CPA AUSTRALIA TRUST STREAMING GUIDE

CPA AUSTRALIA

TABLE OF CONTENTS

1. BACKGROUND

The purpose of this guide is to ensure that practitioners are aware of all the practical and legal requirements that must be satisfied where the trustee of a discretionary trust in Australia wishes to 'stream' capital gains and franked dividends (and accompanying franking credits) to eligible beneficiaries.

Broadly, the streaming of a capital gain is potentially attractive where the recipient beneficiary can apply their own capital losses (or the CGT discount and/or the 50% small business CGT active asset reduction) to reduce the allocated capital gain.[2] For instance, it would be preferable to stream a capital gain of $100,000 to an individual beneficiary with a capital losses of $100,000 rather than include it in trust income where it is distributed to four presently entitled beneficiaries who do not have such losses, and who will pay tax on their $25,000 share of the net capital gain distributed.

Similarly, the streaming of franked dividends may be attractive if they can be distributed to those beneficiaries who are able to most optimally utilise such credits (subject to various integrity rules being met). For example, a trustee of a discretionary trust may only direct franked dividends to resident beneficiaries on the basis that non-resident beneficiaries cannot obtain the full benefit of the franking credits.

Whilst the concept of streaming capital gains and franked dividends appears to be relatively straightforward its application in practice can often be complicated and lead to potentially anomalous results.

This complexity largely arises because streaming is a statutory concept requiring a trustee to make a beneficiary specifically entitled to a share of a capital gain or franked dividend derived by a trust under prescriptive tax rules.[3]

Firstly, a beneficiary who is made specifically entitled to a capital gain or franked dividend (and attached franking credit) will be directly assessed on such amounts under Subdivision 115-C of the Income Tax Assessment Act (1997) (the ITAA (1997)) and Subdivision 207-B of the ITAA (1997) provided all the pre-requisites to streaming such amounts are satisfied.

Secondly, to the extent that there is an amount of a capital gain or franked dividend that has not been allocated to specifically entitled beneficiaries such amounts will also be respectively assessed to beneficiaries under Subdivision 115-C of the ITAA (1997) and Subdivision 207-B of the ITAA (1997). Such accessibility will be based on their present entitlement to trust income (excluding any capital gain or franked dividend distributed to specifically entitled beneficiaries). That is, any residue of a capital gain or franked dividend which is not allocated to specifically entitled beneficiaries will be directly assessed to beneficiaries as a capital gain or franked dividend based on their present entitlement to trust income (which is calculated excluding any specifically entitled capital gains and franked dividends).

[1] For the purposes of this factsheet the expression a 'discretionary trust' refers to a trust where the trustee has a discretion concerning the distribution of trust income and capital under the trust deed. The principles set out in this guide can also be potentially modified or adapted to apply to a 'hybrid trust' where the trust combines characteristics of being both a discretionary trust and a fixed trust and the trustee has some discretion regarding the distribution of trust capital gains or franked dividends under the trust deed.

[2] The streaming of capital gains on non-taxable Australian property to non-resident beneficiaries of discretionary trusts to free those gains from tax is not regarded as tax effective by the ATO.

[3] Prior to the High Court's decision in Commissioner of Taxation v Bamford; Bamford v Commissioner of Taxation (2010) HCA 10 it was generally accepted that a trustee could stream different classes of trust income for tax purposes where permitted under the trust deed and certain other conditions were satisfied. However, the effect of the High Court's decision in the Bamford case was that the proportionate share of a beneficiary in the net income of a trust was to be determined on the basis of the whole of trust income blended together and not its individual components. Accordingly, one of the impacts of the decision was that individual classes of income could not be streamed for tax purposes in the absence of specific legislation enabling that to occur. This position was subsequently confirmed by the Full Federal Court in FCT v Greenhatch (2012) FCAFC 84. Accordingly, legislated streaming rules allowing a trustee of a discretionary trust to make a beneficiary specifically entitled to capital gains and franked dividends were introduced following the enactment of the Tax Laws Amendment (2011 Measures No. 5) Act 2011 being the only classes of income which can be potentially streamed for tax purposes effective from 1 July 2010.

Accordingly, **all** of the capital gains and franked dividends (and attached franking credits) will be directly assessed to beneficiaries as a capital gain and franked dividend (and franking credit) under Subdivisions 115-C and 207-B of the ITAA (1997) respectively, even where only part of such gains and dividends are streamed to specifically entitled beneficiaries.

Division 6E of the Income Tax Assessment Act (1936) (the ITAA (1936)) subsequently applies to exclude such directly assessed capital gains and franked dividends (and attached franking credits) from both the income of the trust estate (i.e. distributable income) and the trust's net income (i.e. taxable income) calculated under section 95(1) of the ITAA (1936).

Following these adjustments a beneficiary's present entitlement to 'Division 6E income' has regard to the amount of trust income derived by the trust excluding capital gains and franked dividends (and franking credits) directly assessed to beneficiaries. Likewise, the adjusted 'Division 6E' net income is calculated on the basis that the capital gain and franked dividends (and franking credits) directly assessed to beneficiaries is excluded from the calculation of the trust's taxable income.

Accordingly, the operation of Division 6E of the ITAA (1936) has the effect that capital gains and franked dividends (and related franking credits) assessed to beneficiaries are not subject to double taxation when trust income is distributed to presently entitled beneficiaries.

Importantly, where no beneficiary has been made specifically entitled to a capital gain or franked distribution, and no beneficiary has been made presently entitled to the income of the trust estate, or there is no trust income, the trustee will by default be assessed on any capital gain or franked dividend (and franking credit) derived by the trust as well as any other sources of net income.

This fact sheet seeks to explain the eligibility conditions that must be met before a trustee can apply the streaming rules as well as the practical impact of making certain beneficiaries specifically entitled to capital gains and franked dividends. In particular, it addresses the following key considerations which should be taken into account by any trustee in applying these rules:

- The general eligibility conditions that must be satisfied by a trustee of a discretionary trust in making a beneficiary specifically entitled to either a capital gain or franked dividend as prescribed under Subdivisions 115-C or 207-B of the ITAA (1997); and
- The practical application of the respective streaming rules where a beneficiary has been made wholly or partly specifically entitled to a capital gain or franked dividend. This discussion also illustrates the application of Division 6E of the ITAA (1936) which disregards specifically entitled amounts in calculating trust income and net income under Division 6E, and explains how amounts are assessed to presently entitled beneficiaries as a result of applying Division 6E.

Each of these factors is discussed further in the commentary below.

A sample trustee resolution and numerous examples illustrating the application of the specific entitlement provisions (and their interaction with the present entitlement rules) are provided throughout the guide.

Finally, there is a trustee streaming checklist at the end of the materials which lists the issues that a trustee should consider before making resolutions distributing capital gains and franked dividends to specifically entitled beneficiaries.

TAX TIP

The specific entitlement rules discussed below adjust many of the rules that apply to the taxation of trust income to presently entitled beneficiaries. Accordingly, it may be prudent for a trustee (and their adviser) to refer to CPA Australia's Trustee Resolution Factsheet before reviewing this guide if they are not familiar with the general rules that apply to the taxation of trusts under Division 6 of the ITAA (1936). This may be important as the Trustee Resolution Factsheet explains various core concepts that apply where a beneficiary of a discretionary trust is made presently entitled to a share of trust income (and thus is assessed on a proportional share of a trust's net income).

TAX TIP

Use of the streaming provisions is not mandatory. A trustee may instead choose to proportionally distribute capital gains and franked dividends amongst eligible beneficiaries. For example, the trustee of a trust with net income comprising rental income, capital gains and trading profits may elect to distribute the overall trust income proportionally amongst all beneficiaries in which case each beneficiary would receive their proportionate share of each class of income of the trust income (i.e. rental income, capital gains and training profits).

2. GENERAL ELIGIBILITY CONDITIONS

Broadly, for a capital gain or franked dividend to be streamed both of the following eligibility conditions must be satisfied:

- The terms of the trust deed must allow the trustee to make a beneficiary specifically entitled to a capital gain or franked dividend and attached franking credit (or at least not prohibit the making of such a distribution);
- A beneficiary must be made specifically entitled to a share of a capital gain or franked dividend. For this to occur the beneficiary must receive, or reasonably be expected to receive, the net financial benefit of the capital gain or franked dividend which must also be recorded in its character as a capital gain or franked dividend in the records of the trust. Where multiple beneficiaries receive such specific entitlements each must be apportioned their particular share of the capital gain or franked dividend.

The practical steps in complying with each of these requirements is explained in the commentary below.

2.1 Streaming permitted under the trust deed

As an initial step the trustee should determine whether specific powers are contained in the trust deed which would enable a trustee to identify, classify and account for different classes of trust income separately, and to distribute those classes of income separately to particular beneficiaries.

Preferably such powers should be expressly provided to the trustee under the terms of the trust deed.[4]

Where the trustee is unsure as to whether streaming powers are granted under the deed it would be appropriate for the trustee to obtain legal advice.

Alternatively, if such powers are not available to the trustee under the trust deed, the trustee may potentially consider amending the trust deed to include such a streaming power provided the insertion of such of clause is validly made pursuant to the exercise of an existing power of amendment under the trust deed.

Taxation Determination TD 2012/21 confirms that such an amendment will not trigger adverse capital gains tax (CGT) issues under either CGT event E1 or E2 provided that the variation does not terminate an existing trust, or cause trust assets to be held on a separate charter of rights and obligations which would lead to the conclusion that the assets are now held on a different trust.[5]

EXAMPLE

The Parker Family Trust is a discretionary trust settled in 1990 to benefit the members of the Parker family. The trust deed for the Parker Family Trust does not contain a provision expressly permitting the trustee of the trust to stream capital gains and franked dividends. However, clause 10 of the trust deed provides the trustee with an unrestricted power to amend the trust deed. Accordingly, the trustee resolves to amend the deed by inserting a separate clause allowing streaming under new clause 6A of the deed as clause 10 of the deed allows the trustee to validly amend the deed to insert such a power. As such an amendment does not terminate the existing trust or cause trust property to be held on behalf of specific beneficiaries under a separate charter of rights and obligations the amendment does not constitute a resettlement for CGT purposes.

[4] Refer to sections 115-228(2)(a) and 207-58(2)(a) of the ITAA (1997) which respectively provide that making a beneficiary specifically entitled to a capital gain or franked dividend may be done pursuant to the exercise of a power under the terms of the trust deed.

[5] Refer to Example 3 of Taxation Determination TD 2012/21 which sets out when a streaming clause may be inserted into a trust deed following a valid amendment of the trust deed.

WARNING

Whilst Taxation Determination TD 2012/21 provides comfort that the insertion of a streaming clause in a trust deed under a valid power of amendment will not generally trigger adverse CGT issues on a resettlement, care must be undertaken before inserting such a clause into a deed to ensure that such an amendment is validly made and that it does not create any adverse stamp duty or trust law issues. Accordingly, it is strongly recommended that a trustee (and their adviser) consult with a trust lawyer to obtain appropriate legal advice before any such amendment is made.

Alternatively, a streaming power may be potentially implied if the trust deed empowers the trustee to distribute income or capital at their absolute discretion and there is nothing further in the trust deed, or trust law in the relevant jurisdiction, that limits that power.[6]

It should be stressed that there is no case law specifically considering the application of such an implied power in the context of the prescribed specific entitlement rules.

Moreover, in practice it may often be difficult to satisfy such an implied power as it will be necessary to review the entire terms of the trust deed to ensure that the trustee has an absolute and unrestricted ability throughout the trust deed to distribute income and capital to specific beneficiaries. From a practical perspective such a review is often highly time-consuming and difficult especially in relation to older trust deeds written in 'legalese' which non-lawyers may find difficult to understand.

EXAMPLE

Clause 3(1) of the trust deed for the Davies Family Trust provides that the trustee shall determine the income of the fund in each accounting period, and pay, apply or set aside all or any part of the income of the trust for any of the general beneficiaries living at the time of that determination. Clause 3(2) of the deed further provides the trustee has a complete discretion as the making of any such determination, and is not required to justify the making of such a determination. Clause 6 of the trust deed also states that the trustee may at its absolute discretion raise any sum and pay that amount out of the capital of the trust fund in addition to any entitlement to income of any of the general beneficiaries. As the trust deed did not contain any other restriction on the capacity of the trustee to distribute either income or capital it could be potentially inferred that there was an implied power to stream income and capital under the trust deed.

[6] Refer to sections 115-228(2)(b) and 207-58(2)(b) of the ITAA (1997) which appear to support the view that a specific entitlement may be made under an implied power if it is made in accordance with the terms of the trust deed and the rules of equity. This would appear to apply to circumstances where there is nothing in the trust deed or the trust law which would prevent a beneficiary being made specifically entitled to a capital gain.

WARNING

Where a trustee or their practitioner is concerned as to whether there is an implied power to stream under a trust deed it would be prudent to refer the trustee to a specialist trust lawyer to ensure that such an implied power exists, and that there are no rules under the applicable State and Territory trust law which would limit the exercise of such a power.

2.2 Making a beneficiary specifically entitled

Where the trustee has a power to stream under the trust deed a beneficiary can be made specifically entitled to the amount of the streamed capital gain or franked distribution provided both of the following conditions are met:

- The beneficiary must receive, or reasonably be expected to receive, an amount equal to the net financial benefit referable to the capital gain or franked dividend to which they have become specifically entitled; and
- The trustee must record the beneficiary's entitlement to the net financial benefit in its character as a capital gain or franked dividend in the accounts or records of the trust.

If these conditions are both met the beneficiary will be assessed on their allocated share of the streamed capital gain or franked dividend which reflects the fact that multiple beneficiaries may be made specifically entitled to a share of a streamed gain or dividend. Each of these requirements is discussed below.

2.2.1 Receive or reasonably expect a net financial benefit

As discussed, it is a prerequisite of the streaming provisions that the beneficiary made specifically entitled to a capital gain or franked dividend receive, or be reasonably expected to receive, the net financial benefit of the capital gain or franked dividend.[7]

A beneficiary will be taken to receive an amount when it has been paid, credited or otherwise distributed to them (including under a re-investment agreement), or it is paid or applied on their behalf or for their benefit.

The 'net financial benefit' received is the financial benefit of the capital gain or franked dividend where the relevant gain or dividend is respectively reduced by certain capital losses or directly relevant expenses.

In this context a financial benefit means anything of economic value.[8] In the case of a capital gain the actual sale proceeds a trustee receives from a CGT event constitutes a financial benefit. Conversely, in the case of a franked dividend the distribution is itself a financial benefit.

A beneficiary's share of the net financial benefit referable to a streamed capital gain will be the amount of the gross capital gain calculated for trust law purposes reduced by trust capital losses, (but only to the extent corresponding capital losses are applied against the capital gain in calculating the net capital gain for tax purposes).[9]

Accordingly, where there is no such capital losses the amount of the streamed capital gain will be the gross amount of the capital gain recognised for trust law purposes.

[7] Refer to sections 115-228(1) and 207-58(1) of the ITAA (1997) which respectively impose this requirement in making a beneficiary specifically entitled to a capital gain or franked dividend.
[8] Refer to the definition of financial benefit in section 974-160 of the ITAA (1997).
[9] This requirement is specified under the definition of 'net financial benefit' in section 115-228(1) of the ITAA (1997).

EXAMPLE

During the year ended 30 June 2020 the Zhao Family Trust sold property at a capital gain of $250,000 as well as shares held as an investment for a capital loss of $40,000. The capital gain and loss recognised in the trust accounts and in the income tax return were calculated on the same basis. The net financial benefit relating to the sale of the property by the trustee of the Zhao Family Trust available for streaming is $210,000 being the $250,000 capital gain made by the trust on the property sale less the $40,000 capital loss on the disposal of the shares. This calculation is consistent with the equivalent CGT treatment which requires the capital loss of $40,000 to be applied against the capital gain derived of $250,000 as required under the method statement used to calculate the trust's net capital gain of $210,000. If, however, the trust made another capital gain on a different property of $60,000 (not eligible for the CGT Discount) and for tax purposes offset the $40,000 loss against it rather than against the $250,000 gain, then it would be necessary to confer on a beneficiary a financial benefit of the full amount of$250,000 to tax effectively stream the gain on that asset to the beneficiary.

TAX TIP

The amount of the capital gain allocated to a specifically entitled beneficiary must be based on the gross capital gain for trust law purposes (reduced by trust capital losses if applicable). Accordingly, it is not possible to separately stream a discounted capital gain based on its tax characteristics so that the taxable portion of the gain is specifically allocated to one beneficiary whilst the portion of the gain sheltered from tax is solely distributed to another beneficiary.

WARNING

No trust capital gain can be streamed if it is fully reduced by trust capital losses as the value of the net financial benefit will be nil.

TAX TIP

As the financial benefit received in respect of a capital gain must be linked to the actual sale proceeds it is not possible to stream a 'tax-only' capital gain which only arises because of the application of the CGT market value substitution rules which either creates or increases a capital gain albeit for CGT purposes only.[10]

[10] A notional capital gain could arise where the trust gifts an asset to a related party for nil consideration and the disposal of the asset is taken to have been made at its market value applying section 116-30 of the ITAA (1997).

When determining a beneficiary's share of the net financial benefit referable to a streamed franked dividend the gross financial benefit of the dividend must be reduced by 'directly' relevant expenses.[11]

As a corollary there is no requirement to apportion general expenses (e.g. accounting fees) amongst different classes of income so that a pro rata amount of such general expenses is offset against dividend income.

The term 'directly relevant expenses' is not defined for these purposes. Accordingly, it is a question of fact as to what expenses were 'directly' incurred in deriving the franked dividend. However, in practice directly related expenses are typically limited to interest paid on funds borrowed to acquire the shares on which the dividend has been paid.

EXAMPLE

The Richardson Family Trust received a fully franked dividend of $15,000 on its shares in HAL Ltd for the year ended 30 June 2020. However, it had borrowed funds of $200,000 under an interest only loan at a rate of 8.5% per annum to acquire such shares resulting in a $17,000 interest expense. In these circumstances there is no net financial benefit as the amount of the fully franked dividend of $15,000 has been fully extinguished by the directly related interest expense of $17,000.

WARNING

No franked dividend can be streamed on a shareholding if it is fully negatively geared as the net financial benefit of the franked dividend will be nil.

To overcome this limitation it is possible to pool all franked dividends received by a trust during a year to ensure that all of the trust's franked dividends are treated as a single class of franked dividend for the purposes of determining the net financial benefit of any streamed franked dividend.[12]

Accordingly, for these purposes a beneficiary can be made specifically entitled to all of the net franked distributions of trust for a particular year (or a share thereof). As a corollary, the amount of any directly related expenses would need to be offset against the total of all franked dividends in working out the net financial benefit of such a franked dividend.

Moreover, upon distributing such a pooled franked dividend the beneficiary receiving the single class of streamed franked dividends would receive the full benefit of any franking credits attached to those franked dividends as it is only the amount of the franked dividend which is reduced by the directly relevant expenses such as interest not the related franking credits.

[11] This requirement is specified under the definition of 'net financial benefit' in section 207-58(1) of the ITAA (1997).

[12] Section 207-59 of the ITAA (1997) set out the conditions that must be satisfied for franked dividends to be treated as a single franked dividend.

EXAMPLE

Assume the same facts as above example except that the Richardson Family Trust also derived a fully franked dividend on its shares in ESA Ltd of $7,000 for the year ended 30 June 2020, and that it did not incur any interest expense in respect of this shareholding. Accordingly, the Richardson Family Trust would treat the $15,000 franked dividend from HAL Ltd and the $7,000 franked dividend from ESA Ltd as being a single class of franked dividend totalling $22,000 for the year ended 30 June 2020.

The interest expense incurred of $17,000 would then be applied against a gross pooled financial benefit of $22,000 in calculating the net financial benefit of the pooled franked dividend being $5,000.

Accordingly, upon the trustee of the Richardson Family Trust making Greg specifically entitled to the single class of all franked dividends he will be entitled to the benefit of all the franking credits that attach to those franked dividends. As neither HAL Ltd or ESA Ltd are base rate entities the attached franking credits will total $9,429 being the sum of the franking credit of $6,429 (i.e. $15,000 X 30/70) for HAL Ltd and the franking credit of $3,000 for ESA Ltd (i.e. $7,000 X 30/70).

TAX TIP

The terms of the trust deed may expressly allow the trustee to differentiate dividends that have been franked from those that have not been franked. In these circumstances, reference must be made in the trustee resolution to any specific clause in the deed allowing the streaming of 'franked' dividends.

WARNING

Following the High Court's unanimous decision in FCT v Thomas and Ors (2018) HCA 31 it is now settled that a trustee cannot stream differential amounts of franked dividends and franking credits under trustee resolutions.

As discussed, a net financial benefit of a capital gain or franked dividend can also arise where the beneficiary can be reasonably expected to derive the net financial benefit allocated in the future.

Some examples of where a beneficiary may reasonably be expected to receive a financial benefit include the following:

- The beneficiary has a present entitlement to the amount;
- The beneficiary has a vested and indefeasible interest in trust property representing the amount;
- The amount is set aside exclusively for the beneficiary; and
- The trustee has resolved to pay a gain made on an asset under a proposed sale.

In addition, Taxation Determination TD 2012/11 provides that in certain circumstances a specifically entitled beneficiary can be reasonably expected to receive a share of a net financial benefit referable to a capital gain where a contract is entered into for the disposal of an asset in a particular tax year which will only settle on various conditions being satisfied after year-end in the subsequent tax year.

Thus, if a trustee enters into a binding contract to sell shares on 1 May 2020 which will only settle on various conditions being subsequently met on 1 September 2020, the trustee can potentially resolve to distribute all of the prospective net financial benefit relating to the capital gain in the year ended 30 June 2020 on the reasonable expectation that the gain will arise on settlement.

TAX TIP

In referring to the net financial benefit for the capital gain or franked dividend received by the trustee there is no requirement that the funds representing that gain or dividend must be traced back to the actual proceeds received for the CGT event or the dividend. These gains or dividends can be reinvested by the trustee during the year. However, the beneficiary must receive, or be reasonably expected to receive, an amount equivalent to such amounts.

2.2.2 Recording a beneficiary's specific entitlement

The next step in making a beneficiary specifically entitled is that the amount of the net financial benefit that the beneficiary receives, or is reasonably expected to receive, must be recorded in its character as referable to the capital gain or franked dividend in the accounts or records of the trust.

A valid written resolution which the trustee completes prior to year-end in accordance with the terms of the trust will be regarded as a record of the trust for this purpose. Records which are merely created for internal tax purposes will not be regarded as trust records for these purposes.

In practice, the trustee resolution should:

- Identify the clause in the trust deed that enables the streaming of the capital gain or franked dividend (net of any applicable trust capital losses and directly relevant expenses);
- Effect a distribution referable to the amount of the net financial benefit to specified eligible beneficiaries; and
- State that the amount of the distribution to the beneficiary is of an amount in its character as a capital gain or franked dividend.

The trust ledgers should then reflect the required book entries in the accounts.

The following resolutions would satisfy the requirement of being appropriately recorded for the purposes of recording the character of the applicable gain or dividend:

- Under the trust deed, a beneficiary is entitled to all of the capital gains of the trust;
- The trustee resolves to distribute all of the dividends of the trust to a beneficiary;
- Under a trust deed that includes capital gains as income (either by default or because the trustee exercises a power to re-characterise the amount as income), a beneficiary is entitled to all of the profits made on or derived from the sale of an asset; and
- Under a trust deed that does not include capital gains as income, the trustee resolves to advance capital representing profits from the sale of an asset equally to the beneficiaries.[13]

However, a specific entitlement will not arise where a beneficiary is merely made entitled to unspecified amounts such as, say, the balance of trust income or half of the trust income.

EXAMPLE

Margaret as the trustee of the Jeffreys Family Trust resolves on 29 June 2020 to distribute a net financial benefit attributable to a gross capital gain of $500,000 derived on the sale of a holiday home under clause 8 of the trust deed to her daughter Vanessa who is an eligible beneficiary of the trust. The amount of such a gross capital gain does not need to be reduced as the trust does not have any capital losses for tax and trust purposes. The resolution also clearly refers to the distribution being made in its character as a capital gain which will be paid directly to Vanessa in accordance with the terms of the trust.

[13] Refer to paragraph 2.64 of the Explanatory Memorandum accompanying Tax Laws Amendment (2011 Measures No. 5) Act 2011.

WARNING

The trust deed must allow a trustee to apply capital losses and directly relevant expenses in reducing a capital gain or franked dividend which is to be distributed to specifically entitled beneficiaries. Reference to any clause under the deed which allows such amounts to be offset should be included in the trustee resolution.

A trustee making a beneficiary specifically entitled to a capital gain must be recorded in that character in the trust's records by 31 August in relation to the preceding 30 June year-end.[14]

By contrast a trustee making a beneficiary specifically entitled to a franked dividend must be recorded in the trust's records by end of the income year (typically 30 June) in which the trustee makes a distribution of the franked dividend.[15]

Whilst this appears to provide additional time to make a beneficiary specifically entitled to a capital gain vis a vis a franked dividend it would be prudent to ensure that a trustee resolution making beneficiaries specifically entitled be completed by 30 June each year (or any earlier date required by the trust deed) regardless of whether it is a capital gain or franked dividend which is being distributed. This process will ensure that such distributions are both appropriately considered at the same time that beneficiaries are made presently entitled to other sources of trust income.

Moreover, it will be essential for such a trustee resolution to make a beneficiary specifically entitled to a capital gain by the end of the income year where there is an income equalisation clause defining the income of the trust estate to be the same as its net income calculated under section 95(1) of the ITAA (1936).

Where such a clause applies any net capital gain will be included in the calculation of the trust's net income and will therefore be considered to be part of the income of the trust estate to the extent of the assessed net capital gain.

Accordingly, where beneficiaries are made presently entitled to all of the trust income by 30 June (or any earlier date under the trust deed) those beneficiaries will be distributed all of the net income of the trust for that year (including any assessable net capital gain) by virtue of the income equalisation clause.

In these circumstances there will be no remaining capital gain available to stream to another beneficiary at 31 August since the assessable net capital gain will have been effectively distributed in accordance with the allocation of net income to presently entitled beneficiaries at the preceding 30 June year-end pursuant to the income equalisation clause.

[14] See section 115-228(1) of the ITAA (1997).

[15] See section 207-58(1) of the ITAA (1997).

EXAMPLE

Example: Clause 3(1) of the trust deed for the Russo Family Trust defines the income of the trust to take its meaning from the definition of net income as calculated under section 95(1) of the ITAA (1936).

On 1 December 2019 Maria as the trustee of the Russo Family Trust sold the goodwill of the trust's pharmacy business and derived a gross capital gain of $300,000 which was included in the income of the trust for the year ended 30 June 2020. The trust also derived net rental income of $200,000 for the 2020 year.

On 30 June 2020 Maria made her children Marco and Luca presently entitled to 50% of the trust income for the year ended 30 June 2020 resulting in an income distribution of $250,000 each. As Marco and Luca had been made presently entitled to all of the trust income on 30 June 2020, there was no capacity for Maria as trustee to make any beneficiary of the trust specifically entitled to the gross capital gain of $300,000 on 31 August 2020 as it was effectively fully distributed to Marco and Luca as presently entitled beneficiaries on 30 June 2020.

Accordingly, if Maria had wanted to, say, make Marco specifically entitled to all of the capital gain of $300,000 this should have occurred by 30 June 2020 before she made Marco and Luca both 50% presently entitled to the balance of trust income which would have been limited to the net rental income of $200,000 had such a specific entitlement be made.

WARNING

When creating a specific entitlement of the beneficiary to a capital gain it is necessary to identify the specific gain which is being streamed as the specific entitlement rules apply on a per asset basis whereas the distribution of a specific entitlement to a franked dividend can be potentially dealt with as a single item being a pooled franked dividend.

TAX TIP

It should be noted that in certain circumstances the trustee of a resident trust may elect to be assessed on a capital gain.[16]

This could especially arise in relation to a resident testamentary trust where the life tenant has no entitlement to capital but may be potentially assessed on a capital gain, and the remainder man under such a trust has no immediate right to be distributed trust capital.

In these circumstances the trustee may take the view that it would be more equitable for the trustee to fund the payment of tax rather than either the life tenant or remainder man.

Where such an election is made the trustee will be deemed to be specifically entitled to the capital gain which will be reduced under the CGT Discount and typically assessed at individual marginal tax rates under section 99 of the ITAA (1936) assuming the Commissioner does not consider it reasonable to do so.

It is a pre-requisite to the operation of the election that no part of the capital gain is paid to or applied for the benefit of a beneficiary within two months after the end of the income year in which the capital gain arose as the trustee must be assessed on all of the capital gain.

[16] Refer to section 115-230 of the ITAA (1997).

A sample trustee resolution under which the trustee makes different eligible beneficiaries specifically entitled to a capital gain and franked dividends received by the trust is attached as Appendix 1.

2.2.3 Allocating each beneficiary's specific entitlement

A beneficiary will be assessable on capital gains and franked dividends based on their share of the financial benefit being the proportion of the financial benefit allocated to them.

Accordingly, to work out the amount of the beneficiary's specific entitlement to a capital gain or franked dividend it is necessary to determine the amount of the total financial benefits referable to the capital gain (reduced by any trust capital losses) or franked dividend (reduced by any directly relevant expenses).

Where a single beneficiary is made specifically entitled to a particular capital gain or to a franked dividend all of the net financial benefit attributable to the gain or dividend will be streamed to that particular beneficiary.

On the other hand where multiple beneficiaries are made specifically entitled to the relevant capital gain or franked dividend it will be necessary to determine the pro rata entitlement of each of those beneficiaries to the net financial benefits attributable to the relevant capital gain or franked dividend.

3. APPLYING THE STREAMING RULES

As discussed, where a beneficiary is made specifically entitled to all of a capital gain or franked dividend (and accompanying franking credits) the beneficiary will directly include such assessable amounts in their own income tax returns pursuant to Subdivisions 115-C and 207-B of the ITAA (1997).

Division 6E of the ITAA (1936) then applies to exclude such directly assessed capital gains and franked dividends[17] from the amount of trust income available for distribution by the trustee to presently entitled beneficiaries. Similarly, the net income (i.e. taxable income) of the trust is adjusted to exclude the amount of such allocated capital gains and franked dividends (and attached franking credits).

Like many tax concepts the operation of these rules can become quite complicated when applied in practice, and there are multiple steps which need to be considered in calculating a beneficiary's specific entitlement and the related adjustments required to be made under Division 6E.

In particular, the calculation of any directly assessed capital gain or franked dividend under Subdivisions 115-C and 207-B of the ITAA (1997) becomes additionally complicated where a beneficiary is only made specifically entitled to only part of the relevant gain or dividend.

In these circumstances a beneficiary made specifically entitled to part of the gain or dividend will continue to be directly assessed on such amounts.

However, an extra capital gain or franked dividend will also be allocated to presently entitled beneficiaries. Essentially, the amount allocated is the beneficiary's present entitlement to trust income (excluding any capital gain or franked dividend to which the beneficiary is specifically entitled) divided by the trust income (excluding the amount of any streamed capital gain or franked dividend to which any beneficiary is made specifically entitled).

The amount of the extra capital gain or franked dividend attributed to such presently entitled beneficiaries is then also adjusted under Division 6E of the ITAA (1936) to ensure that these amounts are also not subject to double taxation.

Thus, the aggregate effect of the above provisions is that all of the capital gain and franked dividend (and accompanying franking credits) will be fully assessable to beneficiaries and fully excluded from the calculation of trust income and net income.

To illustrate the application of the streaming rules and the related operation of Division 6E of the ITAA (1936) the following commentary respectively discusses the different implications that arise where a capital gain or franked dividend (and accompanying franking credits):

- Is fully allocated to specifically entitled beneficiaries; and
- Is partly allocated to specifically entitled beneficiaries and the balance of the capital gain and franked dividend is apportioned amongst presently entitled beneficiaries according to their share (i.e. adjusted Division 6 percentage) of trust income (excluding all of the directly assessed capital gains and franked dividends).

WARNING

It is possible that a beneficiary may be made specifically entitled to a capital gain or franked dividend but not otherwise be made presently entitled to a share of trust income. Accordingly, care needs to be taken in identifying those beneficiaries who have been made specifically entitled to a gain or dividend and those presently entitled to the balance of trust income by the trustee.

[17] There is no requirement to exclude franking credits from the income of the trust estate as the Commissioner of Taxation does not regard such 'tax-only' or notional amounts as being income of the trust as they do not represent a net accretion (i.e. increase) to the income of the trust estate as set out in Draft Taxation Ruling TR 2012/D1.

3.1 Beneficiary specifically entitled to all of gain or dividend

The tax implications of a specifically entitled beneficiary being directly assessed on a capital gain and franked dividend are markedly different. Accordingly, the commentary below separately considers the respective tax treatments that apply where a beneficiary is made specifically entitled to all of a streamed gain or dividend.

3.1.1 Fully streamed capital gain

Essentially, where a beneficiary is made specifically entitled to all of a capital gain by the trustee of a discretionary trust such amounts will be assessed in their own hands.[18]

The relevant tax implications are as follows:

- The trustee of the trust makes the beneficiary specifically entitled to all of the gross capital gain made for trust purposes, (which will be reduced by trust capital losses if the trust has capital losses which could be applied against the capital gain for CGT purposes);
- The beneficiary will be directly assessed on the full amount of the capital gain for CGT purposes as the entire share of the capital gain has been attributed to the beneficiary;
- Division 6E of the ITAA (1936) will apply so that the income of the trust estate excludes the trust capital gain and the net income of the trust will also be adjusted to exclude the net capital gain derived by the trust;[19]
- The beneficiary will gross up the attributed net capital gain to take into account any CGT discounts applied by the trust. Accordingly, if no discounts were applied by the trustee the gross capital gain derived by the trust will essentially be inherited by the beneficiary. Alternatively, if the gain derived by the trust was reduced under either the 50% CGT discount or the small business CGT 50% active asset reduction the attributed capital gain to the specifically entitled beneficiary will be doubled. Finally, if the trust applied both the 50% CGT discount and the small business CGT 50% active asset reduction to reduce the attributed capital gain that amount will be quadrupled;[20] and
- The beneficiary will reduce the grossed up capital gain by current year or carry forward capital losses (if any), and then reduce the balance by the CGT Discount (if eligible) and the small business CGT 50% active asset reduction (if eligible) in calculating the beneficiary's net capital gain[21] applying the standard method statement used to calculate a net capital gain.[22]

[18] Refer to section 115-227(a) of the ITAA (1997).

[19] Refer to sections 109UW and 109UY of the ITAA (1997).

[20] Refer to section 115-215(4) of the ITAA (1997).

[21] It should also be noted that a trust which is eligible to apply either the small business CGT 15 year exemption or the small business CGT retirement exemption may be able to distribute exempted capital gains under those concessions to beneficiaries as non-assessable non-exempt income when certain conditions are satisfied.

[22] Refer to section 102-5 of the ITAA (1997).

The process involving in calculating such a capital gain is illustrated in the example below.

EXAMPLE

Nicola as trustee for the Pappas Family Trust sold land and buildings for a gross capital gain of $900,000 on 15 September 2019 which was subsequently included in trust income. The amount of such a capital gain could not be reduced by capital losses as the trust did not have any such losses for either trust law or tax purposes. However, the trust was able to reduce the $900,000 capital gain by 50% to $450,000 applying the CGT discount in calculating the trust's net income for the year ended 30 June 2020.

Nicola as trustee subsequently made Theo specifically entitled to all of the gross capital gain of $900,000 in a trustee resolution dated 30 June 2020.

Division 6E then applied to respectively exclude the $900,000 gross trust capital gain from the income of the trust and the $450,000 net capital gain from the calculation of the trust's net income for the year ended 30 June 2020.

Theo is subsequently required to double the amount of the attributed capital gain to a gross capital gain of $900,000 as the trust had applied the 50% CGT Discount in reducing the capital gain to $450,000.

As Theo has capital losses of $100,000 this amount must be applied against the grossed up amount of the capital gain to reduce it from $900,000 to $800,000. As he will be taken to have derived the capital gain he will be eligible to apply the 50% CGT discount to reduce the grossed-up amount of the $800,000 capital gain to an assessable net capital gain of $400,000.

WARNING

Where the sum of the net capital gain and franked dividends (less directly relevant expenses) exceed the net income of the trust (excluding franking credits) the taxable amount of any attributed gain will be proportionally reduced to the extent that it exceeds that amount of net income.[23] Such a scenario may arise where the trust derives a net capital gain but its other sources of income are in an overall loss position as would be the case with a trading trust making tax losses.

[23] Refer to sections 115-225(2) and 115-225(3) of the ITAA (1997).

3.1.2 Fully streamed franked dividend

Broadly, where a beneficiary is made specifically entitled to all of a franked dividend derived by the trust the beneficiary will also be directly assessed on the amount of such a franked dividend (less any directly relevant expenses) together with any accompanying franking credits.[24] The beneficiary can then claim a tax offset for the amount of such franking credits in the calculation of the beneficiary's tax payable.

The relevant steps in determining the tax treatment of such an attributed franked dividend are as follows:

- The trustee of the trust makes the beneficiary specifically entitled to all of the franked dividend (which must be reduced by any directly relevant expenses);
- The beneficiary's assessable income will include the attributed franked dividend (reduced by any directly relevant expenses) and the beneficiary's share of franking credits;
- Division 6E of the ITAA (1936) will apply to exclude the franked dividend (net of any directly relevant expenses) from the calculation of the trust's income,[25] and to exclude the franked dividend (net of any directly relevant expenses) and any accompanying franking credit from the calculation of the trust's net income[26];and
- The beneficiary will include the full amount of the franked dividend (less any directly relevant expenses) and the amount of any attached franking credit in the beneficiary's assessable income.[27] Broadly, the beneficiary will then claim a tax offset for the amount of the franking credit in calculating the beneficiary's tax payable.[28]

The tax effect of a specifically entitled beneficiary receiving such a franked dividend is discussed in the example on the right:

EXAMPLE

Jane as the trustee of the O'Connor Family Trust received a fully franked dividend of $7,000 on 31 March 2020 from CRM Ltd which is not a base rate entity for income tax purposes. Accordingly, a franking credit of $3,000 was attached to the franked dividend received from CRM Ltd. As the acquisition of the shares in CRM Ltd was fully funded from internally generated working capital no interest expense was directly incurred in deriving such dividend income. Nor were there any other directly relevant expenses incurred in deriving such income.

Jane as trustee subsequently made Chris specifically entitled to all of the franked dividend of $7,000 received from CRM Ltd in a trustee resolution dated 30 June 2020.

Division 6E of the ITAA (1936) applied to exclude the amount of the franked dividend of $7,000 from the trust income of the O'Connor Family Trust for the year ended 30 June 2020. There was no need to also exclude the attached franking credit of $3,000 from the calculation of trust income as the Commissioner of Taxation regards such a notional or tax only amount as not being trust income under Draft Taxation Ruling TR 2012/D1. However, both the franked dividend of $7,000 and the accompanying franking credit of $3,000 were both excluded under Division 6E from the calculation of the trust's net income under section 95(1) of the ITAA (1936).

Chris is required to include both the $7,000 franked dividend and the related $3,000 franking credit in his assessable income for the year ended 30 June 2020. However, he will be entitled to claim a franking credit tax offset of $3,000 to reduce his tax payable for the year ended 30 June 2020.

[24] Refer to sections 207-37(1) and 207-35(4) of the ITAA (1997).

[25] The Commissioner of Taxation has stated in Draft Taxation Ruling TR 2012/D1 that tax-only amounts such as franking credits do not constitute trust income as they do not constitute a net accretion to the income of the trust estate.

[26] Refer to sections 109UW and 109UY of the ITAA (1997).

[27] Refer to sections 205-35(4)(b)(i) and 205-35(40(b)(ii) of the ITAA (1997).

[28] Refer to section 205-45 of the ITAA (1997).

WARNING

Where the sum of the net capital gain and franked dividends (less directly relevant expenses) exceed the net income of the trust (excluding franking credits) the taxable amount of any attributed franked dividend will be proportionally reduced to the extent that it exceeds that amount of net income.[29]

3.2 Beneficiary specifically entitled to part of gain or dividend

Where a trustee streams only part of a capital gain or franked dividend there are two fundamentally important outcomes for the beneficiaries of the trust estate.

Firstly, the beneficiaries who are made specifically entitled to part of the gain or dividend will be directly assessed on such amounts which will also be essentially excluded from the trust income and net income under Division 6E of the ITAA (1936) as set out above.

Secondly, the portion of the gain or dividend that has not streamed will flow proportionally to presently entitled beneficiaries who will be each taken to receive a pro-rata share of such a gain or dividend.

The mechanism for apportioning such amounts amongst such presently entitled beneficiaries is by applying the beneficiaries' 'adjusted Division 6 percentage'[30] to the income of the trust estate (excluding any streamed capital gains or franked dividends) rather than their original share of the income of the trust estate.

A beneficiary's adjusted Division 6 percentage is calculated by dividing the beneficiary's present entitlement to trust income (excluding any capital gains and franked dividends to which they are specifically entitled) by the income of the trust (excluding any capital gains or franked dividends to which any entity is specifically entitled).

Such allocated capital gains and franked dividends are also then excluded from the calculation of trust income and net income pursuant to Division 6E of the ITAA (1936).

As the calculation of the above adjustments can become complicated, and the tax treatment of capital gains and dividends in the hands of beneficiaries differs, the following commentary addresses the separate issues which apply:

- Where only part of the capital gain is streamed such that the balance of the gain is proportionally allocated amongst presently entitled beneficiaries based on their adjusted Division 6 percentage; and
- Where only part of the franked dividend is streamed such that the balance of the dividend (and attached franking credits) is proportionally allocated amongst presently entitled beneficiaries based on their adjusted Division 6 percentage.

[29] Refer to section 207-37(2) and 207-37(3) of the ITAA (1997).
[30] Refer to section 95(1) of the ITAA (1936).

3.2.1 Partly streamed gain

The following steps must be applied in calculating a beneficiary's extra capital gain on the streaming of a capital gain where only part of the gain has been streamed:

- **Step 1** involves calculating the beneficiary's share of a capital gain.

  Where a beneficiary has been streamed a capital gain the first part of the calculation will be to include that portion of the capital gain to which the beneficiary has been made specifically entitled. It will also include a proportional share of the balance of the capital gain remaining after all specific entitlements have been determined if that beneficiary is also presently entitled to the balance of such capital gain included in trust income.

  Where a beneficiary has not been streamed any part of the capital gain their share of the capital gain will be limited to a proportional share in the balance of the capital gain to which they may be presently entitled after excluding any part of the gain to which any beneficiaries have been made specifically entitled.

  In both cases a beneficiary's proportionate share of any balance of the capital gain is determined by their 'adjusted Division 6 percentage'. To recap a beneficiary's 'adjusted Division 6 percentage' is their percentage of trust income to which they are presently entitled (excluding any capital gain and franked dividends to which the beneficiary has been made specifically entitled) divided by the trust income (excluding any capital gain and franked distribution to which any beneficiary has been made specifically entitled);

- **Step 2** requires that the amount of the capital gain made by each beneficiary under step 1 be divided by the total amount of the capital gain which will provide the beneficiary's percentage share of the capital gain;

- **Step 3** involves multiplying the beneficiary's percentage entitlement calculated under Step 2 to that portion of the net income which includes a net capital gain; and

- **Step 4** involves the beneficiary grossing up to the attributed gain determined under Step 3 for any CGT discounts applied by the trustee in calculating the net capital gain.

Division 6E of the ITAA (1936) is then applied to exclude the amount of any allocated capital gains from both trust income and net income as discussed above.

This above four step process is illustrated in the following example:

EXAMPLE

The Campbell Family Trust derived a gross capital gain of $100,000 for the year ended 30 June 2020. The trust did not have any capital losses for trust or tax purposes which could be applied to reduce the amount of this gain. Nor was the capital gain reduced under the 50% CGT Discount as the asset had been held for less than 12 months. Accordingly, the net capital gain derived was also $100,000 for tax purposes for the 2020 year.

The trust also derived net rental income of $100,000 for the year ended 30 June 2020. It did not derive any other income including dividend income.

Clause 3 of the trust deed states that trust income includes the amount of any gross capital gain. Accordingly, the total trust income for the 2020 year was $200,000 being the aggregate of the $100,000 net rental income and the $100,000 gross capital gain.

Alec as trustee decided to make Jenny specifically entitled to half of the $100,000 gross capital gain derived being $50,000.

He also determined that the remaining balance of the $150,000 trust income should be appointed to Jenny and Gordon as beneficiaries so that they had a 50% entitlement each to trust income.

The amount of the capital gain allocated to Jenny for tax purposes is calculated as follows:

Step 1 – Jenny will include the $50,000 capital gain to which she has been made specifically entitled.

It is then necessary to calculate the share of that part of the gain to which no beneficiary has been made specifically entitled which is $50,000.

Jenny's share of such an amount will be determined by her adjusted Division 6 percentage to trust income. This is calculated by dividing her present entitlement to trust income (excluding the amount to which she is specifically entitled) by the amount of trust income (excluding the amount of capital gains to which any beneficiary has been made specifically entitled).

$$\frac{\textbf{50\% of trust income of \$200,000 - \$50,000 specific entitlement}}{\textbf{Trust income of \$200,000 – \$50,000 specific entitlement}}$$

$$= \frac{\$50{,}000}{\$150{,}000}$$

$$= 33.33\% \text{ of } \$50{,}000$$

$$= \$16{,}667$$

The total amount of Jenny's share of the capital gain is therefore $66,667.

Step 2 – Jenny's percentage share of the capital gain is 66.67% dividing her $66,667 total entitlement by the $100,000 capital gain.

Step 3 – Jenny's attributable gain for tax purposes is $66,667 being the amount of her 66.67% fractional entitlement to the net capital gain of $100,000 which is included in the trust's net income.

Step 4 – Jenny does not need to gross up any gain attributed to her as the trust did not apply any CGT discounts in reducing such an amount.

The amount of the capital gain allocated to Gordon for tax purposes is calculated as follows:

Step 1 – Gordon was not made specifically entitled to any part of the capital gain.

Accordingly, he will only be entitled to his share of the present entitlement to the balance of the capital gain to which no beneficiary has been made specifically entitled being $50,000.

Gordon's share of such an amount will be determined by his adjusted Division 6 percentage to trust income. This is calculated by dividing his present entitlement to trust income by the amount of trust income (excluding the amount of capital gains to which any beneficiary (i.e. Jenny) has been made specifically entitled).

$$\frac{\textbf{50\% of trust income of \$200,000}}{\textbf{Trust income of \$200,000 – \$50,000 specific entitlement}}$$

$$= \frac{\$100,000}{\$150,000}$$

$$= 66.67\% \text{ X } \$50,000$$

$$= \$33,333$$

The total amount of Gordon's share of the capital gain is therefore $33,333.

Step 2 – Gordon's percentage share of the capital gain is 33.33% dividing his $33,333 total entitlement by the $100,000 capital gain.

Step 3 – Gordon's attributable gain for tax purposes is $33,333 being the amount of his 33.33% fractional entitlement to the net capital gain of $100,000 which is included in the trust's net income.

Step 4 – Gordon does not need to gross up any gain attributed to him as the trust did not apply any CGT discounts in reducing such an amount.

3.2.2 Partly streamed dividend

The steps that should be applied in calculating a beneficiary's share of a franked dividend (and accompanying franking credit) where only part of the franked dividend has been streamed is similar to the above process that applies where only part of the trust capital gain has been allocated to specifically entitled beneficiaries. However, this process will not only address the allocation of franked dividends but also the related distribution of franking credits.

Essentially this process involves the following three steps:

- **Step 1** involves calculating the beneficiary's share of a franked dividend.

  Where a beneficiary has been streamed a franked dividend the first part of the calculation will be to include that part of the franked dividend to which they have been made specifically entitled. The calculation will also include a proportional share of the remaining franked dividend after all specific entitlements have been determined if that beneficiary is also presently entitled to the balance of trust income which includes the unallocated portion of the franked dividend.

  Where a beneficiary has not been streamed any part of the franked dividend their share of the franked dividend will be limited to a proportional share of the balance of the franked dividend which is included in trust income to which they may be presently entitled, after excluding the portion of the franked dividend to which any beneficiary has been made specifically entitled.

  As is the case with capital gains the beneficiaries proportionate share of the balance of any unallocated franked dividend is determined by their adjusted Division 6 percentage. As discussed, a beneficiary's adjusted Division 6 percentage is calculated by dividing the beneficiary's present entitlement to trust income (excluding any capital gains and franked dividends to which they are specifically entitled) by the income of the trust estate (excluding any capital gains or franked dividends to which any entity is specifically entitled).

  In calculating the above amounts the gross amount of the franked dividend must be reduced by any directly relevant expenses (if applicable).

- **Step 2** requires that the amount of the franked dividend made to each beneficiary under step 1 be divided by the gross amount of the franked dividend which will provide the beneficiary's percentage share of the franked dividend.

- **Step 3** involves multiplying the trust's net franked distribution (i.e. the franked dividend less any directly relevant expenses) by the percentage worked out at step 2 in calculating the amount of the franked dividend recognised for tax purposes. The franking credits attached to the franked dividend are then multiplied by that percentage in determining the pro rata allocation of franking credits on such dividends amongst beneficiaries.

The application of this three-step process is shown in the example below:

EXAMPLE

The Williams Family Trust derives rental income of $100,000 for the year ended 30 June 2020. It also derived a fully franked dividend of $70,000 paid by a company which was not a base rate entity resulting in an attached franking credit of $30,000 (i.e. $70,000 X 30/70). No expenses were directly incurred in deriving such dividend income. The trust also did not derive any capital gain during the 2020 year.

Clause 2(1) of the trust deed defines the income of the trust to be ordinary income as disclosed in the trust's accounts. Therefore, the total trust income was $170,000 for the year ended 30 June 2020 comprising the $100,000 rental income and the fully franked dividend of $70,000. The $30,000 franking credit was not included as it is a notional or tax only amount and should be excluded from the calculation of the income of the trust applying Draft Taxation Ruling TR 2012/D1.

By contrast the net income of the trust for the year ended 30 June 2020 was $200,000 comprising the rental income of $100,000, the fully franked dividend $70,000 and the assessable franking credit of $30,000.

Ruth as the trustee of the Williams Family Trust resolves to make Roger specifically entitled to $50,000 of the $70,000 fully franked dividend. Accordingly, the amount of the franked dividend to which no beneficiary was specifically entitled was $20,000 being the balance of the unallocated franked dividend.

She also made Roger and his brother Tom, presently entitled to such amounts of the trust income remaining after Roger had been made specifically entitled to 50,000 of the $70,000 fully franked dividend.

The amount of the franked dividend allocated to Roger is calculated as set out below:

Step 1 – Roger will include the $50,000 franked dividend to which he has been made specifically entitled.

It will then be necessary to calculate his share of the unallocated franked dividend of $20,000 to which no beneficiary has been made specifically entitled.

Roger's share of such an amount will be calculated by applying his adjusted Division 6 percentage to trust income. This is calculated by dividing his present entitlement to trust income (excluding the amount of franked dividend to which he is specifically entitled) by the amount of trust income (excluding the amount of franked dividends to which any beneficiary has been made specifically entitled).

$$\frac{\textbf{50\% of trust income of \$170,000 - \$50,000 specific entitlement}}{\textbf{Trust income of \$170,000 – \$50,000 specific entitlement}}$$

$$= \frac{\$35,000}{\$120,000}$$

$$= 29.17\% \times \$20,000$$

$$= \$5,833$$

The total amount of Roger's share of the franked dividend is therefore $55,833.

Step 2 – Roger's percentage share of the franked dividend is 79.76% dividing his $55,833 total pro rata entitlement to the dividend by the $70,000 franked dividend.

Step 3 – Roger's attributable franked dividend for tax purposes is $55,833 being the amount of his 79.76% fractional entitlement to the franked dividend of $70,000. His share of the accompanying franking credits is $23,928 being 79.76% of the $30,000 franking credits attached to such franked dividends.

Accordingly, Roger will include an aggregate amount of $79,761 in his assessable income comprising his share of the franked dividend of $55,833 and his entitlement to the franking credits of $23,928.

However, he will be entitled to claim a franking credit tax offset of $23,928.

The amount of the franked dividend allocated to Tom is calculated as follows:

Step 1 – Tom was not made specifically entitled to any part of the franked dividend.

Accordingly, he will only be entitled to his present entitlement to the balance of the franked dividend to which no beneficiary has been made specifically entitled being $20,000.

Tom's share of such an amount will be determined by his adjusted Division 6 percentage to trust income. This is calculated by dividing his present entitlement to trust income by the amount of trust income (excluding the amount of franked dividends to which any beneficiary (i.e. Roger) has been made specifically entitled).

$$\frac{\textbf{50\% of trust income of \$170,000}}{\textbf{Trust income of \$170,000 – \$50,000 specific entitlement}}$$

$$= \frac{\$85,000}{\$120,000}$$

$$= 70.83\% \text{ X } \$20,000$$

$$= \$14,167$$

The total amount of Tom's share of the franked dividend is therefore $14,167.

Step 2 – Tom's percentage share of the franked dividend is 20.24% which is calculated by dividing his $14,167 pro rata entitlement to the dividend by the $70,000 franked dividend.

Step 3 – Tom's attributable franked dividend for tax purposes is $14,167 being the amount of his 20.24% fractional entitlement to the franked dividend of $70,000 which is included in the trust's net income. His share of the accompanying franking credits is $6,072 being 20.24% of the franking credits of $30,000 attached to such franked dividends.

Accordingly, Tom will include an aggregate amount of $20,239 in his assessable income comprising his share of the franked dividend of $14,167 and his entitlement to the franking credits of $6,072.

He will, however, be entitled to claim a franking credit tax offset of $6,072.

TAX TIP

As will be evident from the above discussion compliance with the streaming provisions is especially problematic where there only part of a capital gain or franked dividend is being streamed to a specifically entitled beneficiary. Essentially, some of the complexity in complying with the legislation is reduced where either the capital gain or franked dividend is fully streamed or otherwise included in trust income and proportionally distributed amongst beneficiaries according to their present entitlement to trust income.

APPENDIX 1– SAMPLE TRUSTEE RESOLUTION

SAMPLE TRUSTEE RESOLUTION WHERE BENEFICIARIES MADE SPECIFICALLY ENTITLED TO A CAPITAL GAIN AND FRANKED DIVIDEND

TRUSTEE:

Kennedy Pty Ltd
ACN 222 333 444

CAPACITY:

It was noted that the company is acting in its capacity as trustee of the Kennedy Family Trust established by deed dated 1 April 1995

PLACE OF MEETING:

7 Fellows Street Hughesdale Vic 3166

PRESENT:

Ian Kennedy being the sole director of Kennedy Pty Ltd
Barry Kennedy, Harry Kennedy, Judy Kennedy and Trudy Kennedy.

ELIGIBLE BENEFICIARIES:

It was noted that the various classes of beneficiaries were described and identified in the Schedule to the deed:

Primary beneficiaries	clause 1.1
General beneficiaries	clause 1.2
Default beneficiaries	clause 1.3

DETERMINATION OF TRUST INCOME:

RESOLVED that the income of the Kennedy Family Trust for the year ended 30 June 2020 be determined in accordance with the powers conferred on the trustee under clause 3(1) of the deed as follows:

- The amount determined to be the net income of the trust calculated in accordance with section 95(1) of the ITAA (1936) subject to
- The exclusion of the amount of franking credits included in the calculation of the net income; and
- Any other written determination by the trustee which alters the amount which would have been the income of the trust estate under clause 3(1) of the deed.

It was noted that no written determination had been made by the trustee in relation to the income of the trust estate.

DISTRIBUTION OF TRUST INCOME:

The meeting noted that clause 5(1) of the trust deed granted the trustee power to account for different classes of income separately and to distribute those classes of income separately to beneficiaries at the discretion of the trustee.

RESOLVED that the income of the trust estate for the year ended 30 June 2020 be distributed to beneficiaries as follows:

Capital gains – specific entitlement:

Pursuant to the powers granted to the trustee under clause 5(1) of the deed the following beneficiaries are, in respect of the capita gain described below, specifically entitled to the capital gain in the proportions indicated and each beneficiary has an equivalent share of the net financial benefit referable to the capital gain:

Barry Kennedy	25%
Harry Kennedy	75%

The capital gain which is the subject of the specific entitlement arose arising from the sale of freehold land and buildings located at 12 Murrumbeena Road in Murrumbeena pursuant to a contract of sale dated 1 November 2019.

It was FURTHER RESOLVED that:

- The amount so distributed be paid to, applied for the benefit of or credited to or set aside for, the beneficiaries in the books of account of the trust; and
- This resolution be taken to record the character of the amount attributable to each beneficiary as being referable to the capital gain.

It was confirmed that each of the beneficiaries was included in the class of beneficiaries described as primary beneficiaries in clause 1.1 of the Schedule to the deed.

Franked dividends – specific entitlement Pursuant to the powers granted to the trustee under clause 5(1) of the deed the following beneficiaries are, in respect of the franked dividends included in the income of the trust estate for the year, specifically entitled to the franked distributions in the proportions indicated and each beneficiary has an equivalent share of the net financial benefit referable to the franked dividends:

Judy Kennedy	90%
Trudy Kennedy	10%

It was FURTHER RESOLVED that:

- The amount so distributed be paid to, applied for the benefit of or credited to or set aside for, the beneficiaries in the books of account of the trust; and
- This resolution be taken to record the character of the amount attributable to each beneficiary as being referable to the franked distributions.

It was confirmed that each of the beneficiaries was included in the class of beneficiaries described as primary beneficiaries in clause 1.1 of the Schedule to the deed.

The remaining income of the trust estate

Pursuant to the powers granted to the trustee under clause 3(1) of the deed the income of the trust estate for the year ended 30 June 2020 (excluding capital gains and franked distributions already distributed by way of specific entitlement) be distributed to beneficiaries as follows:

Barry Kennedy	25%
Harry Kennedy	25%
Judy Kennedy	30%
Trudy Kennedy	20%

It was FURTHER RESOLVED that the amounts so distributed be paid to, applied for the benefit of or credited to or set aside for the beneficiaries in the books of account of the trust.

It was confirmed that each of the beneficiaries was included in the class of beneficiaries described as primary beneficiaries in clause 1.1 of the Schedule to the deed.

DISTRIBUTION OF TRUST CAPITAL:

RESOLVED that pursuant to clause 9(1) of the deed the trustee makes an advance of capital in respect of the discounted portion of the capital gain arising from the sale of freehold land and buildings located at 12 Murrumbeena Road in Murrumbeena pursuant to a contract of sale dated 1 November 2019 to beneficiaries in the following proportions:

Barry Kennedy	25%
Harry Kennedy	75%

CLOSURE:

There being no further business the Chairman closed the meeting.

Signed as a true and correct record.

DATE:

30 June 2020

TRUST STREAMING CHECKLIST

The matters set out below may be relevant to a trustee of a discretionary trust who wishes to stream a capital gain and/or franked dividend to an eligible beneficiary to ensure that an appropriate trustee resolution is prepared, and that the eligibility conditions required to make a beneficiary specifically entitled to a capital gain or franked dividend have been met. The matters highlighted should be considered by the trustee well before 30 June to ensure that all things which require attention before year-end are completed on a timely basis.

The list is a general guide only.

Trustees should always take into account individual facts and circumstances, and therefore matters other than those contained in this checklist may be relevant.

QUESTION	YES	NO	N/A
Is streaming possible under the trust deed?			
Is there a clause under the trust deed providing the trustee with the specific power to identify and allocate different classes of trust income to eligible beneficiaries?			
If not, can the trust deed be validly amended to include such a streaming power without causing any adverse CGT, stamp duty or trust law issues on a resettlement? Has legal advice been obtained prior to making any such amendment?			
Where there is no express power to stream can the trustee make a beneficiary specifically entitled to a capital gain and/or franked dividend under an implied power in the trust deed? Have all the terms of the trust deed been reviewed to ensure reliance can be placed on such an implied power? Should legal advice be obtained before relying on such an implied power?			
Where the trustee is seeking to make a beneficiary specifically entitled to a franked dividend does the streaming clause in the trust deed differentiate dividends that have been franked from those that are unfranked?			
Does the trust deed allow a trustee to apply capital losses and directly relevant expenses in reducing a capital gain or franked dividend as required under the streaming rules?			
Making a beneficiary specifically entitled			
Has the net financial benefit of the capital gain or franked dividend been paid, credited or otherwise distributed to the specifically entitled beneficiary, or has it been paid or applied on their behalf or for their benefit?			
Does the financial benefit (e.g. cash sale proceeds) of any capital gain have to be reduced by any capital losses for trust and tax purposes?			

QUESTION	YES	NO	N/A
Making a beneficiary specifically entitled			
Has the streaming of a capital gain been done on the basis of allocating the gross capital gain for trust purposes rather than the net capital gain for tax purposes?			
Does the trustee recognise that a 'notional' capital gain cannot be streamed as would be the case with a capital gain arising under the market value substitution rule?			
Does the financial benefit of any franked dividend have to be reduced by directly relevant expenses? Has any interest cost relating to the acquisition of the shares on which the dividend has been paid been identified as an offsetting expense? Were there any other directly relevant expenses incurred?			
Has the trustee considered the merits of making a beneficiary specifically entitled to a share of a 'pooled' dividend where the interest costs relating to a particular franked dividend exceed the amount of that dividend?			
Where a specifically entitled beneficiary has not received the net financial benefit of the capital gain or franked dividend can it reasonably be expected that the beneficiary will derive that financial benefit in the future?			
Has the trustee executed a valid written resolution before year-end streaming the capital gain or franked dividend in its character as a capital gain or dividend to eligible beneficiaries? Has reference been made to the appropriate clause(s) in the trustee resolution?			
Does the trustee resolution refer to and identify each capital gain made by the trust which is being streamed?			
Is there an income equalisation clause which effectively requires a capital gain to be mandatorily distributed before the trustee makes any beneficiary presently entitled to trust income at year-end?			
Should the trustee of a resident trust elect to be specifically entitled to a capital gain in lieu of beneficiaries? Has this option being considered where the trust is a testamentary trust?			
Has the trustee allocated each beneficiary's share of the specific entitlement where there are multiple beneficiaries being streamed capital gains and franked dividends?			

QUESTION	YES	NO	N/A
Applying the streaming rules			
Has the trustee determined the impact on a specifically entitled beneficiary being assessed on a share of any streamed capital gain to determine the treatment of that gain when directly assessed to the beneficiary? Has the trustee considered the tax impact on a specifically entitled beneficiary receiving a share of the franked dividend?	☐	☐	☐
Is all of part of the streamed capital gain and franked dividend being distributed to eligible beneficiaries? Where only part of the streamed gain or dividend is being distributed, is the balance of the capital gain or dividend being appropriately allocated amongst presently entitled beneficiaries based on their adjusted Division 6 percentage?	☐	☐	☐
Have adjustments been made excluding the streamed capital gain and franked dividend from the income of the trust and its net income as required under Division 6E? Where a trustee has only streamed part of the gain or dividend, has the balance of the gain or dividend been excluded from the calculation of trust income and net income under Division 6E?	☐	☐	☐
Is a beneficiary receiving a share of a streamed gain aware that they may need to gross up the capital gain in their own hands and then re-apply any eligible capital losses or CGT discounts?	☐	☐	☐
Has the trustee excluded the franking credit from the calculation of its income for trust purposes in accordance with Draft Taxation Ruling TR 2012/D1 when streaming franked dividends?	☐	☐	☐
Does the amount of the streamed capital gain and franked dividend exceed the net income of the trust? If so, has the taxable value of such a streamed capital gain and franked dividend been proportionally reduced?	☐	☐	☐

cpaaustralia.com.au