required to be met out of corpus*

Distributable v Net Income

Distributable trust income and taxable net income are not always the same. In fact, without a s95 clause they are rarely the same.

Non-deductible expenses and timing differences around depreciation and employee entitlement provisions are examples that trigger a difference.

Example

The trust has distributable trust income of $1m. It distributes $500,000 to the bucket company, $300,000 to Sally and $200,000 to Peter. So the bucket company gets 50%, Sally gets 30% and Peter gets 20%.

The allocation of net income will follow these proportions, no matter what the net income actually is.

MORE

50% Stake Test

Pattern of Distributions Test

Are Unit Trusts Fixed