CPA AUSTRALIA TRUSTEE RESOLUTION GUIDE

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1. BACKGROUND

The purpose of this guide is to ensure that practitioners are aware of all the practical steps a trustee of a discretionary trust[1] in Australia must necessarily implement to ensure that distributions of trust income occur in a tax compliant manner, and result in trust income being taxed in the hands of beneficiaries in the proportions intended by the trustee.

Whilst this process is often uncomplicated there are an array of potential traps for the unwary and those not familiar with the requirements of making effective trustee resolutions.

To make sure that a trustee resolution gives effect to proposed distributions of trust income the trustee (and their adviser) should do the following:

- Understand the key clauses of the trust deed;
- Determine the impact of potential trust distributions on trust beneficiaries from a taxation perspective;
- Prepare and execute binding written trustee resolutions effecting such distributions; and
- Ensure that trustee resolutions are completed before the trust's applicable year-end date.

Each of these requirements is separately explained below.

This discussion is followed by an analysis of the impact of the issue of amended assessments by the ATO in respect of distributions of shares of trust income (and therefore a corresponding proportion of net income) previously made by the trustee under a compliant trustee resolution.

Finally, sample trustee distribution resolutions and a trustee distribution checklist are provided at the end of the materials.

The contents of this factsheet are current as at 13 December 2019.

[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 income or capital under the trust deed.

2. KEY CLAUSES OF THE TRUST DEED

As an overarching comment it is critical for the trustee to identify and understand the key clauses of a trust deed that must be applied in making an effective distribution of trust income to beneficiaries under a trustee resolution.

As a starting point, it is imperative that a full copy of the original trust deed (and any subsequent variations to the deed) be located, and that the trustee becomes familiar with the all the specific terms of that deed prior to making any distribution of trust income.

This is crucial as it cannot be assumed that the terms of trust deeds are the same. The legal approach to drafting trust deeds has varied considerably over time as legal drafting processes have periodically changed especially in response to developments in the taxation of trusts. For example, older trusts are often drafted in user unfriendly 'legalese' whereas more contemporary deeds are generally written more in a 'plain English' style.

TAX TIP

Each trust deed is potentially unique as it is a private legal instrument and thus quite different to a standard company constitution. It is therefore critical that a practitioner keep a full copy of the trust deed on file so that it can be readily referred to especially where the trustee plans to distribute trust income to particular beneficiaries before year-end. Accordingly, where a trust deed goes missing it is essential that the full deed be located from other sources. This may require the practitioner to contact either the client, the law firm that drafted the deed or the client's former tax adviser (if applicable).

The key clauses of the deed which should be reviewed by a trustee planning distributions of trust income and capital are those dealing with the following matters:

2.1 Income of the trust estate

Most trust deeds will ordinarily include a specific definition of the 'income of the trust estate'[2].

However, there is considerable disparity in trust deeds concerning the definition of this term as a broad array of different definitions of 'income of the trust estate' have been included in trust deeds over many years.

In some cases the income of the trust may be defined as being equal to the trust's net income for taxation purposes as defined under section 95 (1) of the Income Tax Assessment Act (1936) (the ITAA (1936)) under an 'income equalisation clause' thereby ensuring that the amounts of trust income and net income are the same.

By contrast other deeds may define the income of the trust estate as one of the following:

- Income being ordinary income as defined under trust law;
- Income being ordinary income is defined under trust law but including some specific receipts such as capital gains;
- Income as determined at the discretion of the trustee;
- Income as determined at the discretion of the trustee but which is treated as ordinary income for trust law purposes if the trustee does not exercise such a discretion; and
- Income as determined at the discretion of the trustee but which is treated as being the net income of the trust under section 95(1) of the ITAA (1936) if the trustee does not exercise such a discretion.

[2] Following the decision of the High Court in Commissioner of Taxation v Bamford; Bamford v Commissioner of Taxation (2010) HCA 10 it is clear that the meaning of the phrase 'income of the trust estate' takes its meaning under trust law and not taxation law. Accordingly, where the trust deed includes a definition of income of the trust estate that definition will prevail when applying the taxation of trust provisions of Division 6 of the ITAA (1936).

The income of the trust estate calculated in accordance with the definition contained in the trust deed is commonly referred to as the distributable income of the trust egardless of the specific definition of trust income included under the deed. Thus, often in practice the terms distributable income and trust income become interchangeable from a practical perspective.

Conversely, where the deed does not include any definition of the term 'income of the trust estate' a trustee must refer to the meaning of trust income as determined under trust law. Accordingly, a trustee should proceed with caution in characterising an amount as being either income or capital from a trust law perspective in such a situation, and should seek legal advice if they are in doubt regarding the correct treatment of receipts derived by the trust.

TAX TIP

Where there is no specific definition of trust income a trustee exercising a discretion concerning the determination of trust income should also document and retain a written record of the basis on which they have exercised that discretion noting the power exercised under the trust deed which allowed them to act in that capacity.

EXAMPLE

Clause 4 of the trust deed for the O'Connor Discretionary Trust defines income of the trust to mean 'the amount worked out under section 95 of the tax law'. Accordingly, the amount of trust income available for distribution will be the same as the amount of net income derived by the trust for the relevant year under an income equalisation clause.

2.2 Beneficiaries

Most trust deeds of discretionary trusts will list the primary beneficiaries of the trust being those persons (or entities) specifically named in the trust deed as the objects (i.e. potential beneficiaries) of the trust.

As a corollary the general beneficiaries of a trust are those entities or class of entities who are potential eligible beneficiaries based on their relationship to the primary beneficiaries under the trust deed.

Accordingly, if a husband-and-wife are the sole primary beneficiaries of a trust, any company or trust under which they may potentially benefit may be regarded as a general beneficiary based on their relationship with such primary beneficiaries if the definition of general beneficiaries under the trust deed is based on this association.

EXAMPLE

The Schedule to the trust deed for the Chu Family Trust discloses that the primary beneficiaries of the trust are Kevin and Grace Chu. Clause 1 of the trust deed states that a general beneficiary will include a company in which at least one share is beneficially owned or held by one of the primary beneficiaries. As Chu Holdings Pty Ltd is wholly owned by Kevin that company will be regarded as a general beneficiary for the purposes of any potential distribution of trust income that the trustee may make.

It is also important to recognise that there may be different beneficiaries potentially eligible to receive income and capital distributions by the trustee of the discretionary trust.

A trustee must therefore clearly understand the identity of individuals and entities falling within the parameters of each class of eligible beneficiaries, and recognise that the rights to income and capital to which beneficiaries may be entitled may differ.

WARNING

It should be recognised that a practitioner or the trustee may sometimes require legal advice in determining whether a particular person or entity can be regarded as an eligible beneficiary under the terms of the trust deed. For example, where beneficiaries are described as 'children' of the primary beneficiaries it would be necessary to determine whether that extends to a step child and/or ex-nuptial child in the absence of there being a clear definition of 'child' under the trust deed.

WARNING

Care should also be taken to ensure that a distribution is not made to a particular person or entity who is defined as an 'excluded beneficiary' under the trust deed. For example, some trust deeds may specifically exclude the trustee of the trust from being a potential beneficiary.

Most modern trust deeds also include default beneficiaries who become presently entitled to trust income where the trustee does not make a valid distribution to the primary or general beneficiaries of the trust deed.

Essentially, a trust deed may include default beneficiaries to ensure that the trustee is not taxed at the highest effective marginal rate under section 99A of the ITAA (1936) which would otherwise occur where the trustee fails to make a beneficiary presently entitled to trust income. In these circumstances the default beneficiaries will be taken to have been received the trust distribution even if funds are later paid or applied for the benefit of other beneficiaries. Typically the person(s) chosen to be default beneficiaries are those who pay tax at a rate which is less than the effective top marginal tax rate which is currently 47%.

The existence of such default beneficiaries has added importance from the year ended 30 June 2012 onwards as trustee resolutions are required to be made by year-end (e.g. 30 June), and this mechanism prevents tax being borne under section 99A where the trustee fails to make a valid distribution by that time.

EXAMPLE

Clause 3 of the Tran Discretionary Trust provides that the trustee of that trust must determine the trust income and its allocation to the beneficiaries of the trust by 30 June each year. In the year ended 30 June 2020 Thanh as the trustee of the trust inadvertently failed to distribute trust income in accordance with clause 3 of the deed. However, clause 5 of the trust deed also provided that Vicki Tran would be taken to be appointed by the trustee where the trustee failed to appoint income by the relevant time in accordance with the trust deed. Accordingly, Vicki will be taken to have received all of the trust's income for the year ended 30 June 2020 in her capacity as the default beneficiary of the trust. She will correspondingly include all of the trust's net income for the 2020 year in her assessable income.

TAX TIP

Trustees should check whether distributions of trust income to default beneficiaries are automatically triggered at the end of the income year where there is a failure to make a valid distribution, or whether some other condition under the trust deed must be satisfied before such beneficiaries can be regarded as 'takers in default'.

2.3 Distributions by the trustee

The trust deed should also be reviewed to identify the specific clauses which empower the trustee to distribute trust income to beneficiaries, and which set out what the trustee must do in order to make a beneficiary presently entitled to a share of trust income by the required time.

Compliance with such a clause is critical as an object (i.e. potential beneficiary) of the trust only obtains a vested and indefeasible right to a distribution upon the trustee validly exercising their discretion under the trust deed to appoint them as a beneficiary.

Hence, the trustee's distribution resolution should include references to the relevant clauses identified under the trust deed which grant the power to the trustee to make a beneficiary presently entitled to trust income.

EXAMPLE

Clause 4.2 of the trust deed for the Collins Discretionary Trust requires the trustee John to determine the income of the trust for each year. Clause 4.1 of the deed provides that the income of the trust estate should be calculated by the trustee on the basis that it takes its meaning from the definition of net income under section 95(1) of the ITAA (1936). The trustee subsequently calculates the trust income of the trust for the year ended 30 June 2020 and appoints shares of such income to eligible beneficiaries in accordance with clause 4.3 of the trust deed.

TAX TIP

The trustee would also need to review the trust deed where the trustee intends to make a distribution of trust capital to eligible beneficiaries. In these circumstances the trustee would need to identify those beneficiaries potentially eligible to receive distributions of trust capital; determine the amount of trust capital potentially available for distribution; and apply the procedures under the trust deed in making distributions of trust capital.

TAX TIP

If the trustee wishes to 'stream' distributions of capital gains and franked dividends (and any accompanying franking credits) it is necessary that particular beneficiaries of the trust be made specifically entitled to such amounts. Reference should be made to the CPA Australia Trust Streaming Factsheet for guidance on the various legal and practical requirements that must be met in order for such distributions to be made. This fact sheet also highlights the interaction between beneficiaries who have been made specifically entitled to capital gains and franked dividends and the distribution of the residual trust income to presently entitled beneficiaries.

2.4 Vesting date of the trust

A further key clause to review is the vesting date of the trust being the date on which the trust will come to an end and the trust property will be returned to beneficiaries in accordance with the terms of the trust.

The great bulk of trust deeds will usually specify the vesting date of the trust although in some cases that is referred to as the termination date of the trust under the applicable deed.

Essentially, the inclusion of such a clause is necessary as all Australian States and Territories (other than South Australia) require a trust to vest within 80 years of its creation applying the rule against perpetuities which prevents the indefinite duration of the term of a trust.

Prior to making any distribution it would therefore be prudent for the trustee to confirm that the vesting date of the trust has not been passed (or is not imminent).

Where the discretionary trust has vested the trustee will no longer have any discretionary power to appoint the income or capital of the trust to particular beneficiaries under the trust deed. Instead the trustee will hold the trust property on trust for those beneficiaries specified as takers on vesting under the trust deed who will hold a fixed interest in the trust property upon the vesting of the trust.

EXAMPLE

The Rogers Discretionary Trust was set up to conduct a primary production business. Clause 14 of the trust deed provided that the trust had a vesting date of 1 November 2019, and that the trustee would thereafter hold the trust property for the takers on vesting as tenants in common in equal shares. The trustee did not check to see whether the trust vested and made discretionary distributions of trust income on 30 June 2020. However, as the trust vested on 1 November 2019 under the trust deed, the purported distribution of trust income made by the trustee on 30 June 2020 was ineffective. Instead the income and capital of the trust post-vesting was beneficially owned in equal shares by the takers on vesting.

TAX TIP

The deed of a discretionary trust may give the trustee the power to vary the vesting date of the discretionary trust in certain limited circumstances. Where the trustee is contemplating such an extension to the vesting date the trustee should obtain appropriate legal advice to confirm that such a power exists under the terms of the trust deed, and to understand the implications which may arise from a change to the vesting date for both trust law and tax law purposes.

WARNING

The vesting of a trust may trigger certain CGT events in particular circumstances which is discussed at length in Taxation Ruling TR 2018/6 which should be particularly considered if the vesting date is imminent. The application of these CGT events can be complicated in some cases and specialist advise should be obtained if required.

3. TAX IMPACTS OF POTENTIAL DISTRIBUTIONS

Upon identifying the range of potential beneficiaries the trustee will in practice be required to consider the tax impacts that a distribution of trust income may have on the trust or beneficiaries from an income tax perspective.

In particular, the trustee will need to take into account certain restrictions that are effectively placed on the making of distributions to particular beneficiaries from an income tax perspective which may limit the nature of the distribution made or the amount of tax payable on such a distribution.

For example, the trustee may distribute certain amounts of trust income or capital to particular beneficiaries so that the discretionary trust can satisfy the pattern of distributions test[3] or the 50% stake test in recouping prior year tax losses[4].

In addition, a trustee of a discretionary trust may also make a distribution of 20% or more of trust income and/or capital to a particular beneficiary in the year that the trust has made a capital gain so that beneficiary is regarded as a significant individual for the purposes of the discretionary trust claiming the 15 year exemption or the retirement exemption under the Capital Gains Tax (CGT) small business concessions[5].

However, the three major restrictions imposed under the income tax law on the making of such distributions comprise the following:

- The proportionate approach which places limits on the capacity of the trustee to engage in income splitting amongst the beneficiaries;
- The limits placed on the definition of the income of the trust estate under Draft Taxation Ruling TR 2012/D1 which provides that trust income cannot include ‘notional amounts’ that are only recognised for income tax purposes; and
- The existence of a family trust election which would deter a trustee from making a distribution of trust income (and therefore related net income) to a beneficiary who is outside the family group which would be subject to punitive family trust distribution tax.

[3] Sections 267-30 and Subdivision 269-D of Schedule 2F of the ITAA (1936) provide that the pattern of distributions test will only be satisfied by a non-fixed trust if the same individuals who received distributions of more than 50% of the income and capital of the trust in the tax year in which the loss is recouped also received more than 50% of income and capital distributions in at least one of the preceding six years before the loss recoupment year.

[4] The 50% stake test imposes a continuity of majority ownership requirement on a non-fixed trust which must be met in order for the trust to carry forward or recoup a tax loss under sections 267-40 and Subdivision 269-C of Schedule 2F of the ITA (1936). To satisfy the 50% stake test there must be individuals who have between them, directly or indirectly, fixed entitlements to more than 50% of the income and capital of the trust at all times throughout the period from the start of the loss year to the end of the year in which the tax loss is recouped. However, the 50% stake test will only apply to non-fixed trusts which are hybrid trusts where beneficiaries have some fixed interests in trust income and capital and not to trusts where the trustee has an absolute discretion regarding the distribution of trust income and capital.

[5] Sections 152-50, 152-60 and 152-70 of the ITAA (1997) detail when a beneficiary will be regarded as a significant individual of a discretionary trust just before a CGT event. The trust must, amongst other things, satisfy the requirement of having a significant individual just before the CGT event in order to claim the small business CGT 15 year exemption under section 152-110 of the ITAA (1997 and the small business CGT retirement exemption under section 152-305 of the ITAA (1997).

The practical impact of each of these three key restrictions is discussed below.

3.1 Application of proportionate approach

Where the trustee makes a beneficiary presently entitled to a share of the income of the trust estate (being the distributable income calculated in accordance with the trust deed) under section 97(1) of the ITAA (1936) that beneficiary will be assessed on an equivalent share of the trust's net income (being the trust's taxable income as calculated under section 95(1) of the ITAA (193[6])).

Accordingly, where a beneficiary becomes presently entitled to, say, 50% of the income of the trust estate (as reflected in the distributable income shown in the trust's accounts) that beneficiary will be proportionally entitled to 50% of the net income of the trust for tax purposes (as disclosed in the trust's tax return).

The application of this proportionate approach effectively precludes the trustee from distributing specific amounts of trust income to particular beneficiaries based on a 'quantum' approach as once the fractional interest of the beneficiary to trust income is determined the beneficiary will be presently entitled to an equivalent fractional share of the trust's net income. Thus, once the percentage share of trust income is set there is no capacity to further income split the resulting net income amongst the beneficiaries.

WARNING

Where the trust has not derived trust income as defined under the trust deed no beneficiary will be presently entitled to any share of trust income. As a corollary no beneficiary will be entitled to a share of any net income of the trust. Accordingly, the trustee will be fully assessed on the net income of the trust at the top marginal rate under section 99A as no beneficiary is presently entitled to any trust income.

To further complicate matters the amount of the income of the trust estate for trust purposes may differ from the amount of the net income of the trust where there is no income equalisation clause in the trust deed thereby leading to potential differences between the calculation of the beneficiary's share of trust income and net income.

Accordingly, a trustee cannot assume that the amount returned by beneficiary in their income tax return will be based on their share of trust income as reflected in the accounts as that beneficiary's share of net income may be considerably different depending on the definition of income applied under the trust deed.

[6] The High Court in Commissioner of Taxation v Bamford; Bamford v Commissioner of Taxation (2010) HCA 10 also confirmed that a proportionate approach should be adopted in determining a beneficiary's present entitlement to a share of net income which will be the same as their proportionate share (i.e. fractional interest) in the income of the trust estate.

The application of the proportionate approach in these circumstances is illustrated in the example below.

EXAMPLE

During the year ended 30 June 2020 the distributable income of The Williamson Discretionary Trust was $80,000 applying the definition of income of the trust estate as set out under the deed of that trust. However, the net income of the trust for that year was $100,000 applying the definition of net income under section 95(1) of the ITAA (1936). The $20,000 variance is due to permanent and timing differences in the calculation of trust income and net income.

Assuming the trustee of the trust Karen Williamson resolves to distribute 60% of the income of the trust estate to her partner Paul and 40% of such trust income to her sister Margaret the share of distributable income respectively allocated to Paul and Margaret for the 2020 year would be **$48,000 (i.e. $80,000 X 60%)** and **$32,000 (i.e. $80,000 X 40%)**.

However, such amounts differ from the share of net income that will be respectively included in the income tax returns for Paul and Margaret for the year ended 30 June 2020 which will be **$60,000 (i.e. $100,000 X 60%)** and **$40,000 (i.e. $100,000 X 40%)**.

TAX TIP

The application of the proportionate approach is subject to the trustee streaming capital gains and franked distributions (and accompanying franking credits) to beneficiaries who are made specifically entitled to such amounts where permitted under the trust deed. Where such streaming occurs the specifically entitled beneficiary will be assessed on such capital gains under Subdivision 115-C and franked dividends under Subdivision 207-B of the Income Tax Assessment Act (1997) (the ITAA (1997). Such amounts will then be excluded from the definition of both trust income and net income under Division 6E of the ITAA (1936) so that these amounts are also not subject to double taxation in the hands of presently entitled beneficiaries. The application of these specific entitlement rules are discussed further in CPA Australia's Trust Streaming Factsheet.

3.2 Limits on trust income for 'notional amounts'

As discussed, determining the amount of the income of the trust estate for the year is vital to the process of establishing the proportionate share of net income upon which presently entitled beneficiaries will be assessed.

Whilst acknowledging that the income of the trust estate will be based on the definition of that term contained in the trust deed, the Commissioner of Taxation has also taken the view in Draft Taxation Ruling TR 2012/D1 that 'notional income amounts' which are only recognised for income tax purposes cannot constitute income of the trust estate for trust law purposes.

In reaching this view, the ATO contend that there is a statutory limitation on the meaning of income of the trust estate imposed under Division 6 of the ITAA (1936) in that income of the trust must represent a net accretion (i.e. increase) to the income derived by the trust during a particular year which is distributable to beneficiaries.

This will be the case irrespective of how the particular trust deed otherwise defines income of the trust estate. As such, this approach essentially places a cap on the amounts of income which can otherwise be included in trust income to which beneficiaries may be made presently entitled.

The rationale for the above view is that notional amounts of income which arise in the calculation of the trust's net income for a particular year cannot represent a net accretion (i.e. increase) to trust income as they are 'tax-only' amounts which do not represent any tangible net increase in the value of trust property for that year.

Hence, if the trust deed includes an income equalisation clause which defines trust income as being the net income of the trust for a particular year the ATO view is that such trust income must exclude notional tax-only amounts.

Such notional income amounts will include, amongst others, franking credits, deemed dividends arising under Division 7A of the ITAA (1936) and a capital gain arising because the operation of the market value substitution rule where no capital proceeds are received on the disposal of an asset[7].

[7] Refer to the application of section 116-30 of the ITAA (1997).

The potential application of the Draft Ruling to trust deeds where there is an income equalisation clause and the derivation of notional income amounts is highlighted in the following example.

EXAMPLE

Under clause 4 of the trust deed for the Kumar Family Trust the income of the trust estate is defined to mean the net income of the trust calculated in a particular year in accordance with section 95(1) of the ITAA (1936).

However, the only net income derived by the trust during the year ended 30 June 2020 was a franked dividend received of $140,000 together with an accompanying franking credit of $60,000. Accordingly, the trust's net income for the 2020 tax year is $200,000 being the sum of the $140,000 franked dividend and the $60,000 franking credit.

However, the income of the trust estate is capped to $140,000 as the notional income amount of the $60,000 franking credit is excluded from the calculation of trust income under Draft Taxation Ruling TR 2012/D1 despite the application of the income equalisation clause. Accordingly, any distribution made by the trustee to beneficiaries of the Kumar Family Trust must be based on the $140,000 trust income rather than on the $200,000 net income.

Giri as trustee of the trust subsequently resolved to distribute the following amounts of trust income of $140,000 to eligible beneficiaries for the year ended 30 June 2020 on the following basis:

Deepti Kumar	$416
Amit Kumar	$416
Red Cross	$40,000
Kumar Commodities Pty Ltd	$99,168 Balance

The resulting shares of net income derived by such beneficiaries will be calculated as follows:

		Share of income trust	Share of net income
Deepti Kumar	$416/$140,000	0.030%	$594 (0.003X $200,000)
Amit Kumar	$416//$140,000	0.030%	$594 (0.003X $200,000)
Red Cross	$40,000/$140,000	28.57%	$57,143 (28.57% X $200,000)
Kumar Commodities Pty Ltd	$99,168/$140,000	70.83%	$141,669 (70.83% X $200,000)

TAX TIP

Given the constraints set out in the Draft Ruling it may be possible for the trustee to apply the 'streaming' provisions in order to make certain beneficiaries specifically entitled to franked dividends and capital gains where they constitute tax-only amounts where the trust deed permits the trustee to make beneficiary(s) specifically entitled to such amounts.

WARNING

There is no current indication that the ATO will modify or withdraw Draft Taxation Ruling TR 2012/D1. Accordingly, it can be assumed that the ATO will apply it in an audit situation. Trustees and their advisers should therefore review the Draft Ruling in full to be aware of its potential scope.

WARNING

Where a trust deed includes an income equalisation clause equating trust income to be the net income of the trust, the trust will not have any trust income for a year where the only income derived is a notional tax-only amount. For example, such a scenario would arise where the only amount of income derived during a year is, say, a deemed capital gain arising under the market value substitution rule for tax purposes. In these circumstances there will be no trust income to which a beneficiary can be made presently entitled.

Accordingly, the trustee will be assessed on the net income at the effective highest marginal tax rate under section 99A of the ITAA (1936).

3.3 Distributions made outside the family group

A further important issue for a trustee to consider when contemplating a distribution of trust income to a particular beneficiary is whether the trust has previously lodged a family trust election.

To recap a family trust election is a one-off election made in writing by the trustee of the trust nominating that the trust will be treated as a family trust albeit only for certain purposes of the income tax law.

In particular, the lodgment of a family trust election will:

- Simplify the rules that must be met by a trustee of a discretionary trust in recouping trust losses;
- Enable a subsidiary company of such a trust to trace its beneficial ownership for the purposes of satisfying the continuity of ownership test in recouping its tax losses; and
- Retain a beneficiary's entitlement to use franking credits on franked dividends distributed by the trustee of the discretionary trust where the 45 day holding period rule cannot otherwise be satisfied.

Where such an election has been made a test individual will have been nominated which will establish the members of the family group as the identity of all eligible family members will be determined by reference to that primary individual[8].

However, where a distribution is made to a particular beneficiary who is outside the test individual's family group such a distribution will be subject to family trust distribution tax which is levied at the highest effective marginal tax rate being currently 47%.

Thus, a trustee of a discretionary trust must exercise caution so that a distribution is not made to a person or entity which would be eligible to receive such a distribution under the trust deed where that beneficiary is not also a member of the elected family group. Where such a distribution is made it will be subject to family trust distribution tax at the above punitive rate of 47%.

WARNING

A distribution to a beneficiary outside the family group is not limited to monetary distributions of income. Instead it could also occur where there is a distribution of capital (whether in money or property), a debt forgiveness or an application of income or capital on behalf of the beneficiary. Thus, care should be taken with any distribution made to a non-family group member to ensure that family trust distribution tax does not apply.

TAX TIP

Any distribution made by a trust which has made an interposed entity election to a person outside the family group will also be subject to family trust distribution tax. It is therefore important to also identify whether the trust has lodged an interposed entity election to be part of the relevant family group as any such distributions to non-family group members will similarly be subject to penalty rates of tax.

[8] The members of the test individual's family group are defined in section 272-90 of Schedule 2F of the ITAA (1936).

4. PREPARING AND EXECUTING VALID RESOLUTIONS

After reviewing the relevant clauses of the trust deed, and taking into account any specific tax limitations on the making of distributions, the trustee will be in a position to prepare and execute a valid and binding trustee resolution distributing trust income to particular eligible beneficiaries for the relevant year.

Some of the practical considerations that a trustee may need to consider as part of this process include the following:

- Estimating the trust income derived for the particular year (and as a corollary the related amounts of trust net income for the year);
- Reviewing prior year distributions and the trust deed to identify any changes in eligible beneficiaries, and the amount of income such beneficiaries may have derived for the year of distribution; and
- Executing an effective distribution resolution in accordance with the terms of the trust deed.

These steps are both discussed further below.

4.1 Estimating annual trust income

In the bulk of cases the trustee will not have complete information about the income of the trust estate by the end of the financial year, which typically occurs on 30 June, as the annual financial accounts of the trust will not be completed by that time.

Accordingly, it will not be possible for the trustee to precisely quantify the amount of trust income at year-end (or any related net income of the trust for that year).

The trustee will therefore need to estimate the amount of trust income that may have been derived by the trust for the relevant year.

In making such an estimate it would be prudent for practitioners to have their clients prepare interim financial statements for the eleventh month period ended 31 May and to extrapolate such results for a full year ended 30 June incorporating data from other sources such as management accounts in making a full year estimate of trust income.

Whilst such an approach is reasonably robust it will not ordinarily be possible to precisely determine the income of the trust for the relevant year.

Accordingly, the trustee may wish to draft resolutions where all the beneficiaries selected by the trustee are made presently entitled to a percentage share of the trust income, or alternatively specific amounts are allocated to particular beneficiaries with the balance being provided to a remaining single beneficiary.

TAX TIP

Practitioners should liaise with their trust clients at the earliest opportunity to ensure that trustees have the best possible financial information upon which to make decisions relating to the distribution of trust income for the particular year.

4.2 Identifying potential beneficiaries and their tax position

As a starting point in identifying particular beneficiaries who may receive a trust distribution it would be helpful to ascertain whether there have been any changes in the persons or entities who may potentially qualify to be beneficiaries under the trust deed during the particular year.

For example, the trustee may wish to consider whether there has been any marriages within the family to identify any additional beneficiaries such as the new spouse of an existing beneficiary; the birth of any children to pre-existing eligible beneficiaries; and the establishment of any new family entities as general beneficiaries.

This process is especially important where the trustee of the discretionary trust has elected for the trust to be a family group for the reasons discussed under subchapter 3.3.

It would similarly be prudent to determine whether there have been any specific changes to a beneficiary's circumstances such as where a beneficiary has become a non-resident.

Once this process is completed the trustee may wish to take into account the specific tax position of such beneficiaries.

Whilst the trustee resolution concerns a distribution of a share of trust income to beneficiaries it will also result in such beneficiaries obtaining a commensurate share of the trust's net income for tax purposes which will then be included in the taxable income of the recipient beneficiaries.

It would therefore be beneficial for the trustee to have an understanding of the impact that such a share of net income may have on the tax position of the relevant beneficiaries. Accordingly, the trustee should where practicable obtain an estimate of the taxable income expected to be derived by such beneficiaries from other sources prior to making decisions concerning the distribution of trust income.

TAX TIP

Generally the trust deed will include a power under which the trustee will be able to determine the amount of trust income and its allocation amongst eligible beneficiaries.

Such a resolution must be made by the earlier of 30 June or the date specified under the trust deed.

4.3 Executing an effective resolution

Generally the trust deed will include a power under which the trustee will be able to determine the amount of trust income and its allocation amongst eligible beneficiaries.

Such a resolution must be made by the earlier of 30 June or the date specified under the trust deed.

WARNING

If the trust deed requires the trustee to create a present entitlement to trust income earlier than 30 June, the trustee must comply with the terms of the deed for the distribution resolution to be effective. For all references below to action required to be taken by 30 June, substitute an earlier date if that is required under the particular deed.

While the process of making a distribution will vary depending on the particular terms of the trust deed it will generally involve the following steps being implemented:

- The trustee determining the amount of trust income based on the specific definition of income under the trust deed;
- The trustee resolving to proportionally distribute shares of such trust income to beneficiaries in a clear and unambiguous way in accordance with the relevant distribution procedures set out in the trust deed; and
- The trustee considering and resolving how distributions of income will be paid, applied or set aside to or for the appointed beneficiaries.

Reference should be made in the trustee resolution to the application of the relevant clauses of the trust deed which address the above matters. It should also refer to the date and time at which resolution was made including any details of any directors' meeting where the trustee is a company.

TAX TIP

Whilst the ATO appears to accept that income distribution decisions taken by a trustee up to 30 June may be formalised at a later date in certain situations, it is strongly recommended that trustees ensure that in all cases distribution resolutions are made in writing and signed by the trustee by 30 June (or earlier where required) so that there is no doubt as to the effectiveness of the trustee's actions.

WARNING

Where the trustee is a company regard should be had to any specific requirements that have to be met by the directors of the company in relation to any resolution made for the purposes of the Corporations Act (2001). In particular, section 251A of the Corporations Act 2001 requires that any resolution made at a meeting of the company's directors be recorded in a minute and placed in the company's minute book within 30 days of the resolution being passed.

It should be noted that there is no standard format that needs to be applied in drafting a trustee resolution. However, it is imperative that any style of distribution resolution executed by the trustee clearly comply with the proportionate approach in determining the respective shares of trust income to be received by the beneficiaries identified by the trustee.

As discussed, this could take the form of beneficiaries receiving a specific dollar amount for their share of trust income with any balance being paid to a single residuary beneficiary, or alternatively the income of the trust being allocated amongst all beneficiaries on the basis that their share of trust income is based on a fixed percentage of such distributed income.

The application of both of these approaches as illustrated in the examples below.

EXAMPLE

THE FIXED DOLLAR APPROACH

Sue as trustee of the Davies Discretionary Trust resolves to distribute the income of the trust for the year ended 30 June 2020 on the basis that her children Angela and Judy will receive a fixed dollar amount of $10,000 each as their share of trust income with any balance of the trust income being distributed to her son Peter.

Assuming that the trust income for the year ended 30 June 2020 is determined by the trustee to be $30,000 the three beneficiaries will receive a share of trust income of $10,000 each.

By contrast if the calculation of trust income which is ultimately finalised on the completion of the trust's 2020 accounts is $28,000 then Angela and Judy will continue to receive a share of $10,000 trust income whilst Peter will only be entitled to a share of trust income of $8,000.

EXAMPLE

THE PERCENTAGE APPROACH

Ryan as trustee of the Cook Family Trust resolves to distribute the income of the trust for the year ended 30 June 2020 on the basis that his children Michael, Ian and Karen will respectively receive a share of trust income being 25%, 35% and 40% of the trust's income for that year.

Accordingly, if it is ultimately determined that the trust income for the Cook Family Trust for the rendered 30 June 2020 is $100,000, Michael, Ian and Karen will respectively receive a share of trust income of $25,000, $35,000 and $40,000 each.

However, if the trust's final income is only $90,000 after the trust accounts have been prepared the respective shares of trust income derived by Michael, Ian and Karen will respectively be $22,500, $31,500 and $36,000 each.

An example of a valid trustee resolution is attached as Appendix 1 to this factsheet together with a pro forma resolution which can be adapted by practitioners which is attached as Appendix 2.

TAX TIP

The intended effect of a resolution is to make the selected beneficiaries presently entitled to a share of trust income (and therefore a proportional share of net income). It is therefore important that the rights of an appointed beneficiary under such a distribution are both vested and indefeasible. Accordingly, the nominated beneficiary will not be regarded as being presently entitled to a share of trust income where the entitlement can only arise on the happening of an event in the future or where it can be taken away from the beneficiary upon the occurrence of some condition.

5. RESOLUTIONS MUST BE DONE BY YEAR-END

From a practitioner's perspective a trustee's resolution must be in writing and completed before the year-end date stipulated in the trust deed.

Typically the trust deed will require the trust deed to determine the trust income and the allocation of such trust income by 30 June of each year.

However, the trust deed should be reviewed in each case to ensure that there is no requirement for the trustee to resolve to distribute trust income by a date earlier than 30 June such as where there is a clause which requires that such a resolution must be made by, say, 28 June of each year.

WARNING

The ATO may potentially audit a trustee to ensure that the trustee resolution has been completed by the required date specified in the trust deed. This could include, amongst other things, checking the date that the resolution was typed on a computer to carbon testing the age of the paper upon which the trustee resolution was made. Hence, in all circumstances it is imperative that w the resolution be prepared and executed by 30 June or by any earlier date specified in the trust deed.

Where the trustee has not taken all steps necessary for beneficiaries to be considered presently entitled to their allocated share of income of the trust estate by year-end the following tax consequences will apply:

- The default beneficiaries will become presently entitled to the income of the trust and will be proportionally assessed on it in accordance with the terms of the relevant trust deed. This will be the case even if such amounts of trust income are not paid to the default beneficiaries or the income of the trust is subsequently paid to other beneficiaries on the assumption that the resolution was effective; and
- In the absence of there being default beneficiaries no beneficiary will be regarded as being presently entitled to a share of trust income with the effect that the trustee will be assessed on all of the net income of the trust under section 99A of the ITAA (1936) at the highest effective marginal tax rate.

EXAMPLE

Richard as the trustee of the Hopkins Family Trust prepared a trustee resolution on 5 July 2020 allocating trust income of $200,000 for the year ended 30 June 2020 equally between his daughters Elizabeth and Sally.

The trust's deed defined trust income as being the same as the trust's net income under an income equalisation clause. However, the resolution was ineffective as it was completed after the 30 June year-end date specified under the trust deed. As the deed did not specify any persons who would take in default of such a resolution being made, Richard as trustee will be subject to tax on all of the trust's net income of $200,000 at the highest effective marginal tax rate under section 99A of the ITAA (1936) which is currently 47%.

WARNING

Where beneficiaries are made presently entitled to all the income of the trust estate by 30 June those beneficiaries will be distributed all of the net income of the trust for that year including any assessable net capital gain where the trust deed provides that trust income will be its net income under an income equalisation clause. In these circumstances it will not be possible to stream any remaining capital gain to another beneficiary by the following 31 August since the net capital gain will have been effectively distributed in accordance with the allocation of net income to presently entitled beneficiaries.

Accordingly, where such a trustee is making beneficiaries specifically entitled to a share of a capital gain and beneficiaries presently entitled to the balance of trust income, it is essential that the trustee resolves to make the specific entitlement to the capital gain before making beneficiaries presently entitled to the remaining trust income in a single written resolution which must be made by 30 June.

The operation of these specific entitlement rules is discussed in further detail in CPA Australia's Trust Streaming factsheet.

6. IMPACT OF RESOLUTION ON AMENDED ASSESSMENTS

Where the net income (i.e. taxable income) of the trust is increased by the ATO sometime after the end of the income year (commonly as a result of an audit), it is necessary to have regard to the trustee's distribution resolution and the trust deed to determine how this increased amount of net income will be assessed.

The Commissioner of Taxation considered this scenario in some detail in Taxation Determination TD 2012/22.

Essentially, the ATO's view is that the issue of how such additional income will be taxed would appear to be dependent upon the following three factors:

- Whether the income of the trust estate is defined under the trust deed as being equal to the trust's net income as calculated in accordance with section 95(1) of the ITAA (1936) under an income equalisation clause;
- Whether there are any default beneficiaries specified under the trust deed; and
- The wording of the trustee's distribution resolution and whether it was based on fixed distributable amounts or fixed percentage entitlements to trust income.

TAX TIP

Where a trustee is concerned about the possible impact of a subsequent amended assessment increasing the trust's net income, the above factors should be considered when the trustee resolution has been prepared as the outcomes in relation to the taxation of any such additional net income will vary depending on the above combination of factors.

The various scenarios that can arise from the application of the above criteria is illustrated in the examples below which are adapted from some of the examples provided in Taxation Determination TD 2012/22.

EXAMPLE 1

The income of the Riverdale Family Trust is defined under an income equalisation clause in the trust deed to be equal to the net income of the trust calculated for income tax purposes. The deed does not provide the trustee with any discretion to otherwise characterise a different amount as being the income of the trust.

For the year ended 30 June 2020 the trustee calculated the net income of the trust to be $120,000, and determined to distribute fixed amounts of $40,000 to Ann, Ben and Cy as beneficiaries of the trust.

Upon audit the Commissioner determined that the trustee had omitted $9,000 interest income thereby increasing the amount of the trust's net income from $120,000 to $129,000.

The trust deed did not contain any provision dealing with a situation where the trustee failed to appoint some of the income of the trust estate by a particular time.

Accordingly, the increased amount of assessable income of $9,000 constituted trust income to which no beneficiary was presently entitled, and the trustee was therefore assessed on this amount under section 99A of the ITAA (1936) at the highest marginal rate. Essentially, this outcome arose because trust income of only $120,000 was distributed under the resolution made by 30 June whereas trust income subsequently increased to $129,000, and Ann, Ben and Cy could not receive the additional $9,000 trust income as their earlier distributions were for fixed amounts of $40,000 each.

EXAMPLE 2

This example has the same facts as example 1 except that the trust deed provides that in the event the trustee fails to distribute trust income by a particular time that amount of undistributed income will be considered to be appointed to default beneficiaries in accordance with the terms of the trust deed.

In these circumstances Ann, Ben and Cy will continue to remain assessable on the basis of the $40,000 fixed distribution each received. However, the default beneficiaries specified under the deed will be proportionally assessed on the additional $9,000 net income in accordance with the trust deed.

EXAMPLE 3

TThis example has the same facts as example 1 except that the trustee resolves to distribute a fixed amount of $40,000 each to Ann, Ben and Cy and that any balance of trust income would be distributed to David.

Ann, Ben and Cy would again not be assessable on the additional undistributed income of $9,000 as they received fixed dollar distributions of $40,000 each. However, on the basis of the trustee's resolution David will become entitled to the $9,000 additional trust income post-assessment and would therefore be assessed on a corresponding amount of net income of $9,000.

EXAMPLE 4

This example has the same facts as example 1 except that the trustee resolves to distribute one third of the trust income to each of Ann, Ben and Cy. On the basis of this resolution each of these three beneficiaries will be presently entitled to one third of the trust income. Accordingly, following the increase in trust income (and net income) to $129,000 each beneficiary will be assessed on the amount of $43,000 net income being one third of the increased net income of $129,000.

It should be noted that examples 6 and 7 of Taxation Determination TD 2012/22 also concerns an income equalisation clause in a trust deed defining trust income to mean the net income of the trust. However, in these examples the trustee also resolves to distribute trust income equally to two individual beneficiaries, and that the amount of any additional assessable income arising from any post- assessment adjustment made by the ATO be separately allocated to a corporate beneficiary. Applying the proportionate approach the Commissioner takes the view in the above Determination that the two individual beneficiaries will be assessed on any incremental assessable income arising rom the ATO adjustment rather than the corporate beneficiary.

However, it should be noted that a 'variation of income resolution' allowing a corporate beneficiary to be made presently entitled to additional amounts of assessable income arising from an amended assessment was recently held by the Full Federal Court in Lewski v Commissioner of Taxation[9] to be effective even though trust income was distributed pre-adjustment to the taxpayer who was a separate individual beneficiary.

The ATO subsequently advised in a Decision Impact Statement[10] in respect of Lewski's case that it was open to the Full Federal Court to find that the individual taxpayer was not presently entitled to trust income given the construction of the relevant resolutions and trust deeds in that case. As a corollary the ATO stated that it would subsequently review the terms of Taxation Determination TD 2012/22 as a result of the above decision.

However, the ATO also flagged that it may challenge reliance on such variation of income resolutions in contested cases.

WARNING

Despite the decision in Lewski's case there still appears to be considerable uncertainty regarding the operation of variation of income resolutions. Accordingly, any practitioner advising a trustee to adopt such a form of trust resolution should seek specialist advice.

TAX TIP

Practitioners and trustees are advised to review Taxation Determination TD 2012/22 in its entirety as it includes numerous examples of the differential outcomes that could potentially apply which is significantly influenced by the terms of any binding trustee resolution.

[9] (2017) FCAFC 145

[10] Refer to the Lewski Decision Impact Statement on the ATO website which can be downloaded at https://www.ato.gov.au/law/view/document?docid=LIT/ICD/VID1496of2016/00001

APPENDIX 1 – SAMPLE TRUSTEE RESOLUTION

he following trustee resolution has been prepared on the basis that the income of the trust estate is based on the meaning of the net income of the trust as defined under section 95(1) of the Income Tax Assessment Act (1936), and that the beneficiaries appointed by the trustee have each received a fixed percentage share of trust income as determined by the trustee.

TRUSTEE:

Miller Pty Ltd
ACN 111 222 333

CAPACITY:

It was noted that the company is acting in its capacity as Trustee of the Miller Discretionary Trust established by deed dated 15 February 1980.

PLACE OF MEETING:

1 Spring Street Frankston Vic 3199

PRESENT:

David Miller and Sally Miller.

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 of the Schedule
General beneficiaries	clause 1.2 of the Schedule

DETERMINATION OF TRUST INCOME:

Resolved that the income of the Miller Discretionary 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 being the amount of the net income of the trust calculated in accordance with section 95(1) of the Income Tax Assessment Act (1936).

DISTRIBUTION OF TRUST INCOME:

Resolved that, pursuant to the powers granted to the trustee under clause 4.1 of the deed, the income of the trust estate for the year ended 30 June 2020 be distributed to beneficiaries as follows:

- 20% to David as a primary beneficiary;
- 40% to Sally as a primary beneficiary; and
- 40% to Miller Holdings Pty Ltd as a general beneficiary.

Further, 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 and general beneficiaries in the Schedule to the deed.

CLOSURE:

There being no further business the Chairman closed the Meeting.

Signed as a true and correct record.

DATE:

29 June 2020

APPENDIX 2 – SAMPLE PRO-FORMA TRUSTEE RESOLUTION

TRUSTEE: Name of Trustee

CAPACITY: It was noted that the company is acting in its capacity as Trustee of (name of trust) established by deed dated

PLACE OF MEETING:

PRESENT:

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

Primary beneficiaries	clause
General beneficiaries	clause
Default beneficiaries	clause

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 of the deed as follows:

DISTRIBUTION OF TRUST INCOME: Resolved that, pursuant to the powers granted to the trustee under clause of the deed, the income of the trust estate for the year ended 30 June 2020 be distributed to beneficiaries as follows:

Further, 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. in the Schedule to the deed.

CLOSURE: There being no further business the Chairman closed the meeting.

Signed as a true and correct record.

DATE:

TRUSTEE RESOLUTION CHECKLIST

The matters set out below may be relevant to a trustee charged with the responsibility of deciding to whom trust income will be distributed and with ensuring that an appropriate distribution resolution has been prepared. 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
Definition of "income" in the trust deed			
Is any action required by the trustee in order to determine the amount of trust income? For example, does the trustee have to exercise a discretion or is there a clear methodology concerning the calculation of trust income?			
If action is required, has the trustee considered the application of such a discretion and exercised it before 30 June (or the applicable year-end)?			
Is it necessary to consider whether TR 2012/D1 has any relevance and, if so, whether the implications arising from the application of the Draft Ruling should be considered?			
Where trust income is derived			
Has a reasonable estimate of trust income been calculated in accordance with the definition of trust income under the trust deed?			
If it appears that there may be no trust income (but there is net income), can any steps be legally taken to alter that situation?			
Are there discretions available to the trustee under the deed which may be exercised? For example, could receipts be properly re-characterised to fall within the definition of 'income' for trust purposes?			
Trustee distribution resolution			
Does the trust deed require the resolution to be completed prior to 30 June (or at some earlier time)?			
Is anything further required from the trustee in order to create a present entitlement for beneficiaries in respect of a share of trust income?			
Should consideration be given to framing the distribution resolution in a manner which provides the preferred outcome in the event of a subsequent increase in the net income of the trust for the year following an ATO review or amendment?			

QUESTION	YES	NO	N/A
Beneficiaries under the deed			
Have the classes of eligible beneficiaries been identified, and those beneficiaries which fall within each class?			
Has there been any change in beneficiaries compared to prior years (e.g. new beneficiaries by way of birth or marriage to existing beneficiaries)?			
What are the tax characteristics of beneficiaries which may impact the allocated shares of distributed income (e.g. minors, non-residents, beneficiaries under a legal disability (other than minors) and beneficiaries in receipt of distributions from multiple trusts)?			
If there are corporate beneficiaries, what are the Division 7A implications which may arise if a distribution is made in the current year?			
Access to small business CGT concessions			
Is there an opportunity for the trust to access the small business CGT concessions?			
Can trustee distributions in respect of the current year be structured to improve the trust's ability to claim the small business CGT 15-year concession or the small business CGT retirement exemption?			
Trust Losses			
Does the trust have losses brought forward from a prior year?			
If so, does the deed require losses to be recouped from the income or capital?			
Does the trustee have to make certain distributions to particular beneficiaries in order for the trust to satisfy the trust loss recoupment rules?			
Family Trust Elections			
Has the trust made a family trust election?			
If so, have you identified the 'family group' which arose as a result of the election being made? Have any distributions been made to persons or entities outside the family group?			
If no family trust election has been lodged in a prior year, should such an election be prepared in the current year? If so, who should be selected as the test individual of the family group?			
Has the trust made an interposed entity election? If not, should such an election be made?			